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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 84/52

10:00 a.m., April 4, 1984

J. de Larosière, Chairman

Executive Directors	Alternate Executive Directors
	A. Koné, Temporary
J. de Groote	H. G. Schneider
	X. Blandin
	M. Teijeiro
R. D. Erb	M. K. Bush
M. Finaish	T. Alhaimus
	T. Yamashita
J. E. Ismael	Jaafar A.
R. K. Joyce	L. Leonard
	H. A. Arias, Temporary
G. Laske	G. Grosche
G. Lovato	C. P. Caranicas
	A. S. Jayawardena
Y. A. Nimatallah	
J. J. Polak	T. de Vries
A. R. G. Prowse	K. G. Morrell
G. Salehkhou	O. Kabbaj
	E. I. M. Mtei
	E. Portas, Temporary
J. Tvedt	
N. Wicks	T. A. Clark
Zhang Z.	Wang E.

J. W. Lang, Jr., Acting Secretary
R. S. Laurent, Assistant

Also Present

C. F. Schwartz, Consultant. Asian Department: R. C. Baban. European Department: L. A. Whittome, Counsellor and Director; L. Hansen, R. P. Hicks, P. C. Hole, M. Z. Khan, G. F. Kopits, P. J. F. Nyberg, P. M. Thomsen, G. Tyler. Exchange and Trade Relations Department: S. Mookerjee, Deputy Director; J. O. Bonvicini. Fiscal Affairs Department: M. Z. Yucelik. IMF Institute: S. Kayir, Participant. Legal Department: W. E. Holder. Middle Eastern Department: S. von Post, L. A. Wolfe. Research Department: W. C. Hood, Economic Counsellor and Director; A. D. Crockett, Deputy Director; R. R. Rhomberg, Deputy Director; J. Artus, C. P. Blackwell, J. E. Blalock, M. C. Deppler, S. J. A. Gorne, M. D. Knight, R. Saracoglu, J. S. Smith. Treasurer's Department: W. O. Habermeier, Counsellor and Treasurer; D. S. Cutler. Western Hemisphere Department: S. Dunaway. Bureau of Statistics: W. Dannemann, Director; A. C. Bouter, P. R. Cotterell. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: S. R. Abiad, C. J. Batliwalla, J. Delgadillo, K. A. Hansen, S. El-Khouri, L. Ionescu, H.-S. Lee, G. E. L. Nguyen, Y. Okubo, D. I. S. Shaw, D. C. Templeman. Assistants to Executive Directors: H. Alaoui-Abdallaoui, I. Angeloni, M. Camara, Chen J., L. E. J. M. Coene, M. Eran, G. Ercel, G. Gomel, D. Hammann, N. U. Haque, T. Kivanç, H. Kobayashi, M. J. Kooymans, G. W. K. Pickering, M. Rasyid, D. J. Robinson, A. A. Scholten, S. Sornyanyontr, A. Yasseri.

1. TURKEY - STAND-BY ARRANGEMENT

The Executive Directors considered a request from Turkey for a stand-by arrangement equivalent to SDR 225 million, or 52.4 percent of the new quota (EBS/84/42, 3/7/84; Sup. 1, 4/4/84; Sup. 2, 3/29/84; and Sup. 3, 4/3/84).

Mr. de Groote asked the Executive Board to accept the presence of Mr. Kivanç, his Advisor on the World Bank side and former Vice Minister of Finance for Turkey.

The Board agreed to the proposal of Mr. de Groote.

Mr. de Groote then made the following statement:

> On behalf of my Turkish authorities, I would like to thank the staff for the clear and concise reporting on Turkey's request for a new stand-by arrangement, with which they broadly concur. As noted below, the authorities were prompted, by trends in the economy after the middle of 1983 and by the wide range of economic policies implemented by the newly elected Government, to re-establish relations between Turkey and the Fund on a fresh basis. They have therefore asked that the existing stand-by arrangement be canceled, and have requested a new stand-by arrangement for one year in the amount of SDR 225 million.
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> Following the remarkable results achieved under a comprehensive program of stabilization and structural reform of the economy launched in January 1980 and supported by Fund resources, the Board had approved, in June 1983, a new one-year stand-by arrangement aimed at consolidating the progress achieved over the previous three years. Economic performance in 1983, however, did not permit some program targets to be met: the most important of these were the inflation rate, the rate of monetary expansion, the current account deficit, and the real growth rate. Despite the continued improvement in the public sector accounts following two years of steady decline in inflation, prices began to climb, and by the end of 1983 had risen by 40 percent over the last quarter of 1982. Due to a rapid expansion of central bank credit, and to a postmid-year reduction in nominal interest rates on deposits made in anticipation of a decline in inflation that did not occur, monetary policy turned out to be expansionary. Trends in exports, imports, and workers' remittances, and a further deterioration of the terms of trade brought the current account deficit to about 4 percent of GNP, up from 2.2 percent the year before. Bad weather causing a decrease in the contribution of the value added of agriculture, together with a negative contribution from the foreign balance, slowed the real growth of GNP in 1983 to about 3.3 percent, down from the highs of 4.1 percent and 4.6 percent achieved in 1981 and 1982 and well below the 1983 program target of 4.8 percent.

In December 1983, a newly elected government headed by Turgut Ozal immediately began to implement a wide range of policy measures continuing the reforms begun in 1980. These measures aimed at further opening up the external sector, making the economy more market-oriented, and putting it on the road to an adequate and sustainable growth rate. The authorities are also continuing appropriate policies in the areas of demand management, interest rates, and exchange rates in order to control inflation and restore external equilibrium, and have continued to make structural changes aimed at increasing economic efficiency. Radical measures implemented in pursuit of the short-term and long-term aims of this program included a reorganization of the Government's own administrative machinery, a substantial liberalization of imports, rationalization of export incentives, liberalization of the foreign exchange regime, a new interest rate policy providing a real rate of return on savings and freeing the lending rates set by the commercial banks, and reductions in the financial transaction tax and the withholding tax on interest income.

A sustainable balance of payments required a more outward-looking orientation of the economy, and in this sense the reorientation of the export sector is irreversible. The Government remains convinced that further opening up of the economy will optimize relationships between growth and the balance of payments and assure better resource allocation. A better export orientation of the Turkish economy would permit a rapid increase in the next few years of exports' total share of GNP, which at about 11 percent is still small. Improvement in the external sector has to come mainly from a marked expansion of exports, since the use of other means of improving the current account of the balance of payments, such as import reduction, would adversely affect domestic production and curtail export growth. Besides, the inward-looking character of the Turkish economy, which has impeded the efficiency and competitiveness of the export sector, can best be corrected by removing restrictions in the trade and payments systems, substantially liberalizing imports, and lifting a complex set of foreign exchange controls and restrictions. To this end, the authorities announced at the end of 1983 and the beginning of 1984 a series of changes in the exchange and trade systems, which are explained in detail in Appendix III of the staff report. In addition, the authorities believe that sustained export growth will require that exporters be given access to internal and external financing facilities, that flexible exchange rate policies be applied to strengthen external competitiveness, and that these measures be reinforced by tight demand management. With the implementation of these policies and measures, Turkey should, in the medium term, be able to achieve a sustainable balance of payments situation.

In 1984, it is expected that further important increases in export values, coupled with a moderate increase in imports, will improve the trade balance, and that increases in invisible receipts, mainly workers' remittances and contractors' earnings, will bring the current account deficit to about 2.25 percent of GNP, or about $1 billion. Recent data show that exports for the first two months of 1984 increased by about 30 percent over the first two months of 1983, and that imports in January 1984 were below their January 1983 level. The capital account is expected to show positive movement, mainly from projected use of project credits, Structural Adjustment Loans IV and V from the IBRD, and foreign capital inflows. It is hoped that the gains in political and economic stability, simplification of regulations, and the elimination of several formalities will lead to a substantial expansion of foreign investment in Turkey in the coming years. Turkey's increased creditworthiness in the international markets has provided additional resources for improving its balance of payments situation. The authorities believe that more emphasis should be placed on medium-term borrowings from the international financial markets than on concessional credits. This approach is a realistic one not only for financing balance of payments needs, but also for rebuilding the reserve position, a priority goal of the Fund's programs. Turkey's extremely good record of timely satisfaction of its debt service obligations over the past four years, as well as its continued adjustment efforts, have been an important factor in the restoration of its creditworthiness. The authorities are well aware that the debt service ratio, which was 31 percent in 1983, is projected by the staff report to reach 29 percent in 1984 and 33 percent in 1985, before beginning to decline in 1986. However, as explained in the recent World Economic Outlook paper, debt service ratios are not in themselves sufficiently indicative to serve for assessing debt manageability: the overall economic situation of a country and trends in the internal and external environment give a better picture of the manageability of external debt.

The Government intends to follow tight monetary and fiscal policies to further its external goals and to reduce the inflation rate for 1984. Interest rate policy was designed to increase the effectiveness of demand management and stimulate domestic savings. Effective January 1, 1984, interest rates on time deposits, including CDs, were increased substantially, and withholding tax rates on interest income were reduced from 20 percent to 10 percent, with the result that the effective yield of time deposits and CDs became positive in real terms. On the lending side, banks were freed to determine general lending rates. The commercial banks began to apply general interest rates of 50 percent for short-term credits, and 52 percent for long-term credits, up from 32 percent and 34 percent, respectively. At the same time, to reduce the cost of intermediation and strengthen the interbank market, the financial transaction tax on lending rates was lowered from 15 percent to 3 percent. In parallel with these measures, the interest rates applicable to central bank discount facilities were increased substantially. In March 1984, an additional savings instrument, a one-month time deposit, was introduced. The Government will continue to pursue effective and flexible interest rate policies as a tool for reinforcing other economic policies. Interest rates on deposits will be reviewed at least every three months by the Central Bank. Monetary aggregates have been established in a way consistent with the projected inflation and growth rates and the Government's goal of absorbing the liquidity overhang. These aggregates will also be reviewed in the light of price and balance of payments trends.

Since 1980, the authorities have reduced the public sector borrowing requirement (PSBR) by strengthening the financial performance and reducing the need for transfers to the state economic enterprises (SEEs), by the 1981 tax reform measures, by more effective control of budgetary expenditures to bring them in line with actual revenue trends, and by a public sector investment strategy focused on high-priority projects in the infrastructure, agriculture, and energy sectors. The public sector borrowing requirement is expected to decline further, from 4.7 percent of GNP in 1983 to 3.5 percent in 1984, due to further improvements in the financial performance of the SEEs and a small surplus in the consolidated budget. Revenues declined in 1982 and 1983 owing to several factors; to offset these decreases in revenue, the Government has taken several steps, such as the sale of goods accumulated in customs warehouses, readjustment of production tax rates and of other tariffs, charges and levies, and more efficient tax collection. In addition, Parliament recently passed a law providing for the sale of the incomes of bridges, dams, power plants, highways, ports, and airports belonging to the public sector by profit-sharing documents. A wider choice of treasury bills has been issued. Consolidated budgetary expenditures have continued to decrease, from 24 percent of GNP in 1980 to 19.4 percent in 1983, and a further decrease to 18 percent is expected for 1984. The authorities believe that the SEEs should be permitted to respond more freely to market forces. The market-oriented pricing policies of SEEs will continue in 1984 with small but frequent changes in their prices, as will improvements in their technical and managerial efficiency. Budgetary transfers to the SEEs will decline by TL 320 billion, or by 14 percent in real terms. The SEEs are expected to show increased profitability in 1984.

My Turkish authorities believe that Turkey is on the right track to a sustainable medium-term and long-term balance of payments situation, and to a balanced and sustained development, and they firmly intend to pursue the wide range of economic policies initiated in 1980. The Government has shown itself to be courageously determined to take any strong radical measures that may be required to overcome Turkey's economic problems and to adjust the operation and structure of the economy. I therefore ask this Board to give its approval to the proposed arrangement.

Mr. Laske observed that, following a number of years in which the Turkish authorities had made progress in stabilizing the economy, developments in 1983 had been less favorable. Despite an ambitious adjustment program supported by a stand-by arrangement with the Fund, inflation had overshot the projected target, and the external accounts--particularly the current account--had missed the targets by wide margins. Such disappointing results had been attributable primarily to the effect of overexpansionary monetary policies, which had not only allowed credit to grow far faster than planned but also made interest rates highly negative in real terms.

Upon assuming office late in 1983, the new Government had acted swiftly to correct the maladjustments that had emerged and had taken structural measures designed to give market signals greater prominence, especially in the external sector, by liberalizing regulations and restrictions, Mr. Laske recalled. The program formulated for 1984 and the performance criteria established for the months until the midterm review should promote a return to a better-balanced pattern of growth and a sustainable external position. He could thus support the requested stand-by arrangement.

As monetary policy had been conducted in a rather loose fashion in 1983, so that external and price developments had gone off track, a tight monetary regime would be indispensable for the foreseeable future, Mr. Laske continued. In particular, he welcomed the authorities' early re-establishment of positive real rates of interest, which should help to attract larger inflows of workers' remittances; in 1983, unfortunately, the flow had fallen below the levels registered in earlier years. He was also pleased that the authorities had committed themselves to consulting with the Fund should monetary policy deviate from the intended path. Furthermore, strict adherence to the targets for credit expansion would be of great importance during the first phase of the program in order to work off the liquidity overhang created by the expansionary episode of 1983, which he hoped would prove to have been temporary.

It was fortunate, Mr. Laske said, that the slippages in 1983 had not extended into the fiscal area. During the past three years, the consolidated budget outturn had steadily improved; in the current fiscal year, a small surplus was projected. He encouraged the authorities to pursue the consolidation of the budget with determination and vigor. In fact, fiscal performance would have been even better if substantial delays in tax collection had not occurred. Despite recent fiscal measures providing incentives for entrepreneurship, savings, and investment, however, the share of revenue in GDP would continue to diminish. In itself, that development need not be of major concern, if expenditure were being held in check simultaneously and if the absorption of resources by the public sector were not excessive. The persistence of shortcomings in assessing and collecting taxes did indicate that streamlining bureaucratic procedures would allow further tax cuts, releasing additional resources for investment and other productive purposes.

Better performance in state economic enterprises (SEEs) was welcome, and further improvements had even been cemented into a performance criterion for budgetary transfers to SEEs, Mr. Laske noted. Unfortunately, one of the causes for nonobservance of the monetary performance criteria for 1983 had been unexpectedly heavy short-term borrowing by SEEs. As the borrowing seemed to have occurred at a time when the enterprises had been receiving reduced transfers from the budget, he would like to know which events had led to the unexpected demand for credit. He also invited the staff to explain whether the authorities had taken adequate precautions to forestall a repetition of such unexpected, unwanted, and unplanned credit demand from SEEs.

Under the multiyear stand-by arrangement from 1980 to 1982, Turkey had achieved a remarkable improvement in its balance of payments, Mr. Laske remarked. Part of the gain, unfortunately, had been lost in 1983, when the trade and services accounts had deteriorated, but the return to a more restrictive monetary policy and the continuation of the flexible exchange rate policy were likely to reverse the deterioration. He welcomed the news contained in EBS/84/42, Supplement 3, that, in exchange rate policy, the Turkish authorities had continued to move in the direction agreed with the Fund staff. By deciding to push ahead vigorously with external liberalization, they had opened the economy to more foreign competition, a move that should further the structural rejuvenation of the economy, increase its efficiency, and make it more resilient. While welcoming that move, he wished to observe that the decisive lowering of barriers to imports might well put demand management to the test. The unhappy experience of 1983 had highlighted the fragility of Turkey's balance of payments, a fragility expected to continue for some time. Therefore, the bold steps toward liberalization taken by the current authorities made it all the more necessary for them firmly to implement fiscal and monetary policies and flexibly adjust them to changing circumstances so as to contain overall demand at a level that did not give rise to an unmanageable surge in imports.

Turkey was carrying a heavy burden of external debt, with large amortization payments falling due--especially to private lenders--in 1985 and the years immediately thereafter, Mr. Laske concluded. It was unlikely that Turkey would again be the recipient of special assistance from official lenders, as it had been some years previously. Thus, timely servicing of the external debt would require a steady improvement in Turkey's credit standing with international banks and other private foreign lenders. For the same reason, the authorities would be well advised to adhere as closely as they could to the policies set forth in the current program and thus avoid disturbing slippages.

Mr. Nimatallah recalled that, from 1980 through 1982, the Turkish authorities had adopted a comprehensive stabilization program supported by a three-year stand-by arrangement. Although they had carried out their adjustment effort in a generally adverse external environment, the results had been extremely encouraging. However, in 1983, they had relaxed their adjustment efforts. In particular, they had followed expansionary monetary policies resulting in a resurgence of inflationary pressures, which, together with adverse external developments, had resulted in a worsening of the external payments position. At present, Turkey was requesting a new stand-by arrangement with the Fund in support of a stabilization program for 1984. He fully supported the request. The program was strong and comprehensive, containing bold initiatives in the external sector.

In monetary policy, the program aimed at slowing the rate of expansion of monetary aggregates, which should help to reduce inflationary pressures, Mr. Nimatallah remarked. As the outcome for 1983 had been worse than expected, he welcomed the authorities' decision to revise downward the monetary targets for 1984, a decision that demonstrated their seriousness about adjustment. He also welcomed their intention to consult with the Fund in case the assumptions underlying the setting of the monetary targets did not materialize.

As to fiscal policy, the authorities had made substantial progress in strengthening the finances of both the Central Government and the state economic enterprises, Mr. Nimatallah noted. He supported the additional corrective measures adopted in connection with the 1984 program. As a result of those measures, the budget was expected to show a surplus, while the public sector borrowing requirement (PSBR) was expected to decline further.

In the external sector, he welcomed the authorities' intention to continue to pursue a flexible exchange rate policy, Mr. Nimatallah said. Having helped Turkey to expand its exports substantially in recent years, the policy was essential if export growth were to remain rapid. He agreed with the staff that the steps taken to liberalize the exchange and trade system were major by any standard, and they should open the economy to more foreign competition, thereby increasing economic efficiency and improving the allocation of resources. As the staff recognized, the liberalization measures carried with them the risk that import demand might surge unless the authorities pursued adjustment policies with firmness. It would be helpful if future staff papers on Turkey included an analysis of the impact of exchange and trade liberalization on the balance of payments, for Turkey's experience with liberalization could serve as a useful example to other countries.

Debt service payments were expected to rise sharply in 1985, owing to the effects of earlier reschedulings, and to remain high in 1986 and 1987, Mr. Nimatallah noted. The country's ability to service its debt would be enhanced by a strong and sustained export performance as well as by firm efforts to contain domestic demand. Nonetheless, adjustment need not take place at the expense of growth. Table 2 on page 21 of EBS/84/42 showed that strong adjustment efforts in 1981 and 1982 had made a positive contribution to the foreign balance and, in turn, to growth. The important thing was that a country use the right adjustment tools in achieving its objectives for growth: it should finance the necessary investments in a noninflationary way, promote exports, and encourage efficient import substitution. Turkey was moving in the right direction. He was pleased that Turkey's short-run stabilization efforts were being complemented by structural adjustment efforts with the support of the World Bank. The collaboration between the Fund and the World Bank in helping Turkey to adjust was commendable; other countries could benefit from such collaboration.

Ms. Bush said that the determined efforts made by the Turkish authorities since 1980 showed the extent to which a country could make progress in reshaping its economy along open, more efficient lines. In fact, the recent improvements in economic performance had taken place during a worldwide economic recession. Any relaxation of effort, as had occurred in 1983, could rapidly erode the hard-won gains of previous years.

Initial progress in 1980-82 had been impressive, with a shift from negative to positive real growth, a drop in the annual rate of inflation from over 100 percent to less than 30 percent, and a narrowing of the current account deficit from 6.25 percent of GNP to 2.25 percent, Ms. Bush continued. In 1983, the setback to adjustment had also been general, but the new Government deserved commendation for having acted promptly to reverse the worsening pattern of developments. The targets for 1984 would involve an acceleration in real economic growth, which seemed dependent on agricultural recovery. Had the prospects for agriculture changed since the January staff visit to Ankara? During the past year or two, inflation seemed to have become stuck at 25-30 percent, a rate that the expansion of monetary aggregates continued to accommodate. As experience showed how rapidly the rate could accelerate again, she hoped that the authorities would have more success in bringing it down.

In addition, a stronger current account position in 1984 and for the next few years would be essential if Turkey were to manage its heavy debt burden, Ms. Bush remarked. She would be interested in any comments by the staff on the likelihood of realizing the forecast increase of 17 percent in the volume and value of exports in the current year. In particular, did the breakdown of exports by product and destination support the forecast?

Progress in reducing the size of the public sector borrowing requirement had been impressive, and a further reduction was expected in 1984, Ms. Bush noted. The authorities were to be commended for bringing about a gradual improvement in the financial position and operations of the SEEs. In a country moving steadily toward a more open and market-oriented economy, it was essential that prices should transmit the right signals. A realistic exchange rate was particularly crucial, where it continued to be a major external constraint on growth; the steady real effective depreciation of the Turkish lira since 1980, plus the good record of growth in export volume, lent credence to the reassurances provided by the staff.

Real interest rates, highly negative at the beginning of the adjustment program in 1980, had turned negative again in 1983 but had recently become positive, Ms. Bush observed. She hoped that commercial banks would maintain positive real rates of interest, thus making it unnecessary for the Central Bank to intervene further in setting deposit rates. Sustained positive real rates of interest, the cut in withholding on interest income, and the latest measures described in EBS/84/42, Supplement 3 should all help to restore the ratio of gross domestic savings to GNP to the figure of 20 percent that had prevailed at the beginning of the 1980s. Regrettably, the staff papers contained little recent data on wage rates. Real wages had apparently fallen sharply in 1980, fallen again moderately in 1981 and risen slightly in 1982. What had happened in 1983, and what was expected to happen in 1984? Moreover, did the staff have any reliable information about business profitability? Again, pricing policies of SEEs were said to have become market related; their operating deficits in 1980, 1981, and 1983 had indeed been modest. For 1984, the operating balance of SEEs was expected to be in surplus, but losses in 1983 from the remaining socially oriented price controls had been larger than expected. The authorities ought to guard against similar overruns in the current year.

Besides the stickiness of the inflation rate, one particularly troublesome problem was Turkey's foreign debt, Ms. Bush remarked. The staff's medium-term scenario in Appendix IV of EBS/84/42 clearly showed that the impending peaking of debt repayments mainly concerned debts to private commercial banks. In fact, the pattern of capital flows observed in 1983 and the one expected for 1984 revealed that Turkey had already been reducing its dependence on special assistance from the OECD countries and on debt relief from both official and private creditors, a development that made it all the more important to re-establish the confidence of foreign private capital markets. It should be noted that local-content laws and performance requirements for direct foreign investment served as impediments to inflows of foreign capital. In its calculations for the medium-term scenario, the staff had alerted the Turkish authorities to the possibility that, if export growth or voluntary private capital inflows fell short of the targets, the authorities might have no choice but to cut back somewhat on the rate of real growth. The staff was to be commended for the three scenarios presented in Appendix IV, which showed how sensitive the balance of payments was to various economic assumptions.

In 1978, 1979, and 1980, the Executive Board had approved a series of programs for Turkey, Ms. Bush recalled. In eight of the past nine years, Turkey had made purchases from the Fund. Such prolonged use of Fund credit was not unique to Turkey; even if it drew under the proposed stand-by arrangement, Turkey would be making net payments of $45 million to the Fund in 1984. The broader question of the revolving nature of the Fund's resources would be reviewed soon by the Board: she would hope that a number of countries would be able to make net repayments to the Fund as the world economic situation improved. Furthermore, even without the proposed $180 million in gross drawings from the Fund, Turkey would still be able to rebuild its foreign reserves by $440 million, instead of the $620 million contemplated in the program.

Despite those reservations, her authorities were willing to support the new program, Ms. Bush concluded. However, the lapse in adjustment last year should be promptly corrected. Furthermore, the shift in balance of payments financing from official sources and debt relief toward voluntary inflows of private capital was still in its early stages, and many uncertainties remained. Most important, the new Government had embarked on a new, bold effort at liberalizing the trade and payments regime, even though impediments continued to exist, particularly to direct investment. However, liberalization also increased the uncertainty about the response of the balance of payments in the short run. Continued Fund financing of Turkey was justified for another year, but she would urge the Turkish authorities to regard Fund drawings as a truly "stand-by" source of financing to be used only in the event that unexpected developments should necessitate the further accumulation of such debt.

Mr. Joyce said that economic performance in Turkey in 1983 had clearly been unsatisfactory, particularly in the light of the worsening inflation and the balance of payments. Moreover, it was regrettable that the previous authorities had not maintained the momentum of Turkey's adjustment effort. The strong economic advances arising from the adjustments undertaken in 1980-82 had been reversed because of the failure to continue with sound economic and financial policies. Therefore, he welcomed the re-establishment of relations between Turkey and the Fund "on a fresh basis," as Mr. de Groote had put it. The new Government's determination to return to tight demand management and to push ahead with structural reform and far-reaching import liberalization was to be commended. Nonetheless, in view of the uncertainties attached to economic projections, both the authorities and the staff should watch developments closely to ensure that corrective action was taken without delay, if it proved necessary. The recent measures taken by the Turkish authorities to make up for the larger than expected current account deficit in 1983 were most encouraging.

A strengthening of monetary policy, the area in which things had gone wrong in 1983, and a return to positive real interest rates would greatly assist efforts to control inflation, Mr. Joyce said. However, if monetary policy were indeed to reduce inflation while permitting increased growth, the authorities would have to contain wage pressures and exercise fiscal control to ensure adequate liquidity for the private sector.

The authorities' commitment to implementing a tight fiscal policy in 1984 and to further reducing the public sector borrowing requirement was to be commended, Mr. Joyce continued. Concerned about the projected fall in fiscal revenue as a proportion of GNP, he welcomed the Government's intention to reverse the trend through improving tax assessment and collection. In a recent review of the Turkish economy, the OECD Secretariat had expressed some doubts about the accuracy of the 1983 expenditure estimates. As he understood it, the Secretariat's main concern was that some expenditures--especially transfer expenditures--had been delayed in 1983 and that the delays would build up into unforeseen pressures on expenditure ceilings in 1984. The Secretariat had also pointed out that the practice of recording interest payments on government debt not as current expenditure but rather as financing items was somewhat misleading. He invited the staff to comment either on that point or on the assessment currently being presented by the OECD. Had the staff modified its assessment of the outlook for fiscal 1984?

He welcomed the Government's intention to seek improvement in the financial position of the state economic enterprises, Mr. Joyce said. Principally because of heavy short-term borrowing by SEEs, the program had fallen into difficulty in 1983; indeed, such borrowing had been a major contributor to the failure of monetary policy. Like Mr. Laske, he would appreciate additional information about the reasons for the "unexpectedly" heavy short-term borrowing by SEEs, especially as the staff had noted that the authorities had continued to impose ceilings on the capital capabilities of such enterprises throughout 1983. In fact, the share of the borrowing requirement taken up by short-term borrowing, including tax arrears and suppliers' credits, had increased dramatically in recent years, suggesting that the authorities needed to establish much firmer control over the borrowing activities of those enterprises in order to avoid undue growth in their financial obligations or adverse effects on their debt maturity structure. Further efforts would be required in the coming year. He was particularly glad that the authorities were determined to carry through more realistic pricing policies.

He welcomed the authorities' commitment to liberalizing imports further, rationalizing and simplifying import duties, and maintaining a flexible exchange rate policy, Mr. Joyce went on. They were to be congratulated for the major steps already taken, part of the right policies for the medium term. The substantial reduction in direct fiscal incentives for exports, envisaged for the summer, would represent another positive step, although, as the staff pointed out, liberalization could lead to a surge in imports and a weakening in the external balance, at least in the short run. Apart from a possible faltering in the Government's determination to pursue its fiscal and monetary policies, the major risk in the program appeared to be associated with the external sector. Sustained improvement was crucial, given Turkey's substantial foreign debt service obligations in the period ahead and the need to contain future borrowing requirements.

Perhaps the external stabilization efforts placed too much of the burden of adjustment on exports, given the risks associated with that sector, Mr. Joyce said. In addition to the uncertainties mentioned by the staff about adverse developments in Middle Eastern markets, there was also a possibility of less favorable growth prospects in other foreign markets, particularly if nominal interest rates in the United States remained on an upward trend rather than eased, as the staff projections assumed. Furthermore, a rise in U.S. interest rates could adversely affect workers' remittances, an area of weakness in 1983, as well as interest payments on foreign debt. While appreciating the authorities' desire not to compromise domestic output objectives, he wondered whether the stabilization program--particularly under the newly liberalized import regime--might be one of comparatively high risk, given the high rate of unemployment.

Perhaps the staff could say in which areas of the program the authorities might contemplate further adjustments in order to maintain the momentum of their effort, if the underlying assumptions for the external balance were not met, Mr. Joyce concluded. After all, the staff had said that an even larger decline in the current account deficit could be programmed in coming years, if the authorities achieved an external position adequate to finance the external debt and built up reserves to acceptable levels. In conclusion, he could fully support the proposed decisions, and he congratulated the new Administration for the measures already taken.

Mr. Wicks endorsed the proposed decision. After the progress made under the three-year stand-by arrangement between 1980 and 1982, it was fair to describe 1983 as having been a wasted year for economic policy in Turkey. Economic results in almost every area had proved worse than expected, the main cause having been an inadequate monetary policy. To the great credit of the new authorities, they had decided early on to cancel the program and to begin again; they had already taken encouraging steps affecting interest rates, the exchange rate, and trade.

At 52.4 percent of quota, the program could be regarded as relatively modest; there were two reasons why that approach was correct, Mr. Wicks went on. First, the program recognized the revolving nature of Fund resources; as Ms. Bush had said, Turkey had been using the resources of the Fund since 1978. Therefore, the Fund's involvement in the present stage of the country's evolution should not be too extensive. Second, the adjustment program would be restrained: in 1984, the fiscal deficit was projected to fall by only a little more than 1 percentage point of GNP, while inflation was expected to average 29 percent, only 1 percent lower than in 1983. Perhaps most worrying, the size of the current account deficit was projected merely to return to its 1982 level, even under fairly optimistic assumptions about exports. External debt was to rise substantially, to 45 percent of GDP; in the light of the latest current account figures for 1983, the increase in external debt might turn out to be higher.

The narrowing of the fiscal deficit in 1983, although smaller than programmed, had still been commendable, Mr. Wicks noted; he was glad to see that a further narrowing was projected for 1984. Table 10 in EBS/84/42 showed that, as a percentage of GNP, tax revenue had declined for three years running and was expected to decline again in 1984. As tax arrears still amounted to some 3 percent of GNP--or about one sixth of total revenue for 1984--he welcomed the authorities' efforts to improve tax collection and hoped that they would give that task some priority.

He had been concerned that public sector wages had risen by nearly 10 percent more than private sector wages in 1983 and that further "adjustments"--the term used in the paper--were planned for 1984, Mr. Wicks said. He assumed that the term meant "increases." After the wage bill in the parastatals had risen by over 40 percent in 1983, another increase of the same order appeared to be planned for 1984. Such large increases gave the wrong signal to the private sector at a time when Turkey needed to restrain inflation and improve competitiveness. Had the staff or Mr. de Groote any further comments to offer on the attempts to restrain wage growth in the public sector?

Recent measures taken to adapt monetary policy were both courageous and encouraging, Mr. Wicks remarked. In particular, he welcomed the authorities' commitment to maintaining an average real interest rate of 6 percent on time deposits. However, he was not sure whether it was best to wait for interest rates to become positive as inflation fell. Rather, real positive interest rates were an important method of reducing inflation, and he would have preferred to see an immediate increase in interest rates. Given the worse than expected outturn in the balance of payments in 1983, the steps taken to tighten monetary policy and increase the incentives for private savings, and also to lower the ceiling on net domestic assets of the Central Bank, had been appropriate. Nonetheless, interest rates on personal sight deposits, which were important in attracting workers' remittances back to Turkey, remained substantially negative in real terms, and he wondered whether measures to raise those rates might be helpful.

On external policy, Mr. Wicks said that he welcomed the substantial measures to liberalize the trade and exchange system, which should do much to improve efficiency, promote competition, and improve resource allocation. It was however on the external side that the relatively relaxed pace of adjustment gave the greatest cause for concern, a matter on which he associated himself with the remarks made by Mr. Joyce. Even under the staff's "adjustment" scenario presented in Table 15 of Appendix IV in EBS/84/42, balance in the current account would be achieved only in 1988. In the meantime, Turkey would need to attract capital inflows averaging \$2.5 billion a year, which would have to come increasingly from commercial banks; he agreed with Mr. Laske that it would be most unlikely that special government assistance would again be made available to Turkey. Even if such flows from the banks were to become available, the authorities would have to maintain the pace of adjustment. Therefore, he strongly endorsed the observation on page 18 that they might have to restrain domestic growth in order to maintain external viability.

For 1984, the authorities had correctly said that the current account deficit must not be allowed to exceed \$1 billion, Mr. Wicks stated. Indeed, he agreed with the staff comment on page 16 of EBS/84/42 that an even lower figure would have been desirable, given the already heavy burden of debt and the high debt service ratio. The authorities would need to act quickly if the target appeared to be endangered. They should keep monetary policy tight in order to restrain imports and encourage remittances, and should take a competitive and flexible approach to the exchange rate.

The footnote on page 13 of EBS/84/42 indicated that the limits for new medium-term borrowing excluded certain long-term commitments, which, he understood, were likely to include not merely the Ataturk Dam but also a second Bosporus bridge as well as nuclear power plants, Mr. Wicks pointed out. Was the staff satisfied that the savings in foreign currency generated by those large projects would match the payments on the substantial foreign borrowing required to build them, and that there would be no danger of exacerbating the external debt position? He had also seen that the short-term limits excluded the Dresdner Bank scheme, convertible lira deposits, and trade credits. Although he could understand the reasons for the exclusions, they were the fastest-growing elements of Turkey's short-term debt and also the most unstable. What was the scale of those exclusions from the performance criteria?

As his chair had noted at a discussion in the World Bank Executive Board on March 28, the World Bank appeared to be taking a much more sanguine view than the Fund of the prospects for the capital account in Turkey, Mr. Wicks concluded. The two institutions should reach a common view before the fifth Structural Adjustment Loan was made, and he welcomed the assurances received in the World Bank Board that that common view would indeed evolve. He himself would add that cooperation between the Bank and the Fund on Turkey had been excellent, and he hoped that it would continue.

Mr. de Vries commented that the main thrust of Turkish economic policy in the past three or four years had been most encouraging. At the end of World War I, there had occurred a major social revolution, and a particular economic system had been put in place by the founder of modern Turkey. It might be said that, during the past few years, the authorities had been engaged in bringing that system up to date from 1924 to 1984, and their effort was the backdrop against which Executive Directors judged the latest developments.

As previous speakers had noted, unfortunate events had taken place during 1983, Mr. de Vries went on. The staff correctly noted that the failure of the program had resulted principally from the authorities' unwillingness to implement an effective monetary policy; the staff had made reference to special transactions between the agricultural bank and the Central Bank. As he understood it, a number of window-dressing operations had been going on. While window dressing occurred quite often among commercial banks, it was a different matter if the authorities of a country sought to make matters appear more favorable to the Fund than they actually were. Nothing had occurred that could be called a transgression of the law, but the operations had been unfortunate; the Turkish authorities themselves had decided not to make any further drawings under the Fund program, although, because of the window dressing, they had technically met the performance criteria. He was bringing up the matter because, as the Fund became obliged to ask for more fundamental adjustment programs, the temptation to engage in such statistical operations grew. The Fund had to trust the authorities of its various member countries;

it could not take on the responsibility for inspecting the official figures submitted by member countries that had programs under arrangements with the Fund.

The prospects for 1984 were much more hopeful, Mr. de Vries considered. The authorities were implementing a new economic program and a new strategy, or perhaps they were again implementing the old strategy, in itself an encouraging development. The heart of the program was removal of restrictions in the trade and payments system, substantial liberalization of imports, and the lifting of a complex set of foreign exchange controls and restrictions; the staff indicated that the effort was major by any standard. Whether it would be successful depended largely on whether the authorities could combine a realistic exchange rate with strict management of domestic demand. Like other Executive Directors, he wondered whether the effort to manage demand would be more than modest, as the OECD estimates were less optimistic than those of the staff. For instance, the staff had said that a decline larger than that programmed in the current account deficit would be helpful, but the OECD's estimate of the improvement in the current account was lower than the Fund's estimate. Furthermore, the OECD had estimated that Turkey's current account would improve by about $500 million less than the Fund staff estimate; economic growth would be 3.75 percent according to the OECD, 4.5 percent according to the Fund. The OECD also foresaw that Turkey would not even achieve the 1 percent reduction in the annual rate of inflation cited by Mr. Wicks. The statistical differences could not be resolved, but it was clear that the new adjustment efforts depended greatly on strict control of demand. The Turkish authorities had taken some risks. If it turned out that more measures were needed, they should act quickly to assure the success of their program. He agreed with Mr. Wicks that the size of the proposed drawing was suitable.

The authorities' strategy would encompass further increases in flexibility for state economic enterprises (SEEs), which had continued to be a problem during the Fund program; he was afraid that they would remain somewhat of a problem, Mr. de Vries continued. It was a question not merely of taking economic measures but also of attitude and tradition. The additional measures being proposed sounded encouraging, and he hoped that they would result in a further step forward in the management of SEEs, which would have to adapt the more modern strategy in order to succeed.

The Turkish authorities had made a major effort to adjust, and involvement by the Fund was justified, Mr. de Vries considered. All the parties involved--the governments providing assistance, the Fund, and the Turkish people--felt that perhaps the time had come to see some results of the difficult efforts to restructure the economy thoroughly. He hoped that, under the present program in 1984, all parties would indeed see their hopes realized.

Mr. Salehkhou expressed his support for the proposed decision. It would however have been better if some background information such as a report on recent economic developments could have accompanied the staff paper. Executive Directors needed more data on certain sectors of the economy during 1983--especially the external, investment, and agricultural sectors--to understand the causes of the disappointing performance. He hoped that such data could be presented in time for the mid-year review.

Following successive programs with the Fund, Turkey's performance had been encouraging, Mr. Salehkhou remarked. Real growth had furnished sufficient momentum for wide-ranging programs, while a cautious monetary policy had checked excess liquidity and a flexible exchange rate policy had created a framework favorable to exports. Nonetheless, some of the initial gains seemed to have been reversed in 1983: the growth of exports had slowed, and they had been adversely affected by a smaller than expected increase in volume and a further fall in unit values, the latter having been on a downward trend since 1981. The precise impact of the flexible exchange rate policy would become clear in the future, once Turkish exports resumed their normal geographical pattern, for much of the increase in exports recorded during the past three years had been due to expanded sales to neighboring Middle Eastern countries. In addition, much of the future trade performance would hinge on whether Turkey could extend its success in penetrating Middle Eastern markets into industrial markets as well. In that regard, he welcomed the cautious approach taken by the staff on page 5 of EBS/84/42.

He would appreciate some elaboration on the substantial improvement projected for Turkey's terms of trade in 1984, Mr. Salehkhou said. The most recent letter to the Fund from the Minister of Finance mentioned that exports had risen by 30 percent in the first two months of 1984, certainly a favorable trend. Yet did it indicate that the declining trend in export unit values had been halted? If so, how much of the recovery could be assigned to higher prices for agricultural exports? Furthermore, the unexpected decline in exports in December 1983 was not ascribed by the staff to either price or volume developments; more data would therefore be needed.

If successful, the comprehensive program of import liberalization would aid greatly in preparing the terrain for an efficient trade system, Mr. Salehkhou went on. How well was the program being implemented? The authorities would be well advised to exercise caution, especially considering the low level of foreign reserves and the outlook for workers' remittances.

Agriculture had performed worse than expected in 1983 owing to a drought, poor harvests, and other related problems, Mr. Salehkhou recalled; real agricultural income and agricultural prices had both declined. The authorities' stated goal of real growth in GNP of 5 percent in 1984 seemed to require sizable investment in agriculture and other related measures. As more than one third of Turkey's exports consisted of agricultural products, any measures to enhance output from that sector would favorably affect export performance as a whole. At a time of steadily rising international demand for agricultural commodities produced by Turkey--such as wheat and cotton--an improvement in the organization of agriculture would strengthen the authorities' export drive.

The authorities were rightly concerned about the need to direct financial resources toward productive channels, Mr. Salehkhou observed, some misallocations away from productive sectors having occurred in 1983. Total investment in state economic enterprises had declined steadily during the past three years; pricing policies designed to enhance their profitability should be further examined. With the present trend in investment, the uncertain prospects for the external sector, and the relative decline in agricultural production, for Turkey to achieve a growth rate of 5 percent in 1984 would necessitate extraordinary efforts on many fronts, and he could not be optimistic about whether all the stated objectives would be attained. In the coming months, a clearer picture would emerge; until then, he would urge caution. However, the authorities had addressed the real issues and were aware of potential problem spots.

Mr. Lovato noted that, in the nine months since the previous review, the Turkish economy had deteriorated markedly both in price stability and in the external position. He was disappointed that the stabilization program, begun in 1980 with Fund support and carried out until 1983, had been interrupted, albeit temporarily. Supporting the proposed decision, he strongly endorsed the explicit statement in the staff appraisal that there was no room for further slippages.

Given the degree of Turkey's exposure in international capital markets, any realistic policy for debt management in the years to come would require steady progress toward macroeconomic adjustment as a basis for support from the international community, Mr. Lovato said. The current account and its financing were the key elements. As the authorities had said in their letter of intent, improvements in the external position had to come mainly from exports and had to be all the larger because the effect on imports and capital movements of the steady liberalization of payments remained uncertain. Nonetheless, according to Table 2 of EBS/84/42, the real growth of the economy was currently being supported by growth in domestic demand, and the outlook for 1984 was expected to be about the same. As he had observed when the Board had discussed the previous request for a stand-by arrangement by Turkey, the national accounts data and projections suggested that macroeconomic policies were not fully consistent with the desired adjustment in the current account. Moreover, he was again surprised that the paper contained little or no reference to households' revenue accounts or to incomes policy; those two areas deserved greater attention in view of the necessity of curtailing domestic absorption.

According to the staff, the authorities would place most of the responsibility for stimulating domestic savings on monetary policy, by creating new savings instruments and raising real interest rates, Mr. Lovato noted. He could agree that those two changes would help to direct the flow of savings toward domestic financial instruments, but their effect on private savings was subject to great uncertainty, at least with respect to households. Consequently, in pursuing the objective of reducing domestic absorption, the authorities might have to devise policies to affect the dynamics of disposable income.

On monetary policy, he welcomed the recent trend toward financial innovation and restraint in the growth of monetary aggregates, Mr. Lovato stated. The large borrowing requirement by the public sector during the previous five years had markedly increased the private sector's holdings of financial assets, particularly time deposits. It was essential that those assets should remain attractive in real terms, especially in view of the importance of workers' remittances in the balance of payments and the high degree of substitutability of workers' remittances with investments in foreign assets.

Besides a substantial financial adjustment, Turkey needed a medium-term structural program of modernization focusing on infrastructure and agriculture, Mr. Lovato concluded. The authorities would be taking a major step toward carrying out such a program by improving the quality of public expenditure. On that point, the share of investment in public expenditure had markedly increased during the previous few years. Successful implementation of the adjustment program remained a necessary condition for the structural transformation of the Turkish economy that would continue in the years to come.

Mr. Alhaimus remarked that during the 1983 stand-by arrangement Turkey had been expected to consolidate the improvements made in recent years. Performance had however been below expectations, particularly during the latter part of 1983. In their recent letter of intent, the authorities had candidly admitted to not having achieved some major targets under the program: demand had risen faster than expected, inflationary pressures had intensified, and the external current account deficit had widened. As the authorities and the staff agreed, those occurrences had been attributable chiefly to excessive monetary expansion. After the 1983 outcome, and in view of the recent introduction of a different set of economic policies, the authorities' decision to request a new arrangement was understandable.

The new program under the proposed arrangement involved tight control over both monetary and fiscal policies, including further improvements in the financial performance of SEEs and a continuation of structural change, Mr. Alhaimus commented. In view of the 1983 experience, he was encouraged to note the authorities' determination to keep monetary expansion sufficiently tight in 1984; for instance, they had recently decided to lower the ceilings on net domestic assets of the Central Bank, as reported in Supplement 2 to EBS/84/42. Maintaining that cautious policy stance was necessary in order to absorb the liquidity overhang, slow inflation to the desired rate, restrain domestic expenditure, and achieve the stated external targets.

With respect to the external sector, Mr. Alhaimus noted, first, that the authorities and Mr. de Groote had stressed that the improvement in Turkey's balance of payments must be triggered by a substantial growth in the volume of exports. They expected the series of policy changes in the exchange and trade system announced in December 1983 to encourage exports; in Supplement 2 to EBS/84/42, the staff reported that, during the first two months of 1984, exports had in fact risen by 30 percent. In which major markets had that substantial increase been realized? How would it affect export projections for the program period?

The generalized liberalization of both the domestic and the external sectors, Mr. Alhaimus observed, substantially exceeding that foreseen under the 1983 stand-by arrangement, could generate higher imports than currently projected, especially during the first half of 1984. The staff had indeed emphasized that the possible danger of a surge in imports could not be ignored. On the other hand, Table 5 on page 24 of EBS/84/42 showed that Turkey's total imports had been initially projected to increase by less than 8 percent in 1984; the revised projections in Table 1 of EBS/84/42, Supplement 2 implied a rate of increase of only about 5 percent. He invited the staff to comment further on the rationale underlying that implicit revision and to explain whether earlier fears about imports' rising were no longer warranted.

Finally, Turkey would be making substantial repayments of foreign debt in the next few years, Mr. Alhaimus noted. The likely debt profile through the 1980s underlined the importance of reducing the current account deficit, on which the manageability of Turkey's debt service payments depended. He supported the proposed decision.

Mr. Prowse expressed support for the proposed decision and agreement with the staff appraisal. It was important for Executive Directors to give credit to the Turkish authorities for what they had achieved. Indeed, the results under Turkey's adjustment program in the early 1980s had represented one of the Fund's success stories; against that background, the lapse during the previous year in one or two respects could be seen as all the more disappointing, but at least it had been confined to monetary policy and external performance. With regard to the latter, the staff had properly noted that the failure to achieve the targets had been principally attributable to lower prices for Turkey's exports of primary commodities; by contrast, in fiscal policy and public finance, the authorities' performance had been praiseworthy. For instance, the consolidated budget deficit in 1983 had stood at 0.5 percent of GNP, as programmed, compared with 1.2 percent in 1982, while the consolidated PSBR had fallen to 4.7 percent of GNP in 1983 from 6 percent in 1982 and 12 percent in 1980. Much of the narrowing of the budget deficit had been due to the adoption of sensible, flexible, market-oriented pricing policies in the SEEs. He therefore welcomed the authorities' commitment to taking any additional steps that might seem appropriate to achieve the objectives of the proposed stand-by arrangement. While not regarding the program as modest, he did regard the amount of assistance being offered by the Fund as modest and almost minimal.

He welcomed the authorities' intention to continue the flexible exchange rate policy, Mr. Prowse went on. As other Directors had noted, it was particularly encouraging that the authorities had introduced a number of measures designed to liberalize the trade and exchange system, especially as, for over half a century, the country had accumulated a massive and most complicated set of controls and restrictions on foreign exchange. The import regime had changed fundamentally: some 75 percent of the imports that had been restricted in 1983 would be free of restriction in 1984. Moreover, the authorities had simplified the regulations on foreign investment.

As to monetary policy, Mr. Prowse commented, on page 9 of SM/84/42 the staff said that the increase in broad money was projected at 31 percent in 1984 compared with 41.5 percent in 1983, implying a 2.5 percent rise in velocity. The staff had added that the program allowed for the absorption of the liquidity overhang by the second quarter and provided a safety margin to dampen the possible adverse consequences of external liberalization and to adjust for increased efficiency in the use of financial resources. Perhaps the staff could explain the size of the built-in safety margin. Did the Turkish authorities understand it to be something that would not come into play as long as the external liberalization had no serious adverse effects? Moreover, what had been built in with respect to the presumed increases in efficiency in the use of financial resources?

He asked those questions, Mr. Prowse continued, because monetary policy had turned out to be quite disappointing in 1983 and because it would be the critical area for 1984, fiscal policy and external policy having stayed on track. Perhaps the staff could also explain the remarks on page 2 of EBS/84/42, Supplement 2 in reference to the sharp slowdown in the rate of growth of net domestic assets beginning in the second quarter of 1983. The staff was correct in maintaining that the slowdown should help to absorb the liquidity overhang, but he would add that the effect might be quite dramatic. At any rate, there seemed to be a good case for a smoother and steadier slowdown in the growth of net domestic assets.

Even though somewhat lower ceilings for net domestic assets were included in the revised letter of intent, Mr. Prowse noted, the ceilings should not be described as severe or stern, because of the critical importance of monetary policy. Indeed, the growth allowed appeared to be verging toward the comfortable. Was the staff certain that the ceilings were low enough?

The crucial question was whether the authorities might have to restrain economic growth more than they would wish in order to maintain the external viability of the Turkish economy, Mr. Prowse indicated. As in so many countries that borrowed from the Fund, the issue was at the heart of contention between the Fund and a potential borrower. He concurred in the staff's judgment about Turkey: the projected current account deficit would be financeable, but, in financing it, the authorities would have to bear in mind that they still had to exercise the greatest caution in dealing with the external debt position. Therefore, he agreed that the authorities' policy as they described it--one of great caution--represented the right choice. In that respect, Mr. de Groote had confirmed that the authorities were well aware of the future profile of the debt: the debt service ratio was projected to reach 29 percent in 1984 and 33 percent in 1985, before beginning to decline. However, he was uncertain what Mr. de Groote had had in mind by saying that debt service ratios were not in themselves sufficiently illustrative of a country's external debt manageability, because the overall economic situation of the country and trends in the internal and external environment gave a better picture. Perhaps Mr. de Groote would like to expand on his assessment of the Turkish economy. In any event, he hoped that Mr. de Groote had not been suggesting that the external debt position in Turkey was anything but one in which caution continued to be required.

Mr. Blandin recalled that, as the Chairman had said at the conclusion of the Board discussion of the World Economic Outlook at EBM/84/50 (4/2/84), there was no alternative to adjustment for a country facing worrying imbalances. The main difficulty, however, was to detect the precise moment at which a country was in sufficiently good form to replace short-term adjustment measures by structural reforms aimed at consolidating the results so far achieved. In that respect, Turkey offered a good example of a comprehensive program of stabilization that the authorities had abandoned too rapidly after making remarkable progress in adjusting the current account and lowering inflation. Consequently, inflationary pressures had revived; monetary policy had become too expansionary. A worsening of the terms of trade together with bad weather had led to a widening of the current account deficit. The Turkish authorities deserved commendation for having again begun to implement policy measures like those of 1980, with the support of the Fund, under a new stand-by arrangement.

As to the program itself, he was in broad agreement with the principal assessment made by the staff, Mr. Blandin continued. Turkey's external performance in 1983 had clearly been disappointing: the trade balance had deteriorated by 25 percent. Perhaps the target of a 17 percent increase in exports for 1984 was ambitious, but it could be met, considering developments during the first two months of the year. Nevertheless, like Mr. de Vries, he would appreciate more information from the staff. In addition, the scope for further improvements in workers' remittances would depend mostly on growth in the industrial countries and higher real interest rates in Turkey. In order to avoid any adverse evolution of the trade balance and to give incentives to savings, the authorities should pursue a realistic exchange rate policy. On the domestic side, he agreed with the staff that tight monetary and fiscal policies were called for, and he welcomed the return to positive real interest rates on deposits. Could the staff explain why interest rates for credits and loans seemed to be a little high compared with the rate of inflation?

The medium-term scenarios for external debt and the balance of payments presented in Appendix IV on page 43 of the staff paper were quite useful, Mr. Blandin said. He would encourage the Turkish authorities to stick to the "adjustment" scenario--which assumed that equilibrium would be attained in the current account by 1988--as it would preserve the best chance for a sustainable rate of growth of about 5 percent annually and a manageable debt service ratio of 24 percent. Finally, as mentioned by previous speakers, particularly Mr. Nimatallah and Mr. Wicks, the cooperation between the Fund and the World Bank in Turkey was commendable and should be pursued. He supported the proposed decision.

Mr. Zhang expressed support for the request by Turkey for a new stand-by arrangement.

The staff representative from the European Department recalled that, when the Fund mission had visited Ankara in January, the new Government had been in office less than a month, and on a number of subjects--particularly wage policies--the authorities had not been in a position to provide much information. As part of the negotiations in January, the staff had agreed to remain in close contact with the authorities four times a year. Later in April, the staff would in fact have an opportunity to ask them questions about a number of subjects raised by Executive Directors. The staff would again visit Ankara in the second half of June to hold discussions for the 1984 Article IV consultation and the mid-term review; on the basis of those discussions, the staff would be preparing a detailed report on recent economic developments in Turkey, which would deal much more extensively with a number of topics covered only briefly in EBS/84/42. With respect to World Bank cooperation, a Bank staff member had participated in all the recent visits made by the Fund staff to Turkey.

Performance since 1980 had been admirable overall, so that the reversal in 1983 had been especially disappointing, the staff representative continued. It should be mentioned that 1983 had been an election year. In many countries, the authorities were tempted in election years to relax economic policies for noneconomic reasons, as the Turkish authorities had relaxed monetary policy in 1983.

While there had been much genuine improvement both in demand management and in structural adjustment, in the immediate years ahead Turkey would be faced with a substantial repayment of debt resulting from the rescheduling agreements made in the early 1980s, the staff representative said. Therefore, the future should be viewed with a certain degree of caution, as recognized by the present authorities. They had made the fundamental decision that their two aims of attaining a viable medium-term position in the balance of payments and a rate of growth needed to absorb the high unemployment would be compatible only if there were sustained growth in export volume. Indeed, the 1984 program and the medium-term aims of the authorities were predicated on export growth. The staff believed that, given appropriate policy, substantial growth would be possible in 1984. Unfortunately, for reasons beyond the authorities' control, agricultural performance had been below expectations in 1983, and export prices for agricultural goods had been particularly poor. The staff hoped that conditions would improve in 1984, although, in response to Ms. Bush, the staff had no firm indications about the outlook for agriculture in the current year. It was crucial to realize that, if exports were going to increase strongly, there had to be an adequate supply of export commodities, something that could occur only if domestic expenditure were restrained; he agreed with Mr. Lovato on that point.

According to projections, domestic expenditure was to grow by only 3.5 percent, compared with growth in total output of 4.5 percent, the difference of 1 percent to be directed to the external sector, the staff representative explained. That method was precisely the one by which the authorities had obtained an improvement in the external position in earlier years. In that respect, although the initial projections included in EBS/84/42 were still broadly correct, it was almost certain that the tightening of monetary policy introduced since the staff had written that paper would be reflected in somewhat lower rates of growth for domestic expenditure. He would hope that the slower growth of total output would be more than matched by slower growth of domestic expenditure.

On the fiscal side, the staff would agree with those Executive Directors who had spoken about the unsatisfactory rate of increase of revenue, the staff representative said. By most other measures, fiscal performance had been satisfactory, but sluggishness in revenue growth since 1980 had been the one serious weakness in fiscal performance. He would agree with Mr. Prowse that the decrease in the rate of expenditure growth was welcome because the public sector had been spending too much; over the longer term, however, the relative decline in the growth of expenditure was unlikely to continue, because eventually it would hinder necessary spending, particularly on infrastructure. By the way, the new Minister of Finance had had experience in the Ministry of Finance back in the 1950s and was well aware of all the ins and outs of tax avoidance and tax evasion; he had given every assurance to the Fund staff that he was determined to enhance revenue collection.

With respect to the growth of exports, the figures from January and February 1984 had been quite satisfactory, the staff representative went on. Nonetheless, there had almost certainly been an element of a reversal of leads and lags in those figures. Toward the end of 1983, there had been a fairly widespread conviction inside Turkey that the Government was likely to introduce a faster rate of depreciation of the lira. Inevitably, imports had been speeded up and exports had been held back; the reverse had occurred in January and February 1984. Nevertheless, he would hope that the turnaround also reflected some initial reaction to the external policies that the authorities had made it plain that they intended to follow. Unfortunately, he was unable to offer any information on the commodity composition of Turkey's exports in January and February or on the destination of exports, for the information had not yet become available even to the Turkish authorities.

As Executive Directors had noted, the staff representative commented, EBS/84/42 contained little information on wage rates, because it had not been available to the staff. With respect to Mr. Wicks's observation that wage payments under the budget had risen by 50 percent in 1983, it should be pointed out that the 1982 budget had covered 10 months, not 12. If the wage payments were multiplied by 1.2 to bring them up to a full 12-month total, the nominal increase from 1982 to 1983 would amount to only 25 percent, representing a substantial decrease in real terms. During 1981, 1982, and 1983, real wages in Turkey had declined quite drastically. Indeed, the present Government was coming under strong pressure from the trade unions to grant substantial increases for 1984. The agreement reached through hearings of the High Arbitration Council was for a general increase of 25 percent, with an absolute increase for every wage earner of LT 2,000 a month, representing a basic increase of 30 percent across the board in nominal wages. After a year-on-year average increase in prices of 29 percent, a rough balance had been established between inflation and nominal wage increases. If the not unreasonable assumption of a 1 percent rise in productivity were accepted for 1984, wage costs per unit of output would in fact decline slightly.

The rate of inflation in 1984 was projected to differ hardly at all from the rate of inflation in 1983, the staff representative admitted. Prices at the start of 1984 had been about 40 percent higher than at the start of 1983; to achieve a year-on-year increase of 29 percent, the staff had had to assume that, by the end of 1984, the year-on-year rate of inflation in Turkey would have fallen to 25 percent, or even lower. Diminishing the rate of inflation during the course of one year from 40 percent to 25 percent would represent a sizable achievement. In addition, the more rapid rate of depreciation of the exchange rate for the lira and the substantial increase in prices charged for SEE products--both of which, he was sure, Executive Directors would welcome--were likely to put some upward pressures on prices. Thus, the target for reducing the rate of inflation would not be easy for the authorities to attain.

He had discussed the OECD's projections with the OECD Secretariat in Paris, the staff representative remarked. The Fund staff had begun the examination of Turkey's balance of payments by assuming that it would be inappropriate for Turkey to finance a deficit bigger than $1 billion, although, in the short run, the authorities would be able to finance a bigger deficit, if only by not running up gross reserves to the targeted increase of $600 million. In the staff's view, a deficit bigger than $1 billion would put the future too much at risk. The OECD's projection of a current account deficit of almost $1.5 billion had been made before the Turkish authorities had tightened monetary policy. The Fund staff would also give a heavier weight to the impact through monetary policy of higher interest rates on gross domestic expenditure. If, in fact, it began to seem likely that the deficit would turn out to be as large as the OECD projection, the Fund staff would consider it essential for the authorities to take stronger action to reduce the prospective deficit. There might also be a difference between the judgments by the Fund staff and the OECD staff on agriculture. In any event, the authorities agreed with the Fund staff that the current account deficit should not rise above $1 billion in 1984.

Structural adjustment loans to Turkey from the World Bank had particularly emphasized investment in infrastructure, agriculture, and energy, the staff representative noted. Those three areas had been weak, as the authorities recognized; they were taking steps over the medium term to improve performance.

Differences between World Bank projections and Fund projections derived from four sources, the staff representative explained. First, the World Bank staff had assumed a somewhat higher rate of growth in its projections. In the past, the World Bank had tended to project desirable rates of growth and to assume that the deficits that might result would be financeable. More recently, there had been a growing convergence between the views held by the World Bank staff and those held by the Fund staff: in the future, national authorities would have to place more emphasis on the size of the deficit that could be financed than on the deficit that they would like to finance.

The second difference between the two forecasts was that the World Bank staff had assumed a somewhat higher import elasticity with respect to the growth of total output than had the Fund staff, the staff representative commented. However, the two sets of projections converged toward the end of the period. Again, the difference was one of timing rather than a complete difference of long-term outlook. Third, the World Bank staff had assumed a somewhat higher rate of growth in the volume of exports than had the Fund staff. He hoped that the World Bank staff was correct, but the Fund staff had believed it desirable to exercise caution. Fourth, with respect to the limits on long-term debt, the Fund staff had relied considerably on the judgments of World Bank staff and had thus considered it reasonable to include many of Turkey's long-term debts in the medium-term program, because the World Bank had been willing to accept them for inclusion. At the moment, the Fund staff could apply performance criteria only on the contraction of debt. Disbursements were recorded so slowly that the staff could not use disbursements as an operational method.

Workers' remittances to Turkey through the Dresdner scheme were potentially unstable, as one or two Executive Directors had maintained, but the staff could not envisage circumstances in which Turkey would refuse to accept them, the staff representative remarked. Therefore, the staff believed that it would be inappropriate to include in the ceilings what were really reserve transactions as convertible lira deposits. Unless the staff excluded the possibility, if workers decided to put a larger share of their remittances in the Dresdner scheme, the ceiling might be exceded, and the staff would have to come to the Board for a waiver.

In EBS/84/42, the staff had expressed disappointment about the performance of monetary policy in 1983, and the present Turkish authorities completely shared that view, the staff representative said. Obviously, the monetary expansion on average had been related to the price increase on average. One important factor in monetary policy was the way in which the increase in M-2 was to be generated. In 1983, a large part of the increase had been generated by an expansion of central bank credit and a relatively small part by an increase in the net foreign asset position of the Central Bank. By contrast, in 1984 the authorities planned for a significant share of the increase in reserve money to result from an improvement in the Central Bank's net foreign asset position and a correspondingly diminished share from issuance of new credit by the Central Bank. To that extent, the credit policy of the Central Bank had become substantially tighter than in 1983.

For the first time, the staff had discussed monetary policy with the Turkish authorities on the basis of an econometric model, which included a demand-for-money function taking into account the rate of growth of spending, the rate of inflation, and interest rates, the staff representative went on. The staff had found that the ex ante demand for money in Turkey was sensitive to changes in real interest rates. In 1983, interest rates had been negative by some 9 percent; in 1984, the staff had made its monetary calculations on the basis of positive real interest rates averaging 6 percent. Because of the authorities' interest rate policy, a substantial increase in the real ex ante demand for money had occurred. Some of that ex ante demand would automatically absorb the excess supply of liquidity that had existed at the beginning of the year, as the econometric model had implicitly shown. If no other changes occurred, the much larger demand for real money would be reflected in a decrease in the velocity of circulation, other things being equal. In fact, the staff had in a sense targeted for a 2.5 percent increase in the velocity of circulation, reflecting the soaking up of the excess liquidity generated as a result of developments during 1983. The econometric model also indicated that the liquidity overhang had been more than absorbed, so that the level of interest rates selected by the authorities had been higher than that needed to bring about monetary equilibrium by the end of the year. The authorities had raised rates so high because they wished to provide a built-in safety margin, there being a possibility that imports would surge because the import regime had been liberalized.

In addition, the adjustment made for the increased efficiency of the banking system was the real-world reflection of the reserve money multiplier, a variable extremely difficult to predict, the staff representative explained. In 1984, the staff would have expected the velocity of circulation to increase, but the Turkish authorities were deliberately endeavoring to bring about improved efficiency in the banking system, an endeavor likely to be followed by expanded use of the reserve money in existence. The staff had increased the reserve money multiplier from the 2.3 average that had prevailed in 1983 to 2.35 for the current year. The staff was not happy with having to work on net domestic assets of the Central Bank rather than of the banking system as a whole, but, because of the slowness with which statistics were compiled in Turkey, the staff had no other choice for the moment. As several Executive Directors had observed, the staff had made the evolution of net domestic assets of the Central Bank a condition in the proposed stand-by arrangement.

A question had been asked by Mr. Blandin about the high lending rates charged by banks in Turkey, the staff representative from the European Department concluded. Unfortunately, those rates reflected the existing degree of inefficiency of Turkish banks. It was one of the factors that the authorities hoped to reverse by the banking reform introduced in 1983, which the present Government was pursuing with greater emphasis.

Mr. de Groote commented that the program under the new stand-by arrangement was considered a continuation of the program launched in 1980. Admittedly, 1983, an election year, had coincided with serious setbacks, especially in price inflation and the balance of payments. To correct for the setbacks, the new Government had immediately taken measures that went much further than had been considered necessary under the previous program in eliminating restrictions and in managing monetary aggregates, interest rates, and the exchange rate. Those measures had already begun to produce effects in Turkey: on a year-on-year basis, exports had increased by 30 percent, while imports had declined by 10 percent. There were growing indications, moreover, that the inflation rate would indeed fall by more than the projected 25 percent, also on a year-on-year basis.

The authorities were fully committed to the policies needed to attain the targets in the program, Mr. de Groote remarked, even if the actions required turned out to be stronger than those laid out in the program currently before the Board. The slippages in 1983 had taken place mainly in monetary policy and were therefore amenable to quick correction. The authorities had continued to make progress toward reducing the public sector deficit and also reducing transfers to SEEs as a proportion of GDP. In other words, the basis of continuing the previous policy had not been eroded. However, as the medium-term scenarios given in Appendix IV of EBS/84/42 clearly showed, medium-term perspectives had been greatly influenced by slippages in 1983. Indeed, he did not recall ever having seen such a convincing demonstration of the need to follow correct demand management policies in order to implement medium-term objectives. Appendix IV demonstrated that what might have been perceived as minimal slippages had in fact greatly darkened the medium-term outlook.

According to the Turkish authorities, the new program struck the right balance between structural objectives and demand management, Mr. de Groote pointed out. The authorities knew that installing a market-economy mechanism and opening up the country to foreign competition required prudent demand management to prevent imports from getting out of hand and to ensure that costs in Turkey remained low enough to keep up export competitiveness.

The course of the recovery in Europe would be extremely important for the Turkish economy, Mr. de Groote said. Protectionism in Europe still served as a barrier to Turkish goods. As Ms. Bush had commented that the proposed liberalization of imports into Turkey was admirable, he would like to be able to say that the response given to that liberalization in European markets was admirable as well. Despite rising protectionism, however, there had occurred an extremely strong penetration of Turkish exports into European markets. In 1983, Turkish exports to the Middle East had in fact fallen by about 5 percent; by contrast, they had risen by some 12 percent to OECD countries generally and by about 20 percent to EC countries. On the whole, it had not been the Middle East that had accounted for the enormous expansion of Turkish exports; even more favorable results could be expected if protectionist barriers in the OECD could be lowered. After all, Turkey remained a relatively closed economy: at the beginning of the program period, Turkish exports had represented some 6 percent of GDP, the lowest percentage in the world, together with that of China. The figure had since risen to 11.5 percent of Turkey's GDP, and the authorities believed that the rising trend could continue for a number of years, provided that the business cycle remained on an upswing in the industrial world and that protectionist barriers were demolished. In any event, with control over production and export costs, the authorities expected to continue to expand Turkey's share of overseas markets.

So far, the commercial banks had reacted favorably to financing the deficit of Turkey, whose access to markets was clearly dependent on how successful the policies being implemented by the authorities under the Fund program turned out to be, Mr. de Groote continued. In the past, delays by the banks had made adjustment more difficult, but the market seemed to have re-established confidence in the Turkish economy.

Throughout the adjustment period a large increase in income had taken place in Turkey, Mr. de Groote noted. Except for 1983--when demand management had been less careful than in other years--large increases in income in real terms had coincided with great declines in inflation, large increases in exports, and substantial reductions in the Government's share in total expenditures. In other words, adjustment had been combined with a rapid rate of growth, a point that he was glad to have heard Mr. Nimatallah make. Certainly, the authorities needed no convincing that effective demand management was the key to their objective of maintaining satisfactory increases in real income over time.

In response to Mr. Joyce's question whether the program relied too much on a projected expansion of exports, Mr. de Groote observed that the program was based on favorable forecasts in the light of the limited share of Turkish exports in GDP. Again, the Turkish authorities were aware that there would be no chance of expanding exports in a fundamental way unless they instituted liberalization of imports as well. They felt that they had to be ready to take such a risk in order to achieve a medium-term structural objective of achieving a better performance in the balance of payments.

He was grateful to Mr. Wicks for having drawn Directors' attention to a problem dealt with only briefly in the staff paper because the Turkish authorities had still been working out which measures to take, Mr. de Groote said. At present, discussions were continuing in the High Arbitration Courts between representatives of labor unions, the Government, and the private sector. It was intended to reduce the share of government in total spending and thus to elicit strong supply effects.

A question had been posed by Mr. Salehkhou whether the Turkish authorities accorded enough importance to investing in agriculture, Mr. de Groote observed. Certainly the present authorities regarded it as a high priority. During a recent conversation, the Chairman of the Planning Committee had confirmed that he would give priority attention to that objective. Clearly, investment in irrigation would be extremely important. Although the share of agricultural exports in total exports had declined and the share of industrial production, especially semi-finished goods, had risen greatly, the market for Turkey's agricultural output remained good. With the assistance of the World Bank and technical assistance from various sources, great efforts were being made to rationalize agricultural production, develop fertilizer plants, and regroup enterprises to enhance efficiency. In 1984, agricultural production was forecast to increase by some 3.5 percent, after a decrease in 1983. As in all other countries, agriculture in Turkey depended on climatic conditions. There had been little snow during the previous winter, but the spring rains seemed to have been satisfactory so far.

Both Mr. Prowse and Ms. Bush had asked how the Turkish authorities would adjust debt management policies if the economy happened to expand more rapidly than forecast, Mr. de Groote recalled. Certainly the Turkish authorities did not intend to increase their indebtedness if the expansion of exports turned out to be faster than currently envisaged. To the contrary, they hoped that an economic expansion in Europe would allow them to perform better than under what they regarded as a conservative scenario; they would thus be able to lighten the burden of indebtedness.

Another question raised by Mr. Wicks had been whether the program was modest and therefore deserved modest resources from the Fund, Mr. de Groote commented. He would maintain that it was a strong program, especially on account of the fundamental promotion of exports and liberalization of imports already being carried out. Moreover, the public sector borrowing requirement would fall to 3.5 percent of GDP in 1984, so that there was little further margin for restraint, in the light of the extremely restrictive monetary policies and the positive real interest rates. His Turkish authorities had been satisfied with the amount of financing proposed; they had not asked for more, because they felt that the amount of financing should be reasonably adapted to the performance of their economy over time. The program had recovered its momentum: the balance of payments had been brought closer to equilibrium, and inflation had slowed, thus reducing the need for the assistance provided by the Fund.

In response to Ms. Bush, Mr. de Groote explained that the authorities intended to continue to see the request for Fund assistance from the perspective of their own achievements. However, if the Fund had not helped Turkey for a number of years, the country would have been unable to achieve the results set forth in the staff papers. He would have been happy if the commercial banks had been able to organize a program and gear the implementation of financing to it, but, as they had not done so, it had been useful for the Fund to assist in the effort to re-create suitable conditions for the banking community at large.

A question had been asked by Mr. de Vries whether the Turkish people realized sufficiently that the program was being successful, Mr. de Groote recalled. There had been an increase in real income together with a restoration of political stability, elements highly appreciated by people everywhere, especially in Turkey. Thus, the people had not had to wait long before receiving some of the benefits of adjustment. Moreover, the

Prime Minister, who had been elected twice with ever-increasing majorities, had always told the people directly that he would propose an austerity program. His promises to the electorate had always included the necessary ingredients of control on aggregate demand, moderation of wage increases, and reductions in public spending; it had been precisely on that platform that he had defeated the other parties. Thus, the people of Turkey certainly appreciated both what they had lost when under the more protectionist policies of the previous Government and what they had hoped to gain when the current policies were being carried out.

In conclusion, Mr. de Groote said, Mr. Prowse had correctly expressed an idea that he himself had wished to include in his earlier statement: if Executive Directors felt disappointed about Turkish economic performance in 1983, it had been because they had set their hopes so high and wanted Turkey to continue to be a success story. On behalf of the authorities, he wished to assure Executive Directors that the adjustment program in Turkey would be successful.

Mr. Wicks commented that the staff representative had been admirably frank with Executive Directors about the "window dressing" that had occurred. To the credit of the former Turkish authorities, they had not taken advantage of that maneuver to make the drawing from the Fund to which they would have been entitled. Nevertheless, he found it worrying that there was a possibility that a member might engage in a certain activity that might be allowable under a strict reading of the performance criteria. Perhaps the Chairman could assure Executive Directors that, if the staff ever perceived something like that happening, he would draw it to the attention of the Board before the country concerned could actually make the drawing, so that the Board could consider what action should be taken.

The Chairman responded that if the staff could detect anything of that nature, before it was too late, the staff would draw it to the attention of the Board and would propose that there should be no drawings under such circumstances. The difficulty was that such manipulations usually came to the attention of the Fund only after the event. The staff was writing a paper on the topic.

The Executive Board then took the following decision:

Stand-By Arrangement

1. The Government of Turkey has requested a stand-by arrangement for the period of one year beginning April 1984 for an amount equivalent to SDR 225 million.

2. The Fund approves the stand-by arrangement attached to EBS/84/42, Supplement 4 (4/15/84).

3. The Fund waives the limitation in Article V, Section 3(b)(iii).

4. In accordance with the request of the Government of Turkey, the stand-by arrangement approved by the Fund on June 24, 1983 is canceled as of April 3, 1984.

Decision No. 7658-(84/52), adopted
April 4, 1984

2. GLOBAL CURRENT ACCOUNT BALANCES - STATISTICAL DISCREPANCY

The Executive Directors considered a paper prepared by the Fund staff and the OECD Secretariat dealing with the statistical discrepancy in global current account balances (EBS/84/49, 3/9/84).

Mr. Prowse observed that the staff paper set out the nature and implications of the problem comprehensively; he supported the objective of seeking to reduce the statistical discrepancy. However, the staff could have said more about the mechanics of how to do so, and, indeed, about the rationale for the staff proposals.

In Part I, entitled "Implications of the Discrepancy," the staff had made a convincing case for why action was necessary to reduce the size and variability of the statistical discrepancy, Mr. Prowse went on. Many sorts of decisions and policy advice were affected by official figures on global current account balances, and unsatisfactory figures could only lead to a risk of unsatisfactory and unsuitable advice. Indeed, the paper had concluded: "The case for undertaking action to improve recorded balance of payments estimates rests mainly on the beneficial consequences for official policy formulation and private sector decision making that would result from a better statistical base." The conclusion could scarcely be disputed. It was, however, also evident that the Fund seemed to have gone about as far as it could in establishing regular staff contacts with national authorities. Quite properly, the Fund was searching for a way in which to give impetus to improving global statistics, and the staff paper suggested that a political commitment was required.

In Part II, "Statistical Origins of the Discrepancy," the series of discrepancies was attributed to differences in valuation practices and in the coverage, timing, and classification of balance of payments statistics by national authorities, Mr. Prowse noted. The staff had also said--on page 4 and again on page 12--that it regarded the geographical origins of recording deficiencies as unclear, present information being insufficient to distribute the asymmetry precisely among particular countries. The staff's present attitude contrasted with the one in the appendix to the 1983 World Economic Outlook paper, in which it had attempted to allocate the asymmetry among groups of countries. At that time, the staff had asserted that the large asymmetry of "other investment income"--meaning interest and dividends on investment other than direct investment--could probably be attributed in large part to systematic underrecording of credits concentrated in the accounts of industrial and oil exporting countries, whose residents were the main recipients of investment income. In that appendix, as in the current paper, the staff described investment income as the largest and fastest-growing single component of the asymmetry. Had the staff made any further progress in identifying the causes of the deficiency?

As for measures to contain and reduce it, the staff had made an interesting suggestion that, as a first step, a task force would construct a more comprehensive matrix of international assets and liabilities, which would be an extension of the current work done by the Fund and the BIS on debt statistics, Mr. Prowse remarked. Could the staff explain what might be possible in that field? For instance, an attempt to establish a data base on stocks of foreign assets and liabilities, for private business as well as public authorities, might turn out to be extremely difficult in terms of valuation and estimation of assets. The assets would presumably be financial rather than real.

EBS/84/49 briefly covered problems with statistics on shipping and travel and on official transfers, Mr. Prowse noted. The rapid examination by the staff seemed to underline the need for some kind of political mandate. In the absence of some action--which incidentally would have to involve additional manpower in the Fund--the trend of the asymmetry was likely to be upward.

What would be the suggested composition of the representative committee? Mr. Prowse inquired. EBS/84/49 suggested that all constituencies represented in the Executive Board of the Fund would be entitled to participate. Would it be a good idea to include users of balance of payments statistics? The staff had suggested that the first meeting might be expected to occur two to three months after a political mandate had been given by various national authorities. Before being able to support that suggestion, he would need to know who would be on the committee, who would finance it, when it would meet, whether it would draw upon a task force of experts, and whether those experts would be Fund staff members or would also include staff from the BIS and the OECD. How would the committee, if one were established, fit in with the Executive Board of the Fund and the OECD committees? More important, how would it deal with national authorities? Furthermore, what would be the maximum increase in Fund staff to be devoted to the task? The staff had already said that it would be extremely difficult to gauge, but Executive Directors ought to have some information on the point, even though they would be guided by management.

If the committee were formed, its terms of reference would have to be clear, Mr. Prowse remarked. The staff had proposed not seeking a mandate from the Interim Committee until autumn 1984, a proposal with which he agreed, but the terms of reference would have to be considered before then. The Executive Board ought to consider leaving the committee some flexibility to define the nature and scope of its task, even though it would need guidance from the Board, which could give little useful guidance at the present stage. Moreover, might political support be sought through some channel other than the Interim Committee? Finally, depending on the outcome of the present Board discussion, would the staff be submitting additional papers? When could Executive Directors begin to inform their authorities about the proposal and request their support?

Mr. Polak welcomed the serious attention that the statistical discrepancy and global current account balances were receiving in the Fund and agreed that it was a good idea to cooperate with the OECD. He found the presentation in Table 2 quite useful. The main explanation for the discrepancy in trade was assumed to be timing; he thought that such a discrepancy could be lived with, as it did not seriously affect policy formulation in countries. However, some of the discrepancy in trade statistics related to exchange rate conversions, which deserved great attention.

Investment income showed by far the largest discrepancy as a proportion of the total, Mr. Polak noted. From 1979 to 1982, the entire increase in the discrepancy on global services had been attributable to the rise in the discrepancy of investment income from $6 billion to $60 billion, equal to some 20 percent of the flow. He was not entirely satisfied with the staff's reasoning that payers of interest were banks and governments, which reported transactions, while receivers were private individuals, who often tried not to report. The staff had gone on to note the growth, over time, of offshore centers and other locations to which people sent funds that were never reported. Those two developments alone could hardly account for the enormous bulge in unreported interest payments that had arisen during the past few years. There was scope for some imaginative detective work by the staff to determine the origin of the discrepancy in investment income.

He had been shocked by the large negative discrepancy in official transfers, amounting to $16 billion, or nearly 40 percent of the total flow, Mr. Polak went on. Quite apart from whether the discrepancy might make a difference in policy, it did indicate the possibility that aid statistics might be quite inaccurate, assuming that the inflation of the figures was accomplished mostly by donors and that the receiving governments reported rather accurately.

All in all, Table 2 showed that national balance of payments statistics were in much worse shape than it had previously appeared, Mr. Polak observed. The recent large increases in errors and omissions in national statistics pointed to the same conclusion. A major effort should be undertaken to improve balance of payments statistics, but he was not sure whether the staff was correct in suggesting that much of that effort should be directed toward examining partner country data. After all, the procedure would be quite laborious to begin with, and it would add to previously existing errors those attributable to differences in reporting between the country of origin and the country of destination.

Turning to procedural matters, Mr. Polak commented that political support was needed for the serious efforts that should be made. Countries would have to be moved away from their long-term preferences, even though they had no strong reason to do so. Occasionally, countries moved away from such preferences for extraneous reasons; for example, some ten years previously, the United States had begun to report separately its reinvested earnings as part of current account receipts. Although an endorsement from the Interim Committee would be useful, he favored the idea of a representative committee to examine the statistical discrepancy. The staff had mentioned only users of the data, but it would be well to include the actual compilers and their supervisors as well. Furthermore, it would hardly be a good idea to promise one seat on the representative committee to each of the 22 constituencies represented in the Executive Board.

Improvements in global current account statistics should be seen within the framework of long-term international collaboration, Mr. Polak said. The Fund was charged with setting and monitoring standards, as in the Manual on Balance of Payments Statistics, which contained internationally agreed definitions. At times, the Manual was not being followed, and high-level endorsement was required to eliminate that shortcoming. He had not found helpful the references to compromises that would be necessary, which seemed to suggest ad hoc solutions. If it turned out that major errors were due to national authorities' not following the Manual on Balance of Payments Statistics, the Fund ought to persuade the authorities at fault to follow the Manual. If the Fund found that deficiencies in the Manual were leading to major errors in reporting countries, they should be corrected.

The cooperative effort suggested by the staff could indeed solve that part of the discrepancies attributable to asymmetries in data that were known or could be known, Mr. Polak noted. However, there remained the question of the many transactions intentionally not made known by participants wishing to avoid exchange controls or taxation. Such transactions would not be brought to light by enlarging countries' budgets for their balance of payments divisions or by persuading civil servants to follow the international rules for reporting. Rather, the Executive Board should consider a separate approach dealing with questions like tax-sheltered countries, false invoicing, numbered accounts, and miniscule countries in which large amounts might be hidden.

In conclusion, procedure would be important, Mr. Polak remarked. Perhaps the Chairman would wish to appoint a senior staff member to consider how to proceed further. The Fund had considerable expertise on statistical discrepancies and had held conferences in which national data had been reconciled. The Fund should draw on its experience to determine what means could be found to institute the most effective procedures to reduce the statistical discrepancies in global current account balances.

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/84/51 (4/2/84) and EBM/84/52 (4/4/84).

3. SOCIALIST PEOPLE'S LIBYAN ARAB JAMAHIRIYA - EXCHANGE SYSTEM

The approval by Decision No. 7295-(83/7), adopted January 7, 1983, of the Socialist People's Libyan Arab Jamahiriya's restrictions arising from limits on the access to foreign exchange for certain travel abroad is extended until September 30, 1984 or the completion of the 1984 Article IV consultation with the Socialist People's Libyan Arab Jamahiriya, whichever is the earlier. (EBD/84/103, 3/29/84)

Decision No. 7659-(84/52), adopted April 3, 1984

4. KINGDOM OF THE NETHERLANDS - NETHERLANDS ANTILLES - TECHNICAL ASSISTANCE

In response to a request from the Netherlands Antilles for technical assistance, the Executive Board approves the proposal set forth in EBD/84/101 (3/28/84).

Adopted April 2, 1984

5. SAUDI ARABIA - TECHNICAL ASSISTANCE

In response to a request from Saudi Arabia for technical assistance, the Executive Board approves the proposal set forth in EBD/84/102 (3/28/84).

Adopted April 3, 1984

6. APPROVAL OF MINUTES

The minutes of Executive Board Meeting 83/165 are approved. (EBD/84/100, 3/28/84)

Adopted April 3, 1984

7. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/84/66 (4/2/84) is approved.

APPROVED: September 12, 1984

LEO VAN HOUTVEN
Secretary