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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 84/89

10:00 a.m., June 8, 1984

J. de Larosière, Chairman
R. D. Erb, Deputy Managing Director

Executive Directors	Alternate Executive Directors
	W. B. Tshishimbi
	G. Ercel, Temporary
	X. Blandin
	M. Teijeiro
	M. K. Bush
M. Finaish	T. Alhaimus
T. Hirao	T. Yamashita
	Jaafar A.
R. K. Joyce	L. Leonard
A. Kafka	
G. Laske	G. Grosche
	N. Coumbis
	I. Angeloni, Temporary
	A. S. Jayawardena
	J. E. Suraisry
	T. de Vries
	K. G. Morrell
	O. Kabbaj
	E. I. M. Mtei
	E. Portas, Temporary
J. Tvedt	
	T. A. Clark
Zhang Z.	Wang E.

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

Also Present

H. Barber, Governor, Bank of Jamaica. African Department: O. B. Makalou, Deputy Director. Asian Department: P. R. Narvekar, Deputy Director; B. B. Aghevli, D. A. Citrin, I.-S. Kim, G. R. Kincaid, D. A. Scott, J. Schultz, R. C. Williams. European Department: B. E. Rose, Deputy Director; P. W. Stanyer. Exchange and Trade Relations Department: W. A. Beveridge, Deputy Director; M. Guitian, Deputy Director; S. Mookerjee, Deputy Director; N. Kirmani, J. R. Marquez-Ruarte, M. Nowak. External Relations Department: H. P. Puentes. Fiscal Affairs Department: V. Tanzi, Director; H. Bierman, M. A. Wattlesworth. Legal Department: G. P. Nicoletopoulos, Director; J. G. Evans, Jr., Deputy General Counsel; G. F. Rea, Deputy General Counsel; J. K. Oh, J. V. Surr. Middle Eastern Department: A. S. Shaalan, Director; D. S. Kawar, M. Yaqub. Research Department: L. Alexander, K.-Y. Chu, N. M. Kaibni, E. A. Milne, A. Salehizadeh. Secretary's Department: J. W. Lang, Jr., Deputy Secretary. Treasurer's Department: D. C. Ross. Western Hemisphere Department: S. T. Beza, Associate Director; M. Caiola, A. Cheasty, M. E. Hardy, S. N. Kimaro, C. S. Lee, S. J. Stephens. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: S. R. Abiad, A. A. Agah, E. A. Ajayi, H. A. Arias, J. Delgadillo, S. El-Khouri, K. A. Hansen, L. Ionescu, H.-S. Lee, W. Moerke, G. E. L. Nguyen, Y. Okubo, D. I. S. Shaw. Assistants to Executive Directors: J. R. N. Almeida, R. L. Bernardo, J. Bulloch, M. B. Chatah, Chen J., L. E. J. M. Coene, M. Eran, V. Govindarajan, D. Hammann, A. K. Juusela, H. Kobayashi, J. A. K. Munthali, G. W. K. Pickering, T. Ramtoolah, D. J. Robinson, C. A. Salinas, A. A. Scholten, Shao Z., A. J. Tregilgas, Wang C. Y., M. A. Weitz.

1. EXECUTIVE DIRECTOR - REPORT BY CHAIRMAN

Meeting in restricted session, the Executive Directors considered a report by the Chairman on the absence of an Executive Director.

2. KOREA - 1984 ARTICLE IV CONSULTATION; REVIEW UNDER STAND-BY ARRANGEMENT; AND PURCHASE TRANSACTION - COMPENSATORY FINANCING FACILITY

Executive Directors considered the staff report for the 1984 Article IV consultation with Korea and the review under its stand-by arrangement (EBS/84/99, 5/3/84; and Sup. 1, 5/8/84), together with a paper on Korea's request for a purchase equivalent to SDR 279.7 million under the compensatory financing facility (EBS/84/100, 5/3/84; Cor. 1, 5/11/84; Sup. 1, 6/5/84; and Sup. 1, Rev. 1, 6/7/84). They also had before them a report on recent economic developments in Korea (SM/84/121, 5/25/84; and Sup. 1, 5/25/84).

The staff representative from the Asian Department made the following statement:

> As indicated in SM/84/121, effective from June 1, 1984, negotiable certificates of deposit are to be issued by deposit money banks at a rate of 11 percent, which is substantially higher than the rate on comparable instruments. These certificates of deposit should be an effective instrument for drawing funds from the unorganized money market and thus promote financial intermediation by the banking system. Consequently, an increase in liquidity arising from greater savings in this form should not jeopardize the inflation and balance of payments objectives.
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> The authorities have informed the staff early this morning that the demand for certificates of deposit has been much stronger than anticipated and they have expressed concern about the implications for the observance of the credit ceiling. This is a technical issue arising from the fact that the ceiling on net domestic assets did not take into account the rapid growth in demand for certificates of deposit. Should this trend continue it may be necessary to adjust the ceiling for net domestic assets to allow for the expanded role of the banking system in siphoning financial resources from the unorganized money market and channelling them to productive uses.

Mr. Morrell made the following statement:

> On behalf of my Korean authorities, I would like to thank the staff for their commendably compact and concise report with which the Korean authorities broadly agree.

Since the Korean Government launched its economic stabilization program in 1980, at a time when the Korean economy was facing great difficulties both internally and externally with the support of a Fund stand-by arrangement, it has achieved not only significant structural adjustments but also major macroeconomic objectives. In 1982, real GNP grew about 6 percent, inflation declined to about 5 percent, and the current account deficit of balance of payments diminished to below 4 percent of GNP. Pursuant to the continued objective of the economic adjustment program, which was also supported by a further stand-by arrangement, economic performance in 1983 surpassed the program targets: real GNP grew by 9.3 percent, consumer price inflation was held down to a historically low level of 2 percent, and the current account deficit was reduced to about 2 percent of GNP. These achievements were, in part, attributable to improvement in the world economy, particularly in the United States, but they were mostly due to the implementation of appropriate economic policies in keeping with the principal objectives of Korea's economic management plan for 1983. These objectives were to consolidate the base for long-term sustained economic growth, further hold inflation to a low level, and improve the balance of payments position.

During the program period, policies established have been firm and resolutely maintained, and the result is, I believe, one of the most successful economies among Fund members in terms of current and prospective performance. The words of the staff appraisal are testimony to this. In the first quarter of 1984 real GNP is estimated to have grown by 9.7 percent on an annual basis. As of the end of April, the wholesale price index (WPI) and consumer price index (CPI) increased by 0.3 percent and 2.6 percent, respectively, compared with the previous year. During the first four months of 1984, the current account deficit was $708 million, compared with $1,190 million for the corresponding period in 1983.

In 1983, the performance of the fiscal sector was even better than envisaged. The public sector deficit declined to 1.6 percent of GNP from 4.3 percent in 1982, and consequently the ceiling on credit to the public sector was observed with a substantial margin. An important element in this outcome was the Government's decision to freeze the farm purchase prices of both rice and barley at the 1982 level, thereby reducing the deficit of the Grain Management Fund.

Another result of the success on the monetary front was that the increase of net domestic assets of the banking system was kept well under the agreed ceiling with the Fund. This was achieved even though there were two financial incidents which had detrimental effects on the liquidity position of some commercial banks. As a result of continued monetary restraint, the

expansion of net domestic assets was nearly halved to 22 percent of the previous year's stock of broad money, and broad money growth, which had remained around 27 percent throughout the previous three years, decelerated to 15 percent--the lowest growth rate in over two decades. Nevertheless, adequate credit to the private sector was provided because of the surplus of the public sector with the banking system. Furthermore, the Government has taken strong measures to restructure the financial position of the corporate sector by reducing its reliance on bank credit and increasing equity issues. Heavily indebted companies were encouraged to liquidate their speculative real estate to pay off bank loans before fresh bank credits were extended, and to increase their direct financing from the nonbank private sector.

Considerable improvement has also been made in the balance of payments position. The current account deficit registered $1.6 billion, well below the program target of $2.3 billion. The better than expected outcome was due mainly to the faster growth of exports, which resulted from economic recovery in the United States in the latter half of 1983 and improvement in the terms of trade. Maintaining a flexible exchange rate policy has no doubt contributed to an improvement of the external position, as a depreciation of the won was aided by a marked decrease in domestic inflation relative to inflation abroad.

The reduction of the need for financing the current account deficit made it possible for Korea to improve its external debt position as had been agreed with the Fund. While containing the stock of external debt at a level well below the agreed ceiling, the debt structure was improved by reducing not only the ratio of short-term debt to total debt from 33.5 percent in 1982 to 30.1 percent in 1983, but also the level of such debt to $14.1 billion (below the program ceiling of $14.2 billion). It is particularly noteworthy that this restructuring was made in the midst of the global debt crisis, which hindered Korea's access to international capital markets. The authorities do, however, recognize that there is a need to further improve the structure of their debt, and this is one of the major objectives of the program for the remaining period of the stand-by. The Korean authorities are naturally concerned at the recent rise in international interest rates because of the additional strain this could cause for the balance of payments.

Turning to the program for 1984, the economic management plan for 1984 aims at consolidating the recent gains through continued fiscal and monetary restraint and exchange rate flexibility. The management plan is designed to maintain the momentum for sustained growth (7-8 percent) without rekindling inflation (2-3 percent) while further reducing the current account deficit (to 1 percent of GNP). The price stability that has taken root over the past two years will be reinforced by appropriate policies to eliminate inflationary expectations.

A number of measures have already been implemented toward achieving these targets. The 1984 budget has been frozen at the level of the 1983 budget. The freeze, which covers most public sector wages, will have direct beneficial effects on the public finances, while also giving important signals to the private sector on the desirability of moderating wage demands.

Restraint in the monetary sector will be continued in 1984 in line with real economic growth, taking into account the impact of inflation. During 1984, net domestic assets of the banking system will increase by no more than 14 percent and broad money is anticipated to grow by no more than 13 percent. To ensure adequate expansion of credit to the private sector, the public sector will not resort to bank financing.

One of the main objectives of monetary policy for 1984 is to further liberalize the financial system. The Korean authorities remain firmly committed to financial market liberalization along with economic development. Following the complete denationalization of commercial banks early last year, they have been given autonomy in management and permitted to expand their financial activities by engaging in factoring, trust, and other services. In January 1984 bank lending rates were raised slightly and for the first time a narrow range was introduced within which banks could set their own rates. Also, rates for deposits of one year or longer were raised and those for short-term deposits were lowered. These rate adjustments can be seen as an important step in the right direction in view of the necessity to narrow interest rate differentials between banking and nonbanking institutions.

Effective from June 1, 1984, commercial banks are being permitted to issue negotiable certificates of deposit (CD). These CDs have a maximum annual interest rate of 11 percent, while the corresponding CD-generated loans have a maximum rate of 12 percent. The measure aims at strengthening the financial position of the banking sector and promoting the balance between banking and nonbanking institutions.

As a further step in financial sector liberalization, the Korean Government has announced the timetable for phasing out restrictions imposed on foreign banks. Foreign banks will be given membership in the National Banks Association and the clearinghouse, and later this year they will be permitted to engage in trust business. From 1985, they will be given access to the central bank rediscount window.

The Korean authorities will continue to pursue a flexible exchange rate policy, which has contributed to the strengthening of the external position, and they believe that the present level of competitiveness is appropriate and should be maintained.

Much has been said about external indebtedness in developing countries. With regard to Korea, the staff accurately pointed out that Korea's overall level of outstanding debt is consistent with its servicing capacity. When the Korean Government revised its Fifth Plan, the reduction in the growth of external debt was a primary objective with price stabilization and improved efficiency through the market mechanism complementing the external objective. The growth of outstanding disbursed debt is projected at 6 percent a year through 1986, compared with 20 percent originally planned (total external debt is projected at $47.4 billion by 1986, compared with the original estimate of $64.5 billion). The Government intends to further reduce short-term debt and to increase its gross international reserves during 1984. Staff projections in Tables 9 and 10 of EBS/84/99 indicate the sensitivity of these forecasts to alternative domestic and external market conditions.

It seems ironic that in contrast to the general wave of protectionism over the world, in particular in industrialized countries, the Korean authorities have been pursuing decisively their import liberalization policy as described in the staff paper. As of July 1984, the import liberalization ratio will be increased to 84.8 percent from 80.4 percent in 1983. In this connection, the Korean authorities have expressed deep concern over the intensification of protectionist pressures which casts a shadow over Korea's prospects for meeting its growth potential.

Finally, I would like to draw Executive Directors' attention to the staff's comment that "the Korean success story, however, should not obscure the fact that Korea is still a developing country with a relatively low level of income." I may add simply that Korea still has a large trade deficit.

The request under the compensatory financing facility meets all the requirements under the relevant decision and I commend the request to the Executive Board for approval. When considering this request I would ask Executive Directors to remember that international capital markets are still very unsettled, that Korea is one of the largest developing country borrowers, and that the improvement in its debt structure is an important objective under the current stand-by arrangement. Fund assistance will assist in strengthening Korea's external position and will thus contribute to increased stability in world capital markets.

Extending his remarks, Mr. Morrell said that he had received that morning the information referred to by the staff representative from the Asian Department. It appeared that a desirable financial development, namely, increased financial intermediation by the banking system, was likely to lead to an overrun in the monetary aggregates in nominal, not real, terms. He looked forward to discussing the technical aspects of the issue with the staff.

Mr. Hirao noted that the Korean authorities had implemented far-reaching adjustment policies under the current stand-by arrangement. There had been remarkable progress in curbing inflation and improving the external position, while output growth had nearly doubled to more than 9 percent in 1983. All the performance criteria had been met by a wide margin and all the program targets for 1983 had been far surpassed. He commended the authorities for their strong commitment to economic adjustment. With regard to the Article IV consultation and the review under the stand-by arrangement, he was in broad agreement with the staff appraisal.

The public sector deficit had been substantially reduced to 1.6 percent of GNP in 1983, mainly as a result of the strong determination of the authorities to curb expenditure, and particularly the decision to freeze the purchase price of rice, Mr. Hirao continued. That improvement in the fiscal accounts had produced the first surplus by the public sector with the banking system since 1979. As for the 1984 budget, the authorities intended to maintain their tight fiscal policy by restraining the wage bill and capital expenditures. He joined the staff in emphasizing the importance of resisting pressures to raise the purchase price of rice so that the deficit of the Grain Management Fund could be kept within the budgeted level.

A sharp deceleration of monetary expansion in 1983 appeared to have been instrumental in the reduction of inflation to the historically low level of 2 percent, Mr. Hirao observed. He agreed with the authorities' intention to give the highest priority to controlling inflation through continued restraint on monetary expansion. Some important steps had recently been taken toward the liberalization of the financial system. Introduction of a narrow band for bank lending rates, the broadening of the range of permissible banking services, as well as the easing of restrictions on foreign banks, were all steps in the right direction. In its report on recent economic developments (SM/84/121), the staff stated that excessive regulation had inhibited the growth of the financial sector, particularly the banking system. A gradual liberalization of the financial system would help to develop the intermediation function of the banking system, which was essential for Korean economic development. He welcomed the new endeavor by the authorities announced by the staff representative.

The authorities were to be commended for their flexible exchange rate policy, which had contributed to the strengthening of the external position, Mr. Hirao went on. He welcomed the continuing effort toward import liberalization, despite the adverse external trade climate. A comprehensive tariff reform program was expected to enhance the international competitiveness of Korean industry in the long run; it would also help to mitigate protectionist pressures against Korea's exports.

With regard to debt management policy, he strongly endorsed the authorities' commitment to improve the maturity structure of external debt by reducing short-term debt and accumulating gross international reserves, Mr. Hirao added. That strategy was particularly important in view of

the recent declining trend in the ratio of reserves to short-term debt. The maintenance of the present prudent course of action would further improve Korea's standing in the international capital market. According to the authorities' medium-term projection, the current account would move into surplus in the next few years. A permanent current account surplus would not seem appropriate in view of the continued need for development. However, as an immediate consideration, he could support the authorities' intention to keep borrowing requirements from rising in light of Korea's high outstanding debt.

The request for a purchase under the compensatory financing facility of 60.4 percent of quota would raise total outstanding purchases to the upper limit of 105 percent of quota, Mr. Hirao noted. The excellent performance under the present stand-by arrangement left no doubt that the cooperation requirement had been met. As for the balance of payments need, the overall deficit remained relatively high. The improvement in the current account position had been obscured by reduced net capital flows in recent years. It was clear that the calculated shortfalls, amounting to SDR 557 million, critically depended on the projected rate of growth in exports for 1984 and 1985. The staff's projection of the volume of exports was reasonable in light of Korea's historical performance, although export prospects were subject to uncertainties regarding the future environment in the country's overseas markets. Korea's request for assistance under the compensatory financing facility was justified since the proposed purchase was smaller than the calculated export shortfall by a fairly wide margin. He could support the proposed decisions.

Mr. Suraisry stated that he was in general agreement with the staff's analysis and conclusions and that he could, therefore, support the proposed decisions. All the quantitative performance criteria under the stand-by arrangement had been met for 1983. Furthermore, the targets for growth, inflation, and the balance of payments had been surpassed. The authorities were to be commended on those achievements, which had resulted mainly from the pursuit of strong adjustment efforts.

The program for the remainder of the stand-by arrangement was strong, Mr. Suraisry continued. In particular, he welcomed the continued emphasis on financial restraint. It was encouraging that the authorities intended to limit the public sector deficit to less than 2 percent of GDP during 1984. As the staff had remarked, a strong fiscal performance was essential if the target for the savings ratio was to be achieved. It was, therefore, important that the authorities exercise continued restraint on spending so as to keep the fiscal deficit well within the program target.

The programmed reduction in the rate of monetary expansion in 1984 was important if inflation was to be kept under control, Mr. Suraisry commented. It was encouraging that the public sector would not resort to the domestic banking system to finance its deficit during 1984, thereby allowing more credit to go to the private sector, within the overall framework of restraint. As the staff had pointed out, the Korean economy was becoming increasingly industrialized and complex, and there was a

need to develop further the financial system. He commended the authorities for the various measures that they had adopted recently to reform the institutional structure of the financial system, which had been analyzed in the supplement to SM/84/121. Such special analyses were useful; he hoped that they could be included in reports on recent economic developments in other countries, whenever appropriate.

The authorities' intention to continue a flexible exchange rate policy was also welcome, Mr. Suraisry added. Although that policy had helped Korea to improve its export performance greatly in the recent past, the success of its export-oriented strategy would ultimately depend on the removal of trade restrictions by other countries. The staff showed how extensive those restrictions were in the report on recent economic developments; such reports were the appropriate place to highlight those important issues.

The authorities had made important progress in reducing short-term debt during 1983, Mr. Suraisry observed. However, it remained high relative to reserves; he welcomed the authorities' intention to improve further the debt structure. With regard to the medium-term outlook, even if the current account moved into surplus by 1986, gross borrowings of about $6-7 billion a year would be needed for the rest of the decade in order to finance the accumulation of reserves, repayment of debt, and exports. The authorities' cautious approach toward foreign borrowing was, therefore, appropriate in the present circumstances of uncertainty in the international capital markets and given Korea's high external indebtedness. As the staff pointed out, if circumstances improved, the need for Korea to achieve current account surpluses might have to be re-examined. Finally, the request for a purchase under the compensatory financing facility met all the requirements under the relevant decision. He could support it.

Ms. Bush stated that she agreed with the staff's analysis of Korea's economic adjustment effort and that she could support the proposed decisions. Korea's adjustment record had been exemplary. Not only had there been a steady improvement in growth, inflation, and the balance of payments, but the targets associated with the stand-by arrangement in 1983 had been exceeded; the new performance criteria were built upon that better than expected base. It was worth recalling that Korea had been seriously affected by the oil shocks of the 1970s. In 1980, negative growth of more than 5 percent, an inflation rate of nearly 35 percent, and a deficit in the current account of the balance of payments of 8.7 percent of GNP had reflected the impact of those external events. However, a prompt and forceful policy response by the authorities had demonstrated that noninflationary growth was not a contradiction in terms.

The growth of the monetary aggregates had slowed, and the fiscal deficits had been sharply curtailed, Ms. Bush noted. Furthermore, the reduced access of the Government to central bank financing had contributed to the lower rate of inflation, while permitting adequate increases in credit to the private sector. She was especially pleased to see financial

reforms such as the establishment of a broader range of lending rates according to the borrowers' creditworthiness, a wider array of deposit rates and maturities, and a planned loosening of restrictions on foreign banks' activities. Those measures should help to modernize the financial sector and to ensure continued good savings and investment performance. However, she urged the authorities to reduce controls on interest rates further, and she supported the staff's suggestion that directed credits by the Bank of Korea might be reduced, with some of those credits channeled through specialized development agencies.

Movement toward a sustainable balance of payments position had been substantial, Ms. Bush continued, with the ratio of the current account deficit to GNP falling from a peak of 8.7 percent in 1980 to only 2.2 percent in 1983. The average annual growth in the volume of exports of 12.3 percent in the period 1980-83 had been remarkable, given the near stagnation in world trade during those years. The real effective depreciation of the won from late 1982 until the end of 1983 seemed to have played an important role in maintaining competitiveness. She welcomed the trade liberalization efforts that had accompanied the improvement in Korea's balance of payments position, such as the addition of more items to the list of the automatically approved imports so as to raise the liberalization ratio to 80 percent. Early announcement of the items to be liberalized in 1984 and the following two years in order to give domestic producers time to adjust should help to reduce the impact of liberalization. In addition, the replacement of a system of quotas with tariffs was internationally responsible; it should contribute to the economic efficiency of the Korean economy. However, recent increases in tariff rates had maintained a high level of protection for Korean firms; she hoped that the authorities would adhere to their plans to reduce those tariffs in the next few years.

Despite the sharp reduction in the annual rate of growth of total foreign debt, from 37 percent in 1979 to only 8 percent in 1983, Ms. Bush went on, Korea would have to continue to manage its debt with care, particularly in view of the continued high proportion of short-term debt. Gross international reserves were quite low--at less than three months' imports of goods and services. Consequently, the authorities' targets of a reduction in the level of short-term debt by $0.6 billion and an increase in gross reserves by $0.5 billion in 1984 seemed to be prudent.

Korea had had several upper credit tranche arrangements in the past ten years, Ms. Bush noted. In the Executive Board's forthcoming discussion of the prolonged use of resources, her chair would wish to explore the fundamental question of whether prolonged use was consistent with the basic role of the Fund. She realized that some countries that had demonstrated an ability to adjust might, nonetheless, be interested in continuing to have a stand-by relationship with the Fund in order to demonstrate that they had the Fund's "seal of approval." However, through the Fund's surveillance activities, it should be possible to provide reassurance to creditors, without the absolute need to encumber scarce Fund resources. The matter deserved further exploration.

Referring to the request for a purchase equivalent to SDR 279.7 million under the compensatory financing facility, Ms. Bush said that she had some question as to the adequacy of the balance of payments justification. She invited the staff to comment further on the subject in light of Korea's demonstrated ability to obtain financing from private capital markets.

Mr. Leonard remarked that he supported the proposed decisions relating to the 1984 Article IV consultation with Korea and the review under the stand-by arrangement. Korea's performance under its stand-by arrangement had been outstanding. Following a decline of more than 5 percent in 1980, GNP had grown substantially in subsequent years, at a rate exceeding 9 percent in 1983. That commendable performance had taken place during a period of extremely difficult international conditions; it had been marked by a fall in consumer price inflation, from almost 35 percent in 1980 to only 2 percent in 1983, and by a narrowing of the current account deficit from almost 9 percent of GNP to 2.5 percent. In view of those achievements, the authorities had good reason to believe that the thrust of their policies was correct. He welcomed, therefore, their intention to continue on the current course of adjustment; he was confident that it would give them greater room for maneuver in economic management and that it would render the economy more flexible in reacting to changing economic conditions.

Monetary policy should continue to promote price stability, Mr. Leonard continued. As lower rates of price increase became the norm, the legacy of inflationary attitudes inherited from the past would be dissipated and the confidence of financial markets would be increased. Progress had been made in that respect during the past year; despite having to provide emergency assistance to a number of banks, by taking offsetting measures the authorities had maintained firm control over monetary policy. In the period ahead, an area of concern was the rapid expansion of rediscounts to preferred sectors by the Central Bank; the use of that mechanism constrained the flexibility of monetary policy by forcing the authorities to offset the resulting upward pressure on liquidity through the use of other instruments. He agreed with the staff that the use of the rediscount mechanism should be directed toward influencing reserve money rather than promoting development in selective economic sectors. If the authorities believed that those sectors could not obtain adequate financing from commercial sources, the Government should provide the necessary assistance through specialized development agencies whose activities would not affect the overall level of liquidity. However, the inability of a sector to raise credit would suggest that the market had doubts about a sector's profitability. He hoped, therefore, that the development agencies would take full account of such a signal in deciding on the allocation of government assistance.

The measures being undertaken to liberalize the domestic financial market were welcome, Mr. Leonard commented, and they would encourage the authorities to maintain the momentum of reform. He agreed with the staff that, as the Korean economy became more advanced, its financial requirements would become more complex. If financing bottlenecks were not to

develop over the coming years, the regulatory framework would have to allow for the development of the domestic capital market and an increase in its flexibility.

The Korean economy was performing well on the external side, and the outlook, at least on the basis of Scenario A in Appendix Table 9 of EBS/84/99, was also good, Mr. Leonard observed. Even in the main area of vulnerability--the burden of external debt--the primary concern was not so much the size of the overall debt as the decline in the ratio of international reserves to short-term debt. Understandably, the authorities wished to reduce short-term debt and to increase reserves in 1984. Nevertheless, the question in 1984, as in 1983, was whether Korea had a balance of payments need for a drawing under the stand-by arrangement. The possibilities for commercial external borrowing might well be greater than allowed for in the balance of payments projections for 1984. While he would not deny the appropriateness of using Fund resources to increase reserves, if market conditions proved favorable, the authorities should consider availing themselves of market financing and allow the stand-by arrangement to serve its true purpose.

The fall in the unemployment rate in 1980-83 was attributable to a decline in the participation rate, Mr. Leonard noted, a curious development in view of the high rates of growth in recent years. He invited the staff or Mr. Morrell to comment on the question.

With respect to the request for a purchase under the compensatory financing facility, Mr. Leonard stated that his authorities viewed with concern drawings in respect of "shortfalls" made in a year in which exports had been growing strongly--in Korea's case, by 13 percent in SDR terms--largely on the basis of forecasts that showed even more rapid rates of future growth of exports. However, he realized that the conditions of the compensatory financing decision had been fully met; therefore, he supported the request.

Mr. Laske stated that he agreed fully with the staff's appraisal and that he could support the proposed decisions, including the decision on the request for a drawing under the compensatory financing facility, which met all the necessary requirements. The outstanding performance of the Korean economy under the stand-by arrangement had to be ascribed to the strong commitment of the authorities to correcting the maladjustments that had developed over recent years. It could safely be said that the Korean experience represented a classic adjustment case. The strong reliance on an export-oriented development strategy had proven to be instrumental in the resumption of traditionally high growth rates, together with a substantial decline in inflation and a significant reduction in the external current account deficit. The latter achievement was all the more remarkable given the increasingly protectionist climate to which Korea was exposed in its efforts to export.

The Korean authorities should be particularly commended for having rectified the fiscal imbalance, Mr. Laske continued. Government expenditures had decreased considerably in relative terms, while revenues had increased slightly. Consequently, the public sector deficit had been substantially lower in 1983 than had been envisaged under the program. The slowdown in expenditures, which was attributable to smaller capital outlays for infrastructure projects, reflected a reordering of priorities toward strengthening certain social services and if carried out smoothly, it would benefit Korea's further development efforts. The Grain Management Fund was expected to run an operational deficit again, and it would be a matter for regret if unjustifiable, although in some circles popular, price increases for rice were to intensify the deficit and to upset otherwise well-conceived fiscal policies. He encouraged the authorities to resist pressures threatening the attainment of the fiscal targets.

The slowdown in monetary expansion was welcome, Mr. Laske observed. Monetary policy was crucial to the holding down of inflationary pressures, especially as delayed cost and price effects of the depreciation of the exchange rate in 1983 might still be in the pipeline. The moderate price increases projected--in the 2-3 percent range--would materialize only if monetary policy continued to be cautious. It was particularly satisfying that the authorities intended to continue to accord top priority to the control of inflation. In that context, he shared the concern of the staff about the rapid expansion in rediscounts for preferred sectors; a more global approach to the allocation of credit would certainly enhance the overall efficiency of monetary policy. He also endorsed the staff's suggestion that preferential credits should be channeled through specialized banks or agencies.

There might also be room for further liberalization of interest rates, Mr. Laske added, thereby strengthening financial intermediation and the financial sector in general. The staff representative had mentioned at the outset of the meeting, recent developments that should improve the stance of monetary policy and support the adjustment policies of the authorities. On page 3 of EBS/84/99, the staff noted that private sector savings had recently been well below those of earlier periods. That pattern might be common in developing countries, following the economic upheavals of the past decade, but Korea's experience might be traceable to the limited number of attractive investment opportunities that the banking industry had so far offered its customers. He hoped that the measures recently taken to give potential investors a wider choice of maturities and of rates would have a beneficial effect on the savings performance of the private sector.

The authorities' flexible exchange rate policy had proved effective in reducing the external imbalance, Mr. Laske noted with satisfaction, and had also been actively used to support the authorities' trade liberalization efforts. Although economic developments in Korea were satisfactory, he too was concerned about the size and the maturity structure of Korea's foreign debt. The authorities were aware of the potential problems and were making welcome efforts to keep the debt under control. Nevertheless,

it could be argued that greater priority should be given to a reduction of short-term indebtedness rather than an increase in international reserves; however necessary and desirable the latter might be, such a reordering of priorities might also improve Korea's credit standing in the international capital markets.

The rate of return on real investment in Korea was quite high, Mr. Laske observed, and should attract foreign direct investment, which could make a valuable contribution both to the development of the economy and to the stabilization of the external accounts. He urged the authorities to re-evaluate their attitude toward foreign direct investment, a move that might allow Korea to plan for a smaller increase in its foreign borrowing. The medium-term debt scenario developed by the staff demonstrated the risk inherent in the external debt situation; clearly, prudence was necessary. Nevertheless, considering Korea's successful performance so far, the admittedly rather ambitious targets with respect to growth, inflation, and the current account were realistic and should be achievable.

The way in which the decision on compensatory financing was formulated was of benefit to countries like Brazil and Korea, Mr. Laske continued. Although Korea's request formally met all the requirements of the decision, it would not normally be associated with the notion of a "shortfall" in the literal sense. Moreover, Korea was on the threshold of industrialization, whereas the facility had originally been meant to assist countries exporting primary products. In addition, the failure to take use of Fund resources into account in the formulation of the performance criteria relating to external borrowing under the stand-by arrangement appeared to have created an incentive to make the fullest possible use of the compensatory financing facility. The situation was unsatisfactory; in future, the staff should exercise greater discretion in recommending that members be allowed to draw under the compensatory financing facility.

In the past ten years, Korea had had five arrangements with the Fund in addition to the present stand-by arrangement, Mr. Laske went on. Two of those arrangements had not been drawn upon at all and one had been only partially used. They had, therefore, been true stand-by arrangements--a second line--and it could even be said that the provision of such external finance was the true function of the Fund. Korea's present situation was considerably stronger than it had been when the current stand-by arrangement had been approved (EBM/83/99, 7/8/83), as a result of the authorities' determination and perseverance, a point that should be fully recognized. However, the Korean economy was poised for further improvements; it would be in keeping with the cooperative spirit of the Fund if Korea would consider its present stand-by arrangement in the more narrow sense, bearing in mind the need to preserve the Fund's liquidity and to direct Fund resources to countries in greater and more urgent need.

Mr. Jaafar commented that Korea's performance to date under the current stand-by arrangement was impressive. It was more likely than other highly indebted countries to be able to bounce back from its present

difficulties. Korea's outstanding debt was not of particular concern at present; the robust performance of the external sector, the dynamism with which the country had tackled its problems, and the prospect of a pickup in exports left no doubt about Korea's capacity to service its external debt in the medium term. However, short-term debt was exceptionally large in relation to total outstanding debt, and should be monitored and reduced as soon as possible. The availability of short-term credits and market conditions made Korea's position particularly uncomfortable because its cushion of reserves was lower than desired. He supported the authorities' commitment to increasing reserves and to reducing short-term debt.

He endorsed the staff's views on money and credit policy, Mr. Jaafar stated. The recently enacted reforms were consistent with the need to support a fast growing economy; for example, he cited the move to cease support of the Grain Management Fund and Fertilizer Account, the flexible and more refined structure of interest rates, and the institutional changes in the financial system. The authorities had explained that the differences between interest rates in the bank and nonbank financial sectors were due to entrenched inflationary expectations. The gap appeared to be explainable more in terms of the relative conditions underlying the supply of credit in the two sectors, for example, differences in the institutional framework. If the staff could offer an insight into that aspect of financial and credit development, Directors might have some idea of the extent of the reforms taking place.

The authorities had introduced significant import liberalization, Mr. Jaafar observed. He wished that the same could be said of Korea's major trading partners; the level of protection against Korea's exports was deplorable in view of its dependence on trade for growth and development. He agreed with other speakers that Korea deserved better trading arrangements in order to service its debt and to improve its import performance.

Korea's flexible exchange rate policy was a welcome move to restore external competitiveness, Mr. Jaafar considered. The authorities should strive to preserve that competitive edge in support of their external balance of payments objectives and import liberalization. Relatively low domestic prices and other favorable domestic developments should help in that regard. He welcomed the authorities' intention to continue their flexible exchange rate policy.

Commenting on the authorities' aim of achieving a current account balance in 1985 and moderate surpluses in subsequent years, Mr. Jaafar said that he shared Mr. Hirao's doubts about whether such a strategy was optimal for a newly industrialized country like Korea. He favored a more active policy to promote economic development, in particular so that Korea could take advantage of the high marginal productivity of its investment. There was no harm in incurring a prudent level of deficit in the current account; Korea had much to gain from external savings and from encouraging direct foreign investment along the lines suggested by Mr. Laske.

He could support the request for the use of Fund resources under the compensatory financing facility, for the reasons expressed by Mr. Hirao, Mr. Jaafar stated, as well as the decisions relating to the Article IV consultation and the review of the stand-by arrangement.

Mr. de Vries remarked that the staff papers on Korea provided heartening evidence that Fund policies worked, particularly if followed as prescribed, and if the authorities acted with prudence. The hardships that a number of countries were experiencing could be avoided if they, too, followed appropriate policies, which had encouraging results, particularly if pursued with vigor rather than gradualism. Developments in Korea in 1983 had been particularly impressive: GNP growth had been more than 9 percent, inflation had been very low, and both the external current account deficit and the public sector deficit had been less than 2 percent of GDP. The prospects for 1984 and beyond were equally good. He could, therefore, support the proposed decisions.

Initially, like some other Directors, he had been somewhat surprised at Korea's request for use of Fund resources, given the country's recent economic performance, Mr. de Vries continued. However, the external debt position provided ample justification for the request. The real question was not so much, as some Directors had suggested, prolonged use of Fund resources, but proper use. Korea had clearly used Fund resources properly. Furthermore, the Executive Board should not place itself in the position of implying that if a country performed well it did not need credit, while if it performed poorly it did not deserve it.

The staff raised the fundamental question whether Korea should aim for a current account surplus or whether it should continue to have net recourse to international savings, Mr. de Vries observed. In principle, given the relatively low level of per capita income and the need for continuing development, recourse to international savings would appear to be warranted, certainly as long as the rate of return on investments in Korea remained higher than the interest rate on external loans. However, it might be appropriate for Korea to experiment with different financing techniques. The country was in a favorable position to do so, having established an outstanding record. Like other developing countries, Korea would have to rely less heavily in future on financing through the banking system; direct investment was one of several possible ways in which the country might use its advantageous position to encourage financial flows that carried less risk than short-term, or even medium-term, borrowing from the banking system.

A number of the staff's recommendations deserved particular emphasis, Mr. de Vries commented, namely, that the authorities should resist pressures to raise the purchase price of rice, limit the deficit of the Grain Management Fund, reduce reliance on rediscounts for preferred sectors, and pay greater attention to the level of interest rates.

Mr. Portas stated that he supported the proposed decisions and that he agreed generally with the staff's appraisal. The request for a purchase under the compensatory financing facility met all the requirements set forth in the relevant decision.

The authorities should be commended for the implementation of strong adjustment policies that were clearly responsible for the much better than expected performance of the economy, Mr. Portas continued. In carrying out its economic stabilization program, Korea had complied with all the performance criteria under the stand-by arrangement and had made impressive progress in the adjustment of the external imbalance and in the reduction of inflation while sustaining economic growth. The remarkable outcome on the external and domestic fronts placed the economy on a sounder basis for continued growth with price stability. One of the most important elements of the program had been the greater than expected reduction of the public sector deficit from 4.3 percent of GNP in 1982 to 1.6 percent in 1983, central features of which had been the decision to reduce the Grain Management Fund's deficit by half and the strict adherence to expenditure control, which had substantially increased public sector savings.

Trade policy had also played an important role in the attainment of strong, broadly based economic growth with continued low inflation, Mr. Portas considered. Increased trade liberalization, which had been facilitated by the ample availability of supplies, particularly food products, had allowed foreign demand to stimulate growth while contributing to lower inflation and inflationary expectations. It had also improved the allocation of resources. He joined other Directors in commending the Korean authorities for those efforts, which were particularly notable in an unfavorable external environment characterized by limited availability of commercial foreign financing and an intensification and broadening of protectionist measures.

The program for 1984 appropriately aimed at maintaining the rate of growth achieved in 1983 while containing domestic inflation and further reducing the external current account deficit, Mr. Portas went on. The targets appeared realistic given the policies that the authorities firmly intended to pursue in 1984. The decision to liberalize further the financial system and the exchange and trade system was particularly important. Significant structural measures had already been taken in those areas; further progress, supported by the firm implementation of demand management policies, would facilitate the attainment of the balance of payments objectives. The announcement of the gradual liberalization of trade, including progressive implementation of a tariff reform until 1988, was a particularly welcome development. The continuing effort to improve the maturity structure of external debt while increasing international reserves was another important element in the program.

Although the domestic and external objectives for 1984 appeared attainable in light of the economic policies embodied in the program, Mr. Portas remarked, the continuing uncertainty in international financial

markets and the prospects of increased protectionism in industrial countries, which could affect the growth of Korea's exports, were causes for concern. The recent indication of an improvement in market perception in response to Korea's stabilization efforts was a positive development. However, it was to be regretted that there appeared to be no tendency at present for protectionist measures in the industrial countries to subside. He shared the concerns expressed by the authorities and by the staff regarding the adverse effects of undue protectionist measures on the prospects of export growth and thereby on Korea's economic growth potential in 1984 and beyond. As could be seen from Appendix Table 9 in EBS/84/99, the materialization of the projections in Scenario A depended critically on the maintenance of strong export growth; the expectation of such growth was reasonable in view of the current stance of economic policies and historical performance. The sensitivity analysis presented by the staff showed that under a much less favorable assumption for export growth, the policy response to the more hostile external environment would not be sufficient to avoid a reduction in economic growth or a much higher reliance on foreign borrowing. Neither Scenario B nor Scenario C produced as favorable an outcome as Scenario A. It would be regrettable if the successful export-led strategy followed by the authorities, which had proved essential to the country's economic performance, was further constrained by trade restrictions at a time of economic recovery in industrial countries.

Mr. Clark said that he agreed with the broad thrust of the staff's appraisal. It could be argued that, having regained a sustainable balance of payments position, Korea should be able to make appreciable net repurchases of Fund resources. Both the fiscal and external deficits projected for 1984, at less than 2 percent of GDP, might be regarded by many countries as easily financeable. While it was true that commercial capital markets might be nervous about increasing their exposure to Korea, despite that country's undoubted economic strength, there might be grounds for greater optimism than the staff believed with regard to the financeability of the external deficit.

First, the current account deficit for the first quarter of 1984 had been about $500 million less than in the corresponding quarter of 1983, Mr. Clark observed. The improvement reflected an increase in the value of exports well in excess of the 17 percent forecast by the staff for 1984 as a whole. Thus, it was possible that the fairly modest improvement in the current account projected for 1984 might be comfortably exceeded and, correspondingly, that the projected borrowing need for $1.1 billion might turn out to be on the high side.

Second, although conditions in the international capital markets generally remained difficult, Mr. Clark went on, the climate for borrowing by Korea seemed to have improved as a result of the country's successful adjustment effort. The total of new commercial loans announced so far in 1984 was higher than for the corresponding period of 1983 and the target for a recent borrowing exercise had been raised from $300-500 million to $650 million because of a highly favorable market reception. Admittedly,

as Mr. de Vries had suggested, Korea's level of external debt was already high; on the other hand, borrowing from the Fund was itself a form of external debt.

Third, the forecast overall deficit of $1.1 billion in 1984 depended heavily on the assumption of negative errors and omissions, estimated to be $0.9 billion, Mr. Clark observed. In Table 1 of EBS/84/100, the staff appeared to suggest that the amount in question partly covered the anticipated repayment of short-term borrowing, but most of it seemed to represent unidentified flows. It was not altogether satisfactory that the forecast of the financing need should be so heavily dependent on those unidentified flows, especially when the assumption had been adjusted from zero to minus $900 million since the original program proposal.

His comments were not intended to detract from his commendation of the Korean authorities for their excellent economic achievements, Mr. Clark stressed. He supported the proposed decisions relating to the Article IV consultation and the stand-by arrangement. As his chair had stated at the time of the Board's approval of the arrangement (EBM/83/99, 7/8/83), and as a number of Directors had suggested at the present meeting, it was to be hoped that the authorities would feel able to treat the arrangement on a truly stand-by basis and to refrain from drawing in full unless the external position deteriorated.

Referring to Korea's request for a purchase under the compensatory financing facility, Mr. Clark wondered if the member was actually encountering the balance of payments difficulties cited in paragraph 3 of the compensatory financing decision (Decision No. 6860-(81/81), adopted May 13, 1981). In other respects, the requested purchase was formally consistent with the decision, although it had some interesting technical features. Notwithstanding the outcome of the calculations, it was odd that an economy that had achieved export growth of 14 percent in a particular year could apply to make a purchase under the compensatory financing facility for that year. Moreover, a large part of the further acceleration in exports projected for 1984 and 1985 was attributed to an adjustment of the real exchange rate and other discretionary measures. The question could be raised whether the same measures applied earlier might not have reduced or eliminated the shortfall.

Mr. Blandin said that the case of Korea was in many respects exemplary. The economic situation looked brighter, although action still had to be taken in several areas, for example, to raise the level of income of the population, which was still low by international standards. The staff had adequately identified the main topics on which the authorities should focus their attention. The performance of the economy in 1983 had been impressive, the best proof of success being Korea's ability to meet without difficulty all performance criteria under the current stand-by arrangement. Particularly noteworthy were the slowing down of inflation to the historically low level of 2 percent, the reduction by half of the current account deficit to about 2 percent of GNP, and the increase in the rate of growth to almost 10 percent. The Korean authorities had

managed to adjust their economy in time to benefit fully from the world recovery, especially from recovery in the United States. That achievement had been carried out skillfully and steadily under what the staff characterized as a "classic adjustment program." It was a testimony of market confidence that Korea had been able to obtain better financial conditions from the international capital markets at a critical time.

As for the outlook for 1985, Mr. Blandin said that he shared the staff's view that the objectives set by the Government were at least "challenging." In any other country those objectives could be regarded as ambitious, but such skepticism did not apply to Korea. The staff's recommendations with regard to financial policy were wise.

Two areas deserved particular emphasis, Mr. Blandin suggested. First, the projected increase of 7 percent in 1984 would bring the level of outstanding external debt to $43.4 billion, 53 percent of projected GNP. The high proportion of short-term debt was a cause for concern as it rendered Korea more vulnerable to shifts in market sentiment, which was heavily influenced by Korea's economic performance. Second, the alternative medium-term scenarios produced by the staff in EBS/84/99 provided a useful analysis of the sensitivity of Korea's performance to adverse circumstances. A strong case could be made for an active industrial policy aimed at diversifying the export base, producing import substitution goods, and reviving the domestic market. The risk of inflation was less than in other countries, given the high savings ratio.

Finally, while he shared some of the concerns expressed by Mr. Leonard and Mr. Laske with regard to the request under the compensatory financing facility, Mr. Blandin remarked, he remained strongly attached to the principles of the relevant decision. Given that the request formally met all the requirements of that decision, he could support it.

Mr. Alhaimus noted that the Korean economy had made substantial progress in 1983 as shown by the major economic indicators. Perhaps the most significant achievement had been the doubling of output growth to the high level of 9 percent while inflation had been brought down to a mere 2 percent. Notable successes had also been achieved in the external sector. Such accomplishments had certainly been helped by the moderation in import prices and the pickup of activity in the world economy, but much had also been due to the policies pursued by the authorities, particularly in the area of financial discipline.

The public sector deficit had been brought down by 2.7 percent of GDP to less than half the program target, Mr. Alhaimus continued, as central government expenditure had been markedly less than the program target and revenue had increased somewhat more than envisaged. The contribution to revenue of taxes on income and profits had decelerated in 1983 and was expected to fall further in 1984, mainly due to the 1982 reform of corporate taxes, which had lowered tax obligations, and to the reduction in 1983 of individual income taxes. Insofar as such tax concessions had been intended to act as incentives to growth, it would be useful to have an

assessment of the possible response of investment and output to such incentives. The improvement in 1983, however, had mainly been due to higher indirect taxes, including the new 5 percent tariff on imported oil, which had amounted to about 0.3 percent of GDP. That tariff had been imposed even though domestic prices for petroleum had already been at or higher than world market prices; some petroleum product prices had been among the highest in the world. It was encouraging, however, that the full decline in the world price of oil had been passed on to the major industries to maintain competitiveness.

The prospects for the future appeared to be encouraging because the authorities intended to pursue prudent policies, Mr. Alhaimus commented, as indicated in their program for 1984, and also because of the brighter outlook for the external environment to which the Korean economy was so sensitive. The main uncertainty concerned the realization of domestic and external objectives, which depended critically on the international trade environment; Korea's exports remained subject to strong protectionist barriers in the markets of industrial countries despite the increasingly liberal trade and payments system of Korea. It was particularly depressing for developing countries striving to modernize their economies to see that the efforts of an efficient and liberal economy could be frustrated by protectionist barriers in the markets of industrial countries.

He could support Korea's request for a purchase under the facility for compensatory financing of fluctuations in the cost of cereal imports, Mr. Alhaimus stated, as the request met the requirements of the decision. He recalled that doubts had been raised during the Executive Board's discussion of the current stand-by arrangement, and again by a number of Directors at the present meeting, with regard to Korea's need to draw on the Fund, given the frequency of past use of Fund resources, the strong performance of the economy, and the country's standing in capital markets. He assumed that strong reasons had induced Korea to resort again to the Fund. The arguments put forward by Mr. Morrell and the comments by Mr. de Vries were particularly noteworthy.

Commenting on the broader issue of Korea's medium-term external borrowing strategy, Mr. Alhaimus encouraged the authorities to rely less on foreign savings and to continue their conservative approach, especially in light of the maturity structure of their foreign debt.

Mr. Teijeiro remarked that he agreed generally with the staff's appraisal. Korea's performance under the stand-by arrangement had been outstanding. The rate of growth of the economy had risen to almost 10 percent, inflation had been virtually eliminated, and the current account deficit had decreased. An important cause of the success of the program had been the implementation of strict financial discipline, which had sharply reduced the public sector deficit. The reduction in the rate of monetary expansion was also commendable.

The progress of the authorities in liberalizing the trade regime was welcome, Mr. Teijeiro continued, because it should improve resource allocation in the economy and the efficiency of Korean industry. However, import duties on raw materials were being reduced more rapidly than duties on final products, which could lead to greater distortions in the short run. He invited the staff to comment on the appropriateness of trade policy.

Interest rates were positive in real terms, although still low by international standards, Mr. Teijeiro observed. Could that factor explain the large errors and omissions item in the balance of payments? Greater reliance on market-determined interest rates rather than on administered rates might be appropriate. The introduction of negotiable certificates of deposit yielding 11 percent was a step in the right direction. According to the statement by the staff representative, the success of those instruments could jeopardize the net domestic assets target, which was defined in terms of the net domestic assets of the total banking system. He asked the staff whether it would have been more helpful to define the target in terms of net domestic assets of the Central Bank.

In sum, Korea's pursuit of strong adjustment policies had enabled it to make significant progress against inflation, in improving the balance of payments position, and making structural reforms, while sustaining the momentum of economic growth, Mr. Teijeiro concluded. He supported the authorities' program for 1984, which was designed to achieve a high rate of growth with low inflation and a reduction in the current account deficit. In the medium term, one area of concern was Korea's high external debt. Although the country's record was excellent, the rate of growth of total foreign debt should be prudent from now on; greater reliance on foreign direct investment might be a better alternative. He supported the proposed decisions.

Mr. Ercel noted that the Korean authorities had made substantial progress in the management of their economy in 1983, with more rapid results than expected. Korea's higher growth rate, lower unemployment, and exceptionally better price performance compared with other developing countries, were mainly the result of efficient and timely economic policies in the form of a classic adjustment program. As the staff pointed out, strict economic discipline and a flexible exchange rate policy had combined with recovery in some of the industrial countries to contribute to Korea's economic improvement.

Progress in three areas had been particularly important to the better outcome, Mr. Ercel continued. First, for the first time since 1979, the public sector had become a supplier of credit to the banking system, reducing pressure by the public sector on foreign and domestic borrowing. That development had also had a favorable effect on domestic savings. Second, the growth of aggregate demand had been made up of increases in consumption, exports, and investment in almost equal proportions, although the contribution of the external balance to GNP growth had declined from 3.6 percent in 1980 to 0.3 percent in 1983, due mainly to increased

import demand. Third, although real wages had increased substantially, a slower rise in unit labor costs and gains in productivity in the manufacturing sector had contributed to the decline in inflation. The profitability of the manufacturing sector, which had been a weak point in the economy, had probably increased in 1983 as a result of those developments and of the increase in investment. He invited the staff to provide further information on the topic.

In the monetary area, despite important steps taken in the financial sector, further measures to liberalize the financial markets needed to be considered, Mr. Ercel suggested. For instance, measures to control administrative bank interest rates, and various institutional changes, could help to increase the efficiency of the financial markets. The traditional relationship between domestic commercial bank rates and foreign interest rates had been reversed since early 1982. Although the gap had narrowed to 2 percentage points in 1983, because of recent increases in interest rates in the international financial markets, it appeared to be widening again. What was the staff's view concerning the effects of those movements in domestic and foreign interest rates on savings flows and on capital outflows?

As other Directors had indicated, one area of concern was the large amount of short-term debt, Mr. Ercel remarked. Although Korea's debt service obligations were consistent with its ability to earn foreign exchange, the maturity structure of the debt needed to be improved and international reserves increased; those were important factors affecting the medium-term sustainability of the balance of payments. He supported the proposed decisions, including the request for a purchase under the compensatory financing facility.

The staff representative from the Asian Department noted that the data on the labor force participation rate were poor. Part of the reason for the decline in the rate appeared to be demographic, in that a growing proportion of the population was enrolled in secondary schools and universities.

The staff agreed with Directors that the availability of a wider spectrum of savings instruments and more attractive rates of return would help to revive private savings, the staff representative continued. The recent decline in savings was partly cyclical; most of the adjustment following the 1980 recession had been borne by savings, as consumption had been maintained. Thus, the revival of economic activity should help to boost savings. The recently introduced certificates of deposit should also prove attractive relative to bank deposits, although it was difficult to judge how much of the increased demand for them would represent a substitution of other forms of bank deposits and how much would come from the unorganized financial sector. The rate on one-year bank deposits was 9 percent and the rate on the new certificates of deposit was 11 percent, while inflation was about 2 percent.

In view of the improved price performance, the external adjustment that had taken place, and the unlikelihood of significant movement of the exchange rate, the level of interest rates was such that capital outflows would be discouraged, the staff representative went on. The errors and omissions item in the balance of payments, although it was large, was not out of line by comparison with that of many other countries; relative to exports or GNP it stood out because of the decline in the current account deficit in recent years. While it was unsatisfactory to have to forecast large errors and omissions, the item had been large for a number of years. In 1983, errors and omissions had amounted to $1 billion; they were projected to be about $600 million in 1984, but had so far amounted to $800 million. While the outcome for the year might be close to the projected figure, it was clearly difficult to forecast errors and omissions with any accuracy. On the other hand, the current account performance had been better in the first quarter of 1984 than forecast, and it made little difference whether financing was provided through the current account or errors and omissions. Taken together, those two items had not changed much in 1984 to date relative to the same period in 1983.

Investment in the manufacturing sector, which had been weak for a number of years, had picked up strongly in the second half of 1983 and so far in 1984, the staff representative noted. The share of construction investment was declining, indicating a shift to investment in plant and equipment in the export sector.

On the question of the debt structure and balance of payments need, the staff representative observed that, notwithstanding the sharp reduction in the current account deficit since 1980, Korea had resorted to substantial external financing. That financing had primarily taken the form of short-term debt, which had grown three times faster than medium- and long-term debt. There had, therefore, been a sharp deterioration in the maturity structure; at the same time, reserves had increased only moderately, so that the ratio of reserves to short-term debt had declined sharply from about 109 percent in 1979 to 62 percent in 1982. The issue had been a matter of concern when the program under the stand-by arrangement had been designed because the excessively low level of reserves in relation to imports could cause problems if there was a shift in market sentiment toward a country like Korea that had borrowed such large amounts. The authorities had met the program target for reducing short-term debt, but they had been forced to miss the target on reserves because of the limited availability of funds. Reserves had, in fact, declined instead of increasing as planned.

For the 1984 program, the commitment on reserves had been made more explicit because it would not be appropriate for Korea to meet the short-term debt ceiling through a further reduction in reserves, the staff representative from the Asian Department stated. The authorities had indicated their agreement but believed that they could not act unilaterally; they were dependent on the response of the market which unfortunately was not yet fully aware of Korea's economic performance. Banks tended to emphasize exposure limits, and were reluctant to increase their

lending to Korea, which was a large borrower. Banks also tended to look at absolute levels of debt. Korea's estimated gross borrowings in 1984 would be about $7 billion, about $1 billion of which was a direct result of the reduction in short-term debt and the increase in reserves. The relative increase in medium- and long-term debt was, thus, a consequence of the program, aimed at improving the maturity structure of Korea's debt in order to reduce its vulnerability to shifts in market sentiment. In agreeing to the ceilings for short-term debt, and the reserves target, the authorities had viewed the resources provided by the Fund as an integral part of the financing package for the year. It was, therefore, doubtful whether the improvement in the ratio of short-term debt to reserves would be possible without the use of Fund resources.

The staff representative from the Exchange and Trade Relations Department recalled that a number of Directors had expressed some misgivings about the appropriateness of the use of Fund resources by Korea. Such concerns arose because the demand for Fund resources frequently exceeded their availability. It was, therefore, legitimate to be concerned that Fund resources should be devoted to those countries needing them most and that due account should be taken of the Fund liquidity position. In that context, it had to be noted that it was the lack of appropriate adjustment policies that led to Fund resources being scarce. Therefore, if adjustment policies were implemented promptly and wisely, as seemed to be the case with Korea, use of Fund resources would be appropriate.

The Fund had devised a set of policies--the practice of conditionality--to allocate its scarce resources among members that requested them, the staff representative continued. The basis of conditionality was the appropriateness of the policy package that a country was willing to implement. Sometimes, references were made to a stand-by arrangement "in the true sense" or to what had earlier been called a "symbolic" stand-by arrangement. Such terms were usually used to try to distinguish a "seal of good performance" from an actual stand-by arrangement. However, there was a danger that, if taken too far, such an interpretation of the purpose of a stand-by arrangement could, in practice, penalize good performance by members.

In the specific case of Korea, the staff representative from the Exchange and Trade Relations Department commented, it was more correct to speak of "proper" rather than "prolonged" use of Fund resources, as Mr. de Vries had pointed out. Korea had had a number of arrangements with the Fund in the past ten years, some of which it had drawn upon, others it had left undrawn. Such an approach was in order because Fund resources in stand-by arrangements were intended to be used when circumstances indicated that there was a need. Another consideration was that even if Korea were to draw the full amount available under the current arrangement, its outstanding cumulative use of Fund resources would be well within the maximum allowed by the enlarged access policy. Furthermore, it would be less than logical to make a commitment of Fund resources to a country and at the same time to suggest that the country should not

use them. Indeed, it would be inappropriate for the Fund to ask a member not to draw on the resources available to it because it was performing well, and yet levy a charge for the commitment of those resources.

The staff representative from the Research Department noted that the question had been raised of the appropriateness of a member's access to the compensatory financing facility while its exports had increased at a relatively high rate. Between 1975 and 1979, the formula used to measure the trend in exports had been based on the arithmetic average of exports for five years, which had led to unreasonable results in some cases; for example, if a country's exports grew at a constant annual rate, it would have a shortfall each year. Such a result was not possible using a geometric average, the basis of the revised formula applied since August 1979. Under the latter formula, a shortfall was only possible when the rate of growth of exports in the shortfall year was lower than the average rate of growth in the other four years of the trend period. Thus, the increase in Korea's exports in the shortfall year was less marked than the average increases recorded for the other years of the trend period. In that case, as in another case recently discussed by the Executive Board, the increase in exports in the shortfall year represented a recovery from the effects of recession, but a recovery that was not sufficient to bring exports to the level of the medium-term trend as defined under the formula. As Directors had noted, the result was compatible with the requirements of the decision.

The question had also been raised whether earlier depreciation of the real effective exchange rate would have increased exports in the shortfall year to the point of eliminating the shortfall, the staff representative from the Research Department observed. In principle, such action could have had that result, but in practice it would have been unreasonable to expect the Korean authorities to have so designed their policies over a number of years as to avoid an export shortfall in a given year.

Mr. Morrell said that he would like to express the regrets of Mr. Prowse, who had attended the Article IV consultation discussions in Seoul, that he was unable to be present at the Board's discussion.

As the staff had noted, Korea was a developing country with GNP per capita of about only $1,900, Mr. Morrell continued. Its relative success in the international market should not obscure that fact. The country had shown an ability to use capital resources very efficiently, despite the uncertainties that it faced and that arose from exogenous factors. Some Directors, acknowledging the efficient use that Korea had made of available resources, had questioned the authorities' intention to reduce reliance on external savings in the years ahead. However, the authorities' approach was evidence of their caution in the face of difficult conditions in international capital markets and increasing protectionist barriers against their exports. It was particularly regrettable that Korea had to deal with growing protection against its exports while efforts were being made to open up its domestic markets to imports.

A number of Directors had commented on Korea's need for use of Fund resources, Mr. Morrell recalled, suggesting that the authorities should regard the stand-by arrangement in a "true" stand-by sense. The history of Korea's use of Fund resources indicated that the authorities did not take a cavalier attitude to arrangements with the Fund and that they had drawn on them only in cases of need. The present circumstances showed that the need was indeed real. The slight improvement in Korea's debt structure had been brought about only through a reduction in reserves, and the authorities had not been able to borrow to effect that restructuring. Since the stand-by arrangement had been approved, there had been unsettling events in the Asian capital markets that had affected market sentiment toward large borrowers, including Korea. Although Korea's current account position had improved, problems remained on the capital side of the balance of payments. The fact that Korea had been able to borrow short term in large amounts did not mean that it had easy access to medium- and long-term borrowing. Recognizing the vulnerability of its position, Korea had sought recourse to the Fund in order to improve its standing in the capital markets. In doing so, it was acting in a way that was wholly consistent with the purposes of the Fund, not only in relation to the Fund's obligations to individual members but also in terms of the Fund's responsibilities vis-à-vis the international financial system as a whole.

On the one hand, it had been suggested that the example of Korea was relevant to the forthcoming discussion of the prolonged use of Fund resources, Mr. Morrell went on. On the other hand, it had also been pointed out that Korea had faced a difficult situation in 1980 and 1981 as a result of the second oil shock; the adjustment measures that the Korean authorities had implemented since then had been regarded as commendable. There was a certain contradiction in holding both sets of views at once, because Korea's use of Fund resources under the current stand-by arrangement was clearly justified by its need to cope with a new external shock. It was important that the Fund should be able to respond to circumstances as they arose without undue concern about the number of drawings that a particular country might have made in the past.

Directors had commented favorably on Korea's financial policies, including developments in the financial structure, Mr. Morrell recalled. The authorities appreciated the benefits that would follow from greater freedom in financial markets and more responsive institutions; they were moving in the right direction at a pace consistent with their appropriately conservative approach to financial matters. They had also taken a number of measures in recent years to encourage foreign direct investment in the Korean economy. For example, a new law to take effect on July 1, 1984 would liberalize some of the regulations governing foreign direct investment. While it was difficult at present to say what the effects of that law might be, it again provided evidence that the authorities were opening up the economy. Another example was the liberalization of regulations governing foreign banks in Korea.

The Chairman remarked that only a few months earlier there had been deep concern that unsettling events affecting one South Asian country might have spillover effects on other countries, particularly large borrowers like Korea. The size of Korea's debt, especially the short-term component, placed the country in an uncomfortable position vis-à-vis the financial markets. The quality of the adjustment effort undertaken by the Korean authorities had not yet been fully appreciated by market participants. It was important that the Fund should back such efforts and that it should not act in a way that might be interpreted as a lessening of its support for Korea. Therefore, although Korea's prospects for further longer-term borrowing had improved, the Fund should continue to play its part in strengthening the market's confidence in Korea, not only through technical assistance and surveillance, but also through financing.

The Chairman made the following summing up:

Executive Directors agreed with the thrust of the views expressed in the staff appraisal for the 1984 Article IV consultation with Korea. They warmly praised the Korean authorities for their exemplary adjustment efforts, which included a substantial reduction in the public sector deficit, a sharp deceleration of credit expansion, and a significant improvement in external competitiveness. Those adjustment policies, together with a recovery in export markets, had yielded remarkable results, including the resumption of rapid growth, the virtual elimination of inflation, and a considerable reduction in the external imbalance. The recent performance and short-term prospects of the economy were regarded as impressive.

Directors observed that the Government's economic and financial policies for 1984 were designed to maintain the economy on its noninflationary growth path and to effect further external adjustment. They believed that Korea's adjustment program for 1984 was well formulated and warranted continued Fund support. Directors emphasized the need to persevere in the application of fiscal discipline and monetary restraint, and they endorsed the targets for monetary growth and the public sector deficit. They encouraged the authorities to limit the deficit of the Grain Management Fund by resisting pressures to raise the purchase price of rice.

Directors believed that exchange rate policy had played an important role in promoting exports and improving the external position. They welcomed the authorities' intention of pursuing an exchange rate policy that would support the balance of payments objective and allow for further import liberalization. Directors commended the authorities for their rapid implementation of the import liberalization program at a time when Korea's exports were encountering greater trade barriers abroad. Directors supported the authorities' recent actions in liberalizing the financial sector, and they urged them to take further steps as circumstances permitted. In particular, it was suggested that market

forces be allowed to play a greater role in determining interest rates, and that central bank rediscounting of subsidized credit be reduced.

Directors observed that Korea's overall level of external debt was high but not out of line with its debt servicing capacity. Considerable progress had been made in improving the maturity structure of debt. They commended the Government for reducing short-term debt in 1983 despite the limited availability of medium- and long-term loans. Directors noted, however, that the level of short-term debt was still very high and, in that context, they welcomed the authorities' intention to reduce short-term debt further and to strengthen international reserves, thereby improving market sentiment. Directors were confident that Korea's access to international capital markets would continue to improve as the market became more aware of the country's remarkable economic performance. At the same time, they believed that foreign direct investment could usefully play a larger role in the Korean economy.

The marked strengthening of the external current account in recent years and the cautious medium-term strategy of the Korean authorities were warmly welcomed by Directors. They suggested that the role of foreign savings in the Korean economy and the appropriate posture of the external current account should be assessed in light of development needs, changing conditions in international financial markets, and the need to avoid excessive external indebtedness.

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

The Executive Directors then took the following decisions:

Decision Concluding 1984 Article XIV Consultation

1. The Fund takes this decision in concluding the 1984 Article XIV consultation with Korea, in the light of the 1984 Article IV consultation with Korea conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The existing restrictions on payments and transfers for current international transactions are maintained by Korea in accordance with Article XIV. The Fund welcomes the progressive liberalization by Korea of restrictions on payments for current international transactions and encourages the authorities in their determination to remove remaining restrictions as Korea's external position improves.

Decision No. 7721-(84/89), adopted
June 8, 1984

Review Under Stand-By Arrangement

1. Korea has consulted with the Fund in accordance with paragraph 4(c) of the stand-by arrangement for Korea (EBS/83/119, Sup. 2) and paragraph 3 of the letter dated June 3, 1983 from the Minister of Finance of Korea, in order to review the progress made by Korea in implementing its program, reach understandings with the Fund regarding policies, measures, and establish suitable performance clauses for the remaining period of the stand-by arrangement.

2. The letter dated April 23, 1984 from the Minister of Finance of Korea, together with the annexed technical memorandum, shall be attached to the stand-by arrangement for Korea; and the letter dated June 3, 1983 with annexed memoranda, shall be read as supplemented by the letter dated April 23, 1984 with annexed technical memorandum.

3. Korea will not make purchases under the stand-by arrangement for Korea that would increase the Fund's holdings of Korea's currency in the credit tranches beyond 25 percent of quota or increase the Fund's holdings of that currency resulting from purchases of borrowed resources beyond 12.5 percent of quota:

a. during any period in which the data for the preceding calendar quarter indicate that:

(1) the ceiling on net credit to the public sector from the banking system described in paragraph 1 of the technical memorandum annexed to the letter of April 23, 1984, has been exceeded;

(2) the ceiling on net domestic assets of the banking system described in paragraph 2 of the technical memorandum annexed to the letter of April 23, 1984, has been exceeded; or

(3) the ceiling on overall outstanding disbursed external debt described in paragraph 3 of the technical memorandum annexed to the letter of April 23, 1984, has been exceeded; or

b. if Korea fails to observed the limit on outstanding disbursed external debt with initial maturity of less than one year described in paragraph 3 of the technical memorandum annexed to the letter of April 23, 1984.

4. The Fund decides, pursuant to paragraph 4(c) of the stand-by arrangement for Korea, that the respective review of policies, including the specification of performance clauses for the remaining period of the stand-by arrangement, is completed.

5. Paragraph 4(d) of the stand-by arrangement for Korea in EBS/83/119, Supplement 2, July 11, 1983, shall be amended to read as follows:

(d) during the entire period of this stand-by arrangement, while Korea has any overdue financial obligation to the Fund, or if Korea....

Decision No. 7722-(84/89), adopted
June 8, 1984

Purchase Transaction - Compensatory Financing Facility

1. The Fund has received a request from the Government of Korea for a purchase of SDR 279.7 million under the Decision on Compensatory Financing of Fluctuations in the Cost of Cereal Imports (Executive Board Decision No. 6860-(81/81), adopted May 13, 1981, as amended by Executive Board Decision No. 7602-(84/3), adopted January 6, 1984).

2. The Fund notes the representation of Korea and approves the purchase in accordance with the request.

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

Decision No. 7723-(84/89), adopted
June 8, 1984

3. JAMAICA - 1984 ARTICLE IV CONSULTATION; STAND-BY ARRANGEMENT; AND PURCHASE TRANSACTION - COMPENSATORY FINANCING FACILITY

Executive Directors considered the staff report for the 1984 Article IV consultation with Jamaica and a request for a one-year stand-by arrangement equivalent to SDR 64 million (EBS/84/101, 5/4/84; and Sup. 1, 6/7/84), together with a request for a purchase equivalent to SDR 72.6 million under the compensatory financing facility (EBS/84/102, 5/4/84; and Sup. 1, 6/7/84). They also had before them a report on recent economic developments in Jamaica (SM/84/111, 5/18/84).

The staff representative from the Western Hemisphere Department said that it had not yet been confirmed that Trinidad and Tobago was willing to refinance about $27.5 million of payments falling due in 1984 and 1985 that had been assumed in the program. Further contacts were being made with the Trindad and Tobago authorities on the question. In view of the magnitude of the financing gap, the staff recommended that the Executive Board should grant provisional approval of the program until the matter could be resolved or an alternative plan of action adopted.

Mr. Joyce made the following statement:

The Government of Jamaica is requesting resumption of Fund assistance in the form of a one-year stand-by arrangement in support of its continuing efforts toward the longer-term restructuring of its economy and the achievement of a sustainable balance of payments position. The Jamaican authorities are also requesting a purchase under the compensatory financing facility with respect to an export shortfall for calendar year 1983.

My authorities recognize that the adjustment measures proposed are major and will require continued and determined efforts on their part if they are to succeed. The details of the new stand-by arrangement are set out in the staff paper and the intentions of the Jamaian Government are contained in the letter of intent attached to EBS/84/101. A number of steps have already been taken over the past few months and additional measures were approved by the Prime Minister of Jamaica when he tabled the Expenditure Estimates in Parliament on May 10 and more recently in his Budget Statement of May 24, 1984.

Under the extended Fund facility program approved in 1981, the Government of Jamaica initially made considerable progress toward achieving its twin objectives of economic recovery and structural adjustment. The negative direction of the economy was reversed and real economic growth was restored. Moreover, the rate of inflation was substantially reduced and there was some reduction in the rate of unemployment.

However, continued weakness in bauxite exports, largely as a result of the worldwide recession, led to reduced bauxite production, lower than expected foreign exchange earnings, a shortfall in government revenues, and an increased fiscal deficit. The reduction in bauxite earnings coupled with lower than expected net inflows of official capital and the resumption of private capital outflows resulted in a significant worsening of the balance of payments in the second year of the arrangement.

In these circumstances Jamaica in the spring of 1983 found itself unable to meet all the targets under the program and was obliged to seek a waiver. The additional adjustment measures introduced at that time aimed at bringing the program rapidly back on track but, in the event, the results were only partially successful and with the breakdown of the exchange rate system in September 1983 the program once again went off track.

At the time, the Government took a number of emergency steps to stabilize the parallel market, but these measures proved insufficient. Moreover, Jamaica's problems were compounded by an increasing central government deficit and a rapid expansion of private sector credit which together led to further pressures on the balance of payments.

Faced with growing imbalances, the authorities entered into discussions with the Fund, originally with the intention of trying to restore the extended Fund facility program. It was clear that the first essential was to achieve greater flexibility in the exchange rate regime so that trade and external markets could operate more freely. In November 1983, the authorities decided to unify the exchange rate system and to let the rate fluctuate within an adjustable band. A daily auction system was introduced in December 1983 to determine the rate and to assist the authorities in deciding on the appropriate levels for the band itself.

The Government, of course, was aware that considerable tightening of fiscal and monetary policies would also be necessary if the original objectives of the program were to be achieved. Moreover, such measures were essential if the exchange rate regime itself was to become fully viable.

However, discussions with the Fund were lengthier than originally anticipated. Meantime, the changes in the exchange rate system put in position in November and December failed to produce the desired results. The rate effectively remained stuck at J$3.25 per U.S. dollar. Black market transactions continued and payments arrears accumulated. The net result was that, as the position worsened, the degree of adjustment needed increased. While the Government did take a number of steps to correct imbalances, it was not possible until this spring to reach agreement on a fully orchestrated program--including the necessary private and official financing. It was clear both to the Fund and my authorities that the most appropriate course for the immediate future would be to consider a new stand-by arrangement which would incorporate the adjustment measures to achieve the original extended arrangement targets.

As the staff points out in EBS/84/101, the proposed arrangement is designed to provide a firmer basis for continued recovery and for the longer-term restructuring of the Jamaican economy. It is based upon a market-determined flexible exchange rate regime, supported by significantly stronger fiscal and monetary policies aimed at reducing domestic demand, as well as a more liberalized trade regime to encourage export competitiveness, and a rescheduling of Jamaica's external debt. Many of these measures were already in place.

The measures taken or announced to date by the Government include the following:

1. The exchange rate system was modified in March 1984 to ensure that the twice-weekly foreign exchange auctions operate effectively and that significant levels of unsatisfied demand are reflected in changes in the exchange rate band. Demand relating to payments arrears, which had overhung the market and impeded the

purchase of exchange for current imports, was removed from the market and is to be met on a phased basis over a 12-month period. A forward exchange market has been introduced.

2. The range of goods subject to import licensing was drastically reduced in March 1984 and the remaining items are to be removed from licensing over the next two years.

3. A tax package totaling more than J$200 million has been introduced by the Government. New tax measures--including a 6 percent stamp duty on imports of raw materials and increased taxes on hotel rooms--took effect in April. Further measures were announced in the budget last week, including additional taxes on the hotel sector, taxes on motor vehicles and driver licenses, and increased consumption duties on beer and spirits.

4. A number of subsidies have been removed and certain producer and consumer prices have been increased:

(a) Subsidies on four basic foods have been cut by 50 percent, and the remaining subsidies on imported foods are to be phased out by the end of 1984/85.

(b) The subsidy to the electric utilities for fuel oil was removed effective May 1, 1984 and the incremental costs are now fully reflected in consumer prices.

(c) Increases in producer and retail sugar prices have been announced and took effect May 29. Retail prices went by 36 percent.

(d) Telephone rates are to be increased substantially effective July 1, 1984.

5. Additional steps have been taken to constrain the growth in public expenditures. In particular:

(a) Public sector employment--excluding certain priority sectors--is being cut by 10-15 percent, effectively reducing the scheduled outlay on increased public sector wages.

(b) Significant reductions have been made in planned public sector capital expenditures.

6. A number of other structural changes have been announced:

(i) The Government has announced plans to reorganize the sugar industry and to restructure the National Sugar Company.

(ii) Disinvestment of public sector enterprises is to be accelerated.

(iii) New levy arrangements, designed to stimulate bauxite production, have been introduced.

7. The Government has made a formal request to the Paris Club to reschedule arrears and debt service payments for the period 1984/85. Results of the meeting scheduled for July will affect rescheduling arrangements with the Governments of Trinidad and Tobago and of Venezuela.

8. A number of steps have already been taken to tighten credit by raising cash reserve requirements and modifying and increasing the liquid asset ratio. Selective measures have been taken to ensure that credit to the productive sectors is not unduly constrained. Ceilings have also been imposed on credit expansion by the nonbanks.

The Jamaican authorities believe that the measures already taken and the additional actions contemplated will permit Jamaica to meet the performance criteria under the arrangement and to achieve the program's broader objectives. My authorities remain fully committed to the achievement of these objectives and they will consult with the Fund if it appears that further actions are necessary in order to ensure the program's success. Such consultations, of course, would be in addition to the reviews already provided for in the letter of intent.

Perhaps I can add a few general observations based on the Jamaican experience.

It is clear that major structural changes, such as those envisaged at the start of the original extended arrangement, cannot be accomplished overnight. Indeed, the introduction and implementation of the necessary adjustment measures often take more time than expected. This is especially the case if there is a shortage of experienced and trained personnel.

Fundamental changes are also more difficult to execute when the domestic economy is weak, the external sector suffers from severe shocks, and there is continuing uncertainty and lack of confidence. The difficulties are compounded if a country is particularly dependent upon one or two commodity exports for which international markets are depressed.

The period required to make basic adjustments is likely to be even longer if, at the same time, one is engaged in a fundamental shift toward greater reliance on market forces. This has been the experience not only of Jamaica but also of some of the larger industrial countries which are trying to look more to the private sector and to private investment for sustained growth.

It can be argued, of course, that the Jamaican program might have worked better if more drastic adjustment measures had been introduced earlier in the program. However, the Government felt that given the prolonged hardships endured through the 1970s and the depth to which the economy had already fallen by 1981, it would be more appropriate first to lay a firmer basis for the adjustment process. In their view, a measured approach was necessary if confidence was to be restored and the private sector encouraged to take the steps necessary to bring about more balanced growth.

My authorities were also more optimistic at the time about the prospects for improvements in tourism and bauxite. They believed that an increase in foreign exchange earnings from these sectors would provide much of the support needed until basic changes in industry and agriculture could take hold.

Jamaica did in fact achieve considerable success in the tourism sector and important government initiatives were also taken to restructure the state enterprises, to encourage industry, and to seek new agricultural development. But bauxite exports remained chronically weak due to the world recession, and this proved to be a major impediment to the Government's plans. You will note that new measures have now been taken to stimulate bauxite production. Ultimately, however, success or failure in the bauxite sector will largely depend on factors beyond Jamaica's control. In this connection, I would refer Directors to the document circulated by Prime Minister Seaga entitled "A Review of the Performance of the Jamaican Economy 1981-83," which sets out the impact that the fall in bauxite earnings had on the attainment of the objectives of the extended arrangement.

Finally, let me assure the Board that my authorities are under no illusion as to the seriousness of the problems that still confront them. They recognize that major adjustment measures are required and that success in this endeavor will depend not only on the continuing support of the Fund and the international community, but also on the resolute implementation by the Government and the people of Jamaica of the measures already agreed to under the program. They are also aware that Jamaica will continue to face serious problems even after the immediate objectives of the program have been achieved. In this respect, they recognize that, in particular, the management of the heavy burden of external debt will require continued close cooperation with major creditors for some years to come.

The request for a new drawing under the compensatory financing facility envisages a purchase considerably less than the shortfall experienced in 1983. My authorities are of the view that the requirements for the drawing under this facility have been met and that the request is fully justified on the basis of the circumstances in which Jamaica now finds itself.

Mr. Kafka commented that the conditions of the world economy during the past three years had made it more difficult to rehabilitate and restructure the Jamaican economy; the authorities' determination to proceed with a long-term program was, therefore, particularly commendable. Prime Minister Seaga had noted in a recent speech that the shortfall in achieving the targeted level of performance under the previous extended arrangement could be attributed to the decline in Jamaica's bauxite production to almost one half of the 1980 level, adding that that decline had overwhelmingly been the result of the international recession. He agreed with the Prime Minister's view.

The proposed stand-by arrangement was demanding, Mr. Kafka continued. Both the balance of payments current account deficit and the central government overall deficit were to be reduced by more than half. The planned decline in the Central Government's current account deficit particularly merited Directors' attention. The staff appeared to be skeptical that central government domestic revenues could be raised by almost 4 percentage points of GDP in a single year because the present tax burden was relatively high. However, the Government was determined to carry through that increase; the authorities had already shown their resolve, which could best be illustrated by the depreciation of the real effective exchange rate by 43 percent during the six months ended in April 1984. Consequently, the Executive Board should give Jamaica the benefit of the doubt that the tax package already introduced would achieve its expected results.

As to expenditure reduction, Mr. Kafka remarked, the authorities' determination was similar. In the letter of intent, they referred to their decision to reduce central government personnel by no less than 14 percent in a single fiscal year, an unprecedented and impressive objective. In Supplement 1 to EBS/84/101 the staff noted that the United States had not purchased bauxite for its stockpile as had been expected. In response, the Jamaican authorities had reduced total expenditures and they had taken additional revenue measures and secured cash grants from abroad, including cash grants from the United States, to ensure that the overall budget deficit was maintained at the level initially projected.

The program had a good chance of success, Mr. Kafka considered. The economy was at present almost completely free of major distortions. Wages, interest rates, and the exchange rate were market regulated, and price controls, except for those on a few staple items, were almost nonexistent. The medium-term outlook was encouraging, provided that the bauxite and alumina complex recovered from its current abnormally low level of output, a prospect that was possible so long as the world recovery continued and as the inflow of capital was maintained as planned. The inflow of capital was crucial to the entire program under the stand-by arrangement.

The staff expressed concern about the level of Fund exposure in Jamaica, Mr. Kafka observed. He was confident that the special role of the Fund as a creditor was fully realized by Jamaica. The Fund ought not to withhold or to restrict its assistance because of the size of its

exposure when such assistance was otherwise justified, as was the case in Jamaica's situation. He fully approved the procedures for review under the stand-by arrangement. He also supported the request for a purchase under the compensatory financing facility. The test of cooperation had been amply met and the proposed purchase was well below the amount of the shortfall; there was, therefore, no danger of overcompensation.

Ms. Bush said that she agreed with the staff's assessment that, as a consequence of the inadequacy of past policy responses to unfavorable international developments, Jamaica would be burdened for the foreseeable future by heavy debt service. Sustained commitment to a major adjustment effort would, therefore, be essential if international and private sector confidence, on which Jamaica's medium-term prospects depended, was to be restored. The Jamaican authorities should prepare themselves and the Jamaican people for the possibility that some midterm adjustment might be required. Compliance with the program was important. She urged the Government, with Fund assistance, to monitor progress of the program closely and to act promptly to compensate for any divergencies from programmed performance through further adjustment measures.

A market-determined exchange rate had a major role to play in the medium-term strengthening of the Jamaican economy, Ms. Bush continued, particularly in the manufacturing, agricultural, and tourism sectors. Some initial problems had been encountered in the introduction of a new auction system, as the staff pointed out in the supplement to EBS/84/101. However, she strongly urged the authorities to continue to permit the market to determine the exchange rate. She emphasized the importance of allowing all prices to reflect depreciation in the exchange rate promptly.

The revised outcome of central government operations in 1983/84 was distressing, Ms. Bush commented, with the overall budget deficit at 17.5 percent of GDP, a figure that was not only more than 7 percentage points above the original program target, but more than 2 percentage points above the preliminary figure in EBS/84/101, which had been high by international standards. Given that high base figure, a decline in the deficit in 1984/85 to 7.6 percent of GDP would be a notable achievement. She hoped that the restraint in public spending would continue to be given high priority and that any further cuts would be in current expenditures so as to permit some recovery in capital expenditures. The adoption of the tight monetary policy implemented in January 1984 was welcome. It should considerably improve the prospects for reversing private sector capital outflows. However, the chances of success would be further enhanced by the rapid adoption of positive interest rates. She agreed with the staff's emphasis on the need for wage restraint; the outcome of upcoming negotiations in the bauxite and alumina sector would be crucial in setting the tone for subsequent settlements. She urged the authorities to ensure that a suitable precedent was set. Finally, Jamaica provided another example of the prolonged use of Fund resources. She would take up the issues raised in that regard at the forthcoming Executive Board discussion of prolonged use. Finally, she could support the proposed decision concerning Jamaica's request for a purchase of SDR 72.6 million under the compensatory financing facility.

Mr. Clark stated that the Jamaican authorities faced an extremely serious economic situation. After seven years of almost continuous Fund support, including two extended arrangements, Jamaica was still far from external viability. Indeed, in a number of important respects, the position had worsened significantly during the period of the previous arrangement. Excluding grants, the current account deficit had reached 20 percent of GDP in 1983/84, compared with nearly 14 percent in 1980/81. At the same time, the ratio of debt to GDP had more than doubled to 150 percent, and external arrears had quadrupled. The consolidated public sector deficit had remained at about 15 percent of GDP throughout, resulting in heavy dependence on domestic and external financing. Inflation, after having come down, had accelerated again.

Part of the problem had been due to a continuing and substantial worsening of the terms of trade and to a reduction in capital inflows, Mr. Clark continued. However, as the staff stated clearly, much had also been due to an inadequate policy response to those difficulties. As a result, the previous extended arrangement had been largely wasted in terms of adjustment. Consequently, doubly strong efforts were now required. The targets set in the new program were appropriately ambitious but, on the basis of past performance, they would require strenuous efforts if they were to be achieved. A striking measure of the extent of the required adjustment was that the reductions in both the fiscal and current account deficits planned under the proposed one-year stand-by arrangement were greater than those envisaged in the three years of the previous extended arrangement.

Nevertheless, there were grounds for cautious optimism, Mr. Clark considered. The Jamaican authorities had shown a commitment to the program by taking substantial prior actions, in particular, the institution of the improved auction system for foreign exchange. The backloading of the drawings would provide a strong incentive to stick to the program. It was encouraging that conditionality under the World Bank's second structural adjustment loan was being implemented satisfactorily.

It would be essential for the Jamaican authorities to adhere closely to the letter and spirit of the program, Mr. Clark stressed, and to act swiftly and decisively if the program appeared to be going off track. By the end of the proposed arrangement, Fund credit outstanding to Jamaica under tranche policies would amount to 376 percent of quota and, when drawings under the special facilities were included, debt to the Fund would represent almost one third of GDP. As the staff's medium-term projections indicated, it would be several years before Jamaica could hope to reach a sustainable external position. It would be important for the Fund to provide support by making its resources available, although net new credit would have to be limited. For all those reasons, the level of access proposed was entirely appropriate.

Commenting on fiscal policy, Mr. Clark agreed with the staff that Jamaica's problems were rooted in the highly expansionary policies of the 1970s, which, as experience over the past few years had shown, had proved

extremely difficult to reverse. The central government budget deficit had averaged more than 16 percent of GDP in the past four years--reaching a disturbing 17.5 percent of GDP in 1983/84--a level that had been maintained only by excessive recourse to foreign and domestic borrowing. He welcomed the authorities' intention to cut the deficit by more than half to 7.5 percent of GDP in 1984/85, a substantial and courageous commitment. However, it was surprising that the budget that the authorities had put forward one week before the original Executive Board meeting had been scheduled had not been fully consistent with the measures envisaged in the program, even after allowing for the failure of the bauxite sales to materialize. The corrective measures that the authorities had taken were welcome, and it was encouraging that a safety margin had been allowed for in the projections.

The fiscal deficit would have to be reduced further in future years, Mr. Clark observed. The larger part of the reduction in 1984/85 would take place through revenue measures, bringing the tax burden in Jamaica to historically high levels. Future emphasis would have to be on current expenditure in order to reverse the rising trend of recent years. The heavy burden of debt service represented almost one third of current expenditure, implying that much of the adjustment would have to fall on wages and salaries. As for the rest of the public sector, the improvement in the overall balance of the parastatals was encouraging but it had been largely due to cuts in capital expenditure. The operating balance had worsened significantly, as a result of the maintenance of the prices of imported foods at predevaluation levels. While the political difficulties were understandable, it was essential that the pressure on the fiscal deficit and on the current account should be reduced; he welcomed the authorities' commitment to phase out subsidies by 1985/86. He also welcomed the substantial pricing measures taken in the budget; it would be important to ensure that public enterprise prices in general were fully adjusted to take account of future exchange rate developments.

He strongly endorsed the staff's view that real wage restraint would be essential if inflation and balance of payments pressures were to be held down, Mr. Clark stated, and if the high level of unemployment was to be reduced. The authorities' target of 15 percent wage increases in the private sector might prove difficult to achieve with inflation projected at 20 percent, especially given the experience of the previous two years and the 17 percent increase in wages in the public sector. He welcomed the authorities' commitment to keep public sector wages in the medium term at or preferably below the rate of inflation. Such restraint should be maintained in the private sector as well.

The policies that the authorities had followed in the monetary area in the past year had been much looser than required, Mr. Clark commented. They had led to a worsening of both the current and capital accounts and to a resurgence of inflation. It was encouraging that a number of the previous year's measures had been reversed and that the authorities now intended to follow a tight monetary policy. The 2 percent increase in interest rates in February was welcome, although rates continued to be

substantially negative in real terms and would become more negative later in 1984 if inflation increased as projected. Given the need to encourage private savings which, at 7 percent of GDP, were low, and to discourage capital outflows, he urged the authorities to increase interest rates. That area should be covered thoroughly in the first review under the program.

Although the current account deficit had fallen by about 10 percent of GDP in 1983/84, even including grants, it remained at a high level, Mr. Clark remarked, and well above the program target, despite the imposition of import restrictions and largely as the result of excessively expansionary demand management policies. The auction system for foreign exchange introduced in December 1983 had not operated satisfactorily and external arrears had increased to almost 20 percent of GDP. The planned reduction in the current account deficit would require not only the tight demand management policies envisaged, but also the effective operation of the new auction system for foreign exchange. It would be especially important that the authorities should allow the rate to move freely. It was encouraging that the system appeared to be working well so far; he welcomed the establishment of a forward exchange market. The reduction in the coverage of the import restrictions introduced in 1983 was also a welcome addition to exchange policy; it would allow the market to reflect the demand and supply for foreign exchange more efficiently. The authorities intended to phase out the remaining restrictions over the next two years. That policy would have the added advantage of further encouraging private direct investment, which could play an important role in covering the financing gaps projected for the rest of the decade.

The medium-term prospects, shown in the staff's projections, appeared difficult, Mr. Clark added, even on the optimistic assumption of a 14 percent increase in exports in dollar terms each year until 1990. Continuing international financial assistance would probably be needed until the end of the decade. Much would depend on the level of bauxite exports and interest rates, where sensitivity analysis would have been useful.

With regard to the request for a purchase under the compensatory financing facility, Mr. Clark remarked, Jamaica met the criteria of balance of payments need and of cooperation with the Fund. The weak world price and demand for bauxite and alumina made it clear that the shortfall had been beyond the authorities' control; he could support the proposed drawing.

However, two additional general points, not specifically related to Jamaica, deserved consideration, Mr. Clark suggested. First, it would be helpful if the staff could clarify present policy with respect to financing arrangements and conditional approval of programs. In the case of Jamaica, an important part of the financing picture--not just the short-term liabilities mentioned in the revised decision--apparently still had to be put in place. In the circumstances, would it not have been more appropriate to grant approval in principle, with broad conditions? Second, the four-week rule for the advance circulation to the Executive

Board of papers dealing with programs was applied flexibly, and Directors often received supplementary material much closer to Executive Board meetings. However, in a number of recent instances--for example, with regard to the financing arrangements for Morocco, the fiscal measures in Peru, and the aid position for Sudan--material changes had been reported to the Executive Board very shortly before or even at the Board meeting at which a proposal was to be discussed. Jamaica provided another instance. It was difficult to assess such last minute changes properly; they did not make for effective scrutiny of programs by the Executive Board.

Mr. Angeloni said that the recent history and present situation of the Jamaican economy had been appropriately described by the staff as resulting from a mix of unfavorable external circumstances and policy errors. On the one hand, the effort to revitalize economic activity that had been central to the program started in 1981 had been jeopardized by the unexpected depth of the international recession, which had adversely affected Jamaica's trade flows and external accounts, and which had indirectly hit government finances. On the other hand, economic policies had not been consistent with the need to contain and to finance those imbalances; overappreciation of the real exchange rate and sharply negative real interest rates in 1983 had been crucial in producing a wide gap in the foreign capital account and a greater than expected recourse to monetary financing of the public sector deficit.

After a decade of difficulties and of continuing use of Fund resources, the policies agreed under the proposed arrangement, together with better world economic conditions, appeared to offer a more promising basis for economic adjustment, Mr. Angeloni continued. He could, therefore, support the proposed decisions; the limited amount of the arrangement was particularly appropriate in light of the possible need for further assistance.

With regard to the public sector deficit, Mr. Angeloni remarked, little improvement--1.9 percent of GDP according to the revised estimates--could be expected on the expenditure side, particularly because of the effect of redundancy payments on the wage bill. If those payments were taken into account, average labor costs in real terms would tend to rise soon after the reduction in employment, limiting the beneficial effect on public finances and the flexibility of fiscal policy. Attention to that point would be advisable during the course of subsequent wage negotiations in the public sector.

The projected expansion of central government revenues was substantial, Mr. Angeloni added, and the contribution of the new tax measures was welcome. However, the data in Table 1 of EBS/84/101, Supplement 1, indicated that a large part of the revenue increase would be provided by the bauxite levy; under the new levy regime, the projected increase would have to be based on a strong expansion in the domestic currency value of exports. In view of the importance of that factor for many aspects of the program, he invited the staff to say what part of the increase in revenue might reflect export growth in U.S. dollar terms rather than exchange

rate depreciation, what degree of uncertainty could be attached to the projected 17.2 percent increase in export volume, and how much of that increase would be accounted for by growth in the size of the market rather than in Jamaica's share of the market.

The financing of the public sector deficit was also important, Mr. Angeloni stated. The data in Tables 5 and 6 of EBS/84/101 indicated a pronounced increase in external borrowing and a related strong reduction in financing of the public sector by the Bank of Jamaica. That policy was clearly consistent with the need to tighten monetary conditions in the short run, and to increase foreign exchange reserves, but it did not eliminate the necessity of developing an adequate market for securities in the medium term in order that the public sector deficit could be financed from domestic nonmonetary sources. Although, in principle, the international mobility of capital should make the creation of domestic and foreign debt equivalent in real terms, domestic financing was likely to allow in practice a greater degree of policy autonomy and flexibility. The growth of the ratio of financial assets to GDP, particularly the sharp rise in the private sector's holdings of savings deposits in recent years, suggested that there might be opportunities for further development of the domestic capital market.

Mr. Finaish said that the staff's analysis of the performance of the Jamaican economy over the past three years clearly indicated a difficult situation. Performance under the previous extended arrangement had been well below expectations. Although there had been a few signs of improvement in the first year of the program, the rapid deterioration in the fiscal position during the second and third years aggravated the weakness of the balance of payments and contributed to the rapid accumulation of external payments arrears. While some of those developments had been attributed to adverse exogenous factors, the staff had also pointed to the inadequacy of policy responses and program implementation. The nonobservance of a number of performance criteria had been reflected in Jamaica's inability to purchase the remaining SDR 74.9 million under the arrangement.

The new program was one in a series of stand-by and extended arrangements, in addition to seven previous purchases under the compensatory financing facility, that had involved a relatively large use of Fund resources since 1973, particularly when measured in per capita terms, Mr. Finaish continued. The program's main objective was to produce a turnaround in the balance of payments through strict fiscal discipline, a relatively large increase in exports, and a considerable increase in capital inflows in 1984/85, with sustained inflows thereafter.

On the fiscal side, Mr. Finaish went on, the expectation was that the central government deficit as a percentage of GDP, would be reduced by half within one year. In the letter of intent, the sharp fiscal adjustment was expected to be underpinned by two programs designed to increase budget revenues and to reduce expenditures. Some of the measures involved, such as the "slimming of the bureaucracy," the attrition of government posts, and the removal of all existing job vacancies, had already been

introduced; they should result in some savings. The other measures aimed at reducing expenditures and at raising tax revenues. However, in view of the experience of the past few years, those measures might not be adequate and further adjustment might be needed if the attainment of the rather ambitious fiscal objective were to be threatened.

With respect to the receipts from exports and travel, the projections in Table 8 of EBS/84/101 assumed a recovery in those earnings at an average annual rate of 16 percent in 1984 and 1985, Mr. Finaish observed. In spite of assurances regarding the resumption of bauxite and alumina exports to Jamaica's major customers, there was still a risk that the projected increases might be on the optimistic side, particularly for 1985, in view of the volatility in prices of those commodities and developments in the market in recent years. The authorities' stated medium-term objective was to diversify not only Jamaica's export markets but also the composition of its exports. However, the projections in Table 8 showed that exports of bauxite, which had represented 64 percent of the country's total exports in 1983/84, were projected to account for about the same portion of total merchandise exports by the end of the decade. He invited the staff to comment further on the diversification strategy and its timetable.

As for capital flows, Mr. Finaish noted that the turnaround in the overall balance of payments position in 1984/85 depended heavily on a substantial change in the capital account. Achieving that objective could hardly be dissociated from the restoration of creditors' confidence in the economy. As the staff stated, "the loss of confidence that has been engendered by the inadequacy of the adjustment has made the country's economic situation even more difficult" in recent years. The reversal of that development would be difficult to achieve without the elimination of external arrears to bilateral creditors, some of whom were members of his constituency. Furthermore, it was important to settle without delay external financial obligations to multilateral and regional development organizations, such as the OPEC Fund. The ability of such organizations to provide assistance on a revolving basis to needy and deserving countries depended crucially on timely repayment by borrowers.

Taking up the request for a purchase under the compensatory financing facility, Mr. Finaish remarked that Jamaica's proposed drawing was its eighth since the early 1970s. Such a large incidence of calculated shortfalls was, of course, statistically possible, given the fact that the estimation of a shortfall depended to a large degree on export projections, which might prove to be too high. It would be interesting, however, if the staff could say how many of the seven previous estimated shortfalls had actually materialized.

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

4. SUDAN - STAND-BY ARRANGEMENT - EFFECTIVE DATE

The Chairman recalled that on April 30, 1984, the Executive Board had approved in principle a stand-by arrangement with Sudan, to become effective not later than May 31, 1984, provided that the Fund found that satisfactory arrangements had been made to finance the uncovered gap in Sudan's balance of payments for 1984 (EBS/84/83, 4/11/84; Sup. 1, 4/23/84; and Sup. 2, 5/11/84; EBM/84/69, 4/30/84). While substantial progress had been made toward achievement of that objective, the gap had remained partially uncovered on May 31, at which time the Executive Board had agreed to grant Sudan a one-week extension until June 7, 1984 (EBS/84/83, Sup. 3, 5/31/84). Although the financing gap had been further reduced during the intervening week, it had not been fully covered--about $30 million of financing remained to be secured--but there was a reasonable prospect that it would be covered within the next few days. Therefore, a proposal to extend the deadline to June 15 had been distributed to Executive Directors so that Sudan could conclude the necessary arrangements (EBS/84/83, Sup. 3, 5/31/84). He asked Executive Directors to agree to take a decision to that effect on a lapse-of-time basis by the close of business that day, June 8, 1984. 1/

The Executive Directors agreed to the Chairman's proposal.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/84/88 (6/6/84) and EBM/84/89 (6/8/84).

5. JOINT COMMITTEE ON REMUNERATION OF EXECUTIVE DIRECTORS - SUBMISSION OF REPORT TO BOARD OF GOVERNORS

1. Section 14(e)(ii) of the By-Laws states that Reports of the standing Joint Committee on the Remuneration of Executive Directors and their Alternates shall be submitted to the Board of Governors for a vote on any recommendations contained therein without meeting, in accordance with Section 13 of the By-Laws.

2. The Board of Governors is therefore requested to vote upon the recommendations of this Committee without meeting, pursuant to Section 13 of the By-Laws of the Fund.

3. The Secretary is authorized and directed to send on Friday, June 8, 1984, to each member of the Fund by airmail or other rapid means of communication the following letter of

1/ See EBS/84/83, Supplement 4, 6/8/84; Decision recorded in minutes of EBM/84/91 (6/13/84).

transmittal, together with the Report of the standing Joint Committee to the Board of Governors:

> The standing Joint Committee on the Remuneration of Executive Directors and their Alternates has adopted a Report and recommendations to be submitted to the Board of Governors. At the request of the Joint Committee, I am transmitting its Report and recommendations herewith. The Joint Committee neither discussed with nor disclosed to Executive Directors its Report and recommendations prior to their transmittal to the Governors.
>
> The Board of Governors has been requested to vote without meeting, pursuant to Section 13 of the By-Laws of the Fund, on the Resolution attached to the Report. The Executive Board has decided, pursuant to Section 13(d) of the By-Laws, that no Governor shall vote on the Resolution until June 15, 1984.
>
> To be valid, votes on the Resolution must be cast by Governors or Alternate Governors and must be received at the seat of the Fund on or after Friday, June 15, 1984, but not later than Monday, July 16, 1984. Votes received before June 15, 1984, or after 6 p.m., Washington time on July 16, 1984, will not be counted.
>
> It would be appreciated if you would transmit the Report to the Governor of the Fund representing your country with the request that he vote on the Resolution attached to the Report. No particular form of vote is required, so long as the Fund receives a clear indication as to whether the Governor approves or disapproves the proposed Resolution; such communication should be signed by the Governor or Alternate Governor or there should be a clear indication that he has given instructions that his vote be transmitted by the sender.

4. All votes cast pursuant to this decision on the proposed Resolution shall be held in the custody of the Secretary until counted. As soon as practicable after the poll is concluded, the Secretary shall canvass the votes on the proposed Resolution and report thereon to the Executive Board. Any Executive Director may challenge the Report or the status of any vote counted or disqualified, in which case the Executive Board determines the result of the vote.

5. The effective date of the Resolution of the Board of Governors shall be the last day allowed for voting.

6. The Secretary is authorized to take such further action as he shall deem necessary or appropriate in order to carry out the purposes of this decision.

Adopted June 6, 1984

6. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 84/10 through 84/13 are approved. (EBD/84/158, 5/31/84)

Adopted June 6, 1984

7. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/84/124 (6/6/84) and Correction 1 (6/7/84) is approved.

APPROVED: January 22, 1985

LEO VAN HOUTVEN
Secretary