INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 84/86

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

R. D. Erb, Acting Chairman

Executive Directors	Alternate Executive Directors
	J. K. Orleans-Lindsay, Temporary
	H. G. Schneider
	G. E. L. Nguyen, Temporary
	M. A. Weitz, Temporary
	D. C. Templeman, Temporary
	M. B. Chatah, Temporary
	T. Yamashita
	Jaafar A.
	L. Leonard
A. Kafka	C. Robalino
	W. Moerke, Temporary
	N. Coumbis
	V. Govindarajan, Temporary
	S. El-Khouri, Temporary
	L. Ionescu, Temporary
	K. G. Morrell
	H. Alaoui-Abdallaoui, Temporary
	E. I. M. Mtei
	J. L. Feito
	I. Fridriksson, Temporary
	D. J. Robinson, Temporary
	Wang E.

L. Van Houtven, Secretary
R. S. Franklin, Assistant

Also Present

B. Legarda, Consultant. Exchange and Trade Relations Department: W. A. Beveridge, Deputy Director; S. Kanesa-Thasan. IMF Institute: E. Joseph, L. Lebrun, Participants. Legal Department: J. K. Oh. Secretary's Department: J. W. Lang, Jr., Deputy Secretary. Western Hemisphere Department: J.-P. Amselle, M. Caiola, M. A. Da Costa, P. Ewenczyk, H. E. Khor, M. C. Spinola, S. J. Stephens, G. L. Terrier, G. Yadav. Advisors to Executive Directors: H. A. Arias, Y. Okubo. Assistants to Executive Directors: J. M. Jones, G. W. K. Pickering, Wang C. Y.

1. DEPUTY MANAGING DIRECTOR

Mr. Kafka, speaking on behalf of his colleagues, welcomed Mr. Richard Erb in his new role as Deputy Managing Director of the Fund.

The Deputy Managing Director and Acting Chairman, after thanking Mr. Kafka for his welcome, reminded the Executive Directors that the Managing Director was scheduled to speak during the day at a monetary conference in Philadelphia; copies of the speech that he planned to give had been circulated to Directors. Also, the Managing Director would be meeting with the Commercial Bank Advisory Committee for Mexico. As the Managing Director had indicated in his speech, he believed there would be several advantages to a longer time frame for bank rescheduling arrangements for countries that had made or were making substantial progress toward adjustment; and the Advisory Committee would apparently be discussing the possibility of a multiyear debt rescheduling exercise for Mexico.

2. ST. LUCIA - 1984 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1984 Article IV consultation with St. Lucia (SM/84/86, 4/24/84; and Sup. 1, 6/1/84). They also had before them a report on recent economic developments in St. Lucia (SM/84/105, 5/11/84).

The staff representative from the Western Hemisphere Department, commenting on the nature of the information in the supplement to SM/84/86, recalled that, when the budget document had been received at Fund headquarters, it had been necessary for the staff to seek clarification from the authorities on some items. The staff had felt that an effort to ensure an overall deficit of no more than 2 percent of GDP in FY 1984/85 was the minimum the authorities should do to strengthen government finances. In order to achieve such an improvement, the authorities would need to hold current expenditure during the fiscal year at approximately the previous year's level, and the staff had suggested that one way to do so would be to avoid any increase in civil service pay. However, the budget contemplated a civil service wage increase of up to 7 percent, a provision that, if enacted, would contribute to a widening of the projected overall deficit.

On a related matter, as far as the staff had been able to determine, not all the resources to finance the deficit had yet been secured, the staff representative remarked. Equally important, no provision had yet been made for the elimination or reduction of outstanding arrears. In that respect, the authorities had requested--and the Fund had agreed to provide--technical assistance in the compiling of data on outstanding arrears, with a view toward their possible elimination. It was clear to the staff and the authorities that, given the unfinanced budget deficit, the problem of arrears could be exacerbated if the authorities did not strengthen expenditure control.

Mr. Leonard made the following statement:

The previous Board discussion of the Article IV consultation with St. Lucia was in June 1983. Since then, the economy of the island has progressed favorably on a number of fronts:

GDP grew in 1983 at about the same rate as in the previous year and is expected to accelerate strongly to about 6 percent in 1984.

The agricultural sector has further strengthened, following the good recovery in 1982 from the low levels of output in the first years of the decade. Manufacturing output is expanding steadily at a rate that has varied between 14 percent and 18 percent a year since 1979. Its importance in the economy is increasing and, in 1984, it is expected to make a major contribution to the rise in national output, along with construction, which is picking up after a weak performance in 1983 when the Hess Oil terminal was completed. Tourist-related activities also show a useful, if not striking, rate of growth.

There has been a remarkable slowdown in the rate of inflation, with a fall in the rate of consumer price increase from 19.6 percent in 1980 to 15 percent in 1981 and 1.5 percent in 1983. The downward movement reflects both trends in import prices and a decline in domestic food prices in 1982 and 1983.

The current deficit on the external account, which stood at about 28 percent of GDP in 1982, fell to less than 13 percent in 1983, while in both years the overall account was close to balance. Higher merchandise exports and a falloff in imports because of reduced domestic demand accounted for the narrowing of the current deficit.

Lack of data prevents precise discussion of labor market trends, but it is clear that progress in the provision of sustainable jobs is not yet satisfactory and that unemployment is high at over one fifth of the labor force.

Consolidation and expansion of the gains in the real economy depend on further exploitation of the island's agricultural, tourist, and manufacturing potential. In this regard, the authorities are in general agreement with the staff on what is required for the good management of the economy in the period ahead.

As well as remedying a number of weaknesses in the fiscal area, it is the Government's objective to reduce the burden of the public sector on the rest of the economy. In its structural aspects, this will take time and can be expected to come about, in part, as a result of the expansion of the private sector, which is being encouraged by the Government; and this should ease political pressure for public sector job creation. Even in the long run, however, the relative size of the public sector in St. Lucia, as in other small island states, is likely to remain higher than in other larger states at about the same level of development because of diseconomies in the cost of administering a population of only 125,000.

As to immediate action to contain the public sector burden, the Government has ruled out the adoption of new tax measures over the next two fiscal years. Room will accordingly have to be found for the realization of other fiscal objectives through revenue buoyancy, administrative efficiency, and cutting back on low-priority expenditure. Objectives that have to be accommodated in this way include the conversion of the small current budget deficits of recent years to currency savings, the elimination of arrears, and increasing the scope for discretionary spending by the Government.

The Government's 1984/85 budget has been drawn up in line with these objectives. No new taxation is being imposed, but tax revenue as a proportion of GDP will rise by about 1 1/4 percentage points as a result of better collection measures. At the same time, expenditure as a share of GDP is being slightly reduced so that overall current savings of about 1 1/2 percent of GDP should result and should be available to meet other commitments.

The accrual of any additional arrears will be avoided through careful management of cash flows and tight expenditure control. The legacy of debts from earlier in the decade is being sorted into its components of debts due by the Government to public sector entities, commercial arrears in the true sense, and debts that should be more properly seen as short-term trade credits. Consideration is being given to meeting public sector liabilities through a bond issue while other arrears will be paid off as quickly as possible from budgetary revenues. As noted in the supplementary staff paper, Fund technical assistance is being sought in cash-flow and expenditure management and in dealing with arrears.

Public sector pay accounts for over 55 percent of current government expenditure. Continued restraint in pay levels and in recruitment to the public service is vital for the success of the Government's fiscal strategy. In 1983, the Government was able to impose a moratorium on pay increases for the period to April 1984. Current negotiations on the arrangements to follow the moratorium are now under way. The Government faces the possibility of labor unrest and a setback to the good labor relations needed for industrial development if pay expectations, even though in some respects they may be unrealistic, are too bluntly disappointed. In conducting the negotiations, the Government has to have regard to this factor while seeking the low level of increase that the fiscal position and the general circumstances of the economy require. In particular the budgetary outcome could be favorably affected and further savings achieved if the Government has a reasonable degree of success in its negotiating aims.

The generation of a current budget surplus is part of a wider government attempt to stimulate national savings. At present, domestic consumption expenditure is the equivalent of nearly 90 percent of GDP, so that investment, which in recent years has averaged over 40 percent of GDP, is mainly financed externally. Moreover, the execution of certain projects for which external finance is available has hitherto been impeded by the lack of domestic counterpart funds. It is hoped that, with greater domestic savings resulting from the Government's efforts and positive interest rates, it will be possible for these projects to proceed and for other major infrastructural investments for which donor finance is being sought to be completed.

The authorities of St. Lucia have asked me to express their thanks for the valuable work done by the Fund mission in the course of the consultation and the helpful papers that have resulted from it. The advice given by the mission and its sensitivity to the problems of the island are greatly appreciated.

Mr. Robinson, endorsing the staff appraisal, noted that St. Lucia's authorities had made considerable progress in a number of areas in 1983. Inflation had fallen sharply, in line with that in the United States, to the low level of 1.5 percent; tight control of current expenditures--including the freeze on civil service wages and an improvement in the performance of the parastatals--had resulted in a reduction in the overall public sector deficit equivalent to 5 percent of GDP; exports had increased by 19 percent; and, while the 2 percent increase in real GDP had been modest by historical standards, a strong revival in private sector activity and a real growth rate of 5-6 percent were in prospect for 1984.

Despite the substantial improvements in 1983, the Central Government's use of domestic bank credit remained high and domestic arrears continued to grow, Mr. Robinson remarked. In the circumstances, a futher strengthening of the fiscal position and an early move toward the achievement of the Government's target of public sector savings equivalent to 10 percent of current revenues were essential. The increase in the fiscal deficit to 6 percent of GDP announced in the budget--which was three times higher than the staff's proposal--was therefore worrying, especially since it included a financing gap of nearly 1.5 percent of GDP. The proposed rise in public savings to 1.5 percent of GDP was a welcome step toward the Government's targets, but it seemed to be dependent on a 13 percent rise in revenues which, if he had understood Mr. Leonard correctly, was expected to come about largely through improvements in tax collection. He would welcome further elaboration on the possibility of such improvements.

The problems he had mentioned highlighted the importance of continued public sector wage restraint, Mr. Robinson commented. Like the staff, he was concerned that the prospective settlement of a 7 percent increase in 1984/85 could prove too high, especially given the current low level of inflation. It was worth noting in that context that, despite the wage freeze in 1983, salaries for established civil servants had risen by 37 percent since October 1980, and the wages of daily paid workers had risen by even more; at the same time, prices had increased by only about 25 percent. High wage raises in the public sector would send the wrong signals to the private sector, where wages generally rose faster. Although private sector wage increases had been smaller in recent years, they had nonetheless represented substantial increases in real terms. In combination with the appreciation of the Eastern Caribbean dollar, those increases had had serious implications for competitiveness and must be an important factor in the continuing high level of unemployment. In addition, excessive increases in wages would deter foreign investment, and he therefore agreed with the staff that the authorities' guideline of a 10 percent upper limit on wage settlements in the private sector was too high and should be reduced.

The level of domestic arrears, which had been used to finance the budget deficit in four of the past five years, was also of concern, Mr. Robinson continued. Roughly calculated, the buildup of arrears since 1979 had amounted to 5 percent of 1983 GDP, or about one eighth of annual revenue. Although that amount might not all be arrears in the true sense of the word, as Mr. Leonard had noted in his statment, the total was nonetheless worrying. Arrears to the private sector were not only undesirable in themselves, they also denied resources to the private sector just as much as did excessive use of bank credit. He observed from Appendix C of SM/84/105 that, in the public sector, central government arrears to the parastatals had not only led to serious liquidity problems but had also directly resulted in a buildup of further arrears between the parastatals themselves. He was therefore happy to see that the authorities had begun the process of producing a definitive list of arrears by creditor and were intending to take measures to prevent in future the tendency to resort to borrowing as a means of deficit financing. He hoped that it would soon be possible to formulate a timetable for the complete elimination of arrears as a matter of priority; perhaps Fund assistance would prove helpful in that endeavor.

He welcomed the steps the authorities had taken to reduce the level of subsidies and transfers, which had increased to 6 percent of GDP in 1983, and particularly the proposed measures to limit transfers to Castries City Council, Mr. Robinson commented. As shown in Table 29 of SM/84/105, transfers since 1979 had increased from one third to two thirds of the Council's total revenue. Over the same period, the Council's cash deficit had quadrupled, and it had also run up domestic arrears.

He shared the staff's concern about the growing proportion of statutory and contractual obligations in current expenditure, Mr. Robinson said. Given the limited potential for monetary and exchange rate action, it was clearly important to maintain maximum flexibility in fiscal policy, which again highlighted the need to restrain wages and reduce transfers and subsidies. On monetary policy, he had been happy to note that interest rates were currently at more realistic levels, which should not only strengthen domestic savings but should also encourage depositors to keep their money in St. Lucia.

Commenting on external policy, Mr. Robinson observed that the sharp reduction in the current account deficit had been due to a great extent to the completion of the Hess transshipment terminal and had been offset by a corresponding reduction in private capital inflows. The 19 percent increase in exports had been most encouraging, with bananas and clothing doing particularly well, but he shared the authorities' concern that the 13 percent appreciation of the Eastern Caribbean dollar since 1979 might have adverse implications for St. Lucia; in particular, it might hinder nontraditional exports and the effort toward diversification. He would be interested in knowing where the proposal that the East Caribbean Central Bank should conduct a study of the effects of the appreciation stood at present. Such a study could be a useful adjunct to a one-time surveillance exercise by the Fund on the prospects of the East Caribbean Central Bank members as a group. Finally, the authorities' willingness to encourage private direct investment had continued to pay dividends; he was pleased to note from the staff report that, with the completion of the Hess terminal, further projects were in prospect.

The staff representative from the Western Hemisphere Department said that the differences between the estimates for revenue put forward by the staff and those by the authorities were in part due to the fact that the authorities had been working with more recent data. Of course, differences in assumptions existed as well. For example, the staff continued to have some reservations about the extent to which tax revenues could be substantially increased through administrative efforts, while the authorities in St. Lucia were confident that there existed pockets of outstanding income tax arrears that could be tapped for revenues in the current year. On another matter, the study by the East Caribbean Central Bank on the effects of the appreciation of the Eastern Caribbean dollar since 1979 was under way, and the Fund was playing its part by providing the Central Bank with technical assistance.

Mr. Leonard agreed that the potential for an undesirable drift of policy did exist in St. Lucia; Mr. Robinson had appropriately made reference in that respect to the Government's use of bank credit and to the importance of resisting public sector pay increases. However, it should be noted that information on wages in St. Lucia was patchy at best; it had frequently turned out in the past that, what had appeared to be sizable pay increases--in percentage terms--had been provided mainly to very low-paid workers and had not been indicative of wage movements generally. Moreover, pay levels in St. Lucia, compared with those in other areas, were low enough to allow a good deal of margin for competitiveness. Indeed, he understood from a recent survey of investors and potential investors in the Caribbean area that pay was not the primary incentive for investment in the islands; good labor relations and incentives of other sorts were more important factors influencing the decisions of investors. That was not to say that pay levels should not be monitored; if they were to move seriously out of line with developments in pay elsewhere in the area, competitiveness and the growth of manufacturing on the island could be endangered.

With regard to questions on arrears, Mr. Leonard said that he was pleased to note that no new arrears were envisaged for the current fiscal year. And his authorities were well aware of the importance of eliminating the existing arrears, which had accumulated over time.

Ways of improving the administration of such quasi-governmental bodies as the Castries City Council were called for, Mr. Leonard continued. The authorities were in the process of working toward that end and examining how the revenues of the Castries City Council could be improved so that it would not be so much of a drain on central government finances in future. Most governments had to face the problem posed by the high proportion of revenues already pledged in the form of statutory or contractual obligations. In fact, in Western Europe and elsewhere, countries usually found that 95 percent of their expenditures in any given year had been pledged beforehand; and if that problem was going to be tackled, a medium-term perspective would have to be adopted.

It was disappointing that savings on current account had not been as great as expected by the staff during the consultations, Mr. Leonard remarked. However, information that had become available since that time indicated that the sort of adjustment envisaged during the discussions was scarcely feasible. The authorities had made a good start in meeting their difficulties and had included a number of good measures in the budget; even if none of the measures went quite as far as had been hoped, they were certainly an indication of the readiness of the authorities to move in the direction expected of them.

The Acting Chairman made the following summing up:

> Executive Directors were generally in agreement with the staff appraisal contained in the report for the 1984 consultation discussions with St. Lucia. They noted that St. Lucia's economy had recovered from the setback caused by the hurricane in 1980, and that domestic inflation had slowed in the past two years in response to both an abatement in domestic demand pressures and the slowing down in the rate of price increases of imported goods. Directors welcomed the favorable economic prospects and agreed that the projected strong revival in private sector activity could contribute to a speedup in the rate of growth in 1984 and to an easing of unemployment pressures.
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> Directors suggested, however, that the reduction of unemployment and the maintenance of a viable balance of payments were contingent on the pursuit by the Government of St. Lucia of firmer policies in

the fiscal and wage areas, action that was particularly important in view of the constraints on exchange rate policy deriving from St. Lucia's membership in the East Caribbean Central Bank. In that respect, Directors expressed concern that the new budget estimates for the Central Government showed a prospective deterioration in the overall deficit. The authorities were encouraged to tighten fiscal policy without delay, including the taking of additional action on transfer payments.

Directors commended the authorities for the firm stand taken on civil service wages and salaries in FY 1983/84 and strongly urged the authorities to continue the same degree of restraint in the current fiscal year. They expressed grave concern about the effects of the civil service wage proposal on the public finance and labor costs in general, given the country's competitive position.

In the view of Directors, public finances and administration--which had improved over the past two fiscal years--remained weak; the accumulation of payments arrears was of particular concern, as was the weakening of the public sector wage policy. Directors therefore felt that it was crucial that every effort be made to reduce significantly the overall public sector deficit in the current fiscal year and to eliminate outstanding arrears. In the latter connection, they supported St. Lucia's request for short-term technical assistance from the Fund.

Directors also welcomed St. Lucia's initiative in requesting the East Caribbean Central Bank to study the implications of the real appreciation of the Eastern Caribbean dollar for St. Lucia and other member countries of the Central Bank.

It is expected that the next Article IV consultation with St. Lucia will be held before December 1985.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/84/85 (6/1/84) and EBM/84/86 (6/4/84).

3. SUDAN - STAND-BY ARRANGEMENT - POSTPONEMENT OF EFFECTIVE DATE

1. The Government of Sudan has requested a stand-by arrangement for a period of one year for an amount equivalent to SDR 90 million.

2. The Fund approves the stand-by arrangement set forth in EBS/84/83, Supplement 2, subject to paragraph 3 below, and waives the limitation in Article V, Section 3(b)(iii).

3. The stand-by arrangement set forth in EBS/84/83, Supplement 2 shall become effective on the date, but not later than June 7, 1984, on which the Fund finds that satisfactory arrangements have been made to finance the uncovered gap in Sudan's balance of payments in 1984.

Decision No. 7716-(84/86), adopted
June 1, 1984

4. ADMINISTRATIVE BUDGET FOR FY 1984 - ACTUAL EXPENSES AND TRANSFER OF APPROPRIATIONS

The Executive Board approves the report on actual expenses in FY 1984 and the proposal for a transfer of appropriations, as set forth in the memorandum attached to EBAP/84/115 (5/29/84).

Adopted June 1, 1984

5. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 84/8 and 84/9 are approved. (EBD/84/153, 5/25/84)

Adopted June 1, 1984

APPROVED: January 4, 1985

LEO VAN HOUTVEN
Secretary