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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 84/87

10:00 a.m., June 6, 1984

J. de Larosière, Chairman

Executive Directors	Alternate Executive Directors
	W. B. Tshishimbi
	H. G. Schneider
B. de Maulde	X. Blandin
	J. Delgadillo, Temporary
	M. K. Bush
M. Finaish	T. Alhaimus
	H. Kobayashi, Temporary
	Jaafar A.
R. K. Joyce	L. Leonard
	C. Robalino
G. Laske	G. Grosche
	I. Angeloni, Temporary
	A. S. Jayawardena
	J. E. Surasiry
J. J. Polak	T. de Vries
	K. G. Morrell
G. Salehkhou	O. Kabbaj
	E. I. M. Mtei
M. A. Senior	
J. Tvedt	
	T. A. Clark
Zhang Z.	Wang E.

L. Van Houtven, Secretary
C. Fairbairn, Assistant

Also Present:
R. Sapunxhiu, Alternate Executive Director, World Bank. A. Peacey, Principal Resident Representative for South Africa. European Department: L. A. Whittome, Counsellor and Director; Brian Rose, Deputy Director; J. T. Boorman, D. A. Brodsky, U. Dell'Anno, L. Hansen, W. E. Lewis, H. O. Schmitt, G. H. Spencer, R. G. Thumann, H. Vittas. Exchange and Trade Relations Department: C. D. Finch, Director; S. Mookerjee, Deputy Director; M. Guitian, Deputy Director; A. B. Petersen. External Relations Department: A. F. Mohammed, Director. Fiscal Affairs Department: A. A. Tait. Legal Department: G. P. Nicoletopoulos, Director; W. E. Holder, S. A. Silard. Research Department: W. C. Hood, Economic Counsellor and Director; T. Gudac. Secretary's Department: J. W. Lang, Jr., Deputy Secretary; A. P. Bhagwat. Western Hemisphere Department: M. E. Hardy. 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, C. J. Batliwalla, S. E. Conrado, S. El-Khouri, K. A. Hansen, L. Ionescu, W. Moerke, G. E. L. Nguyen, Y. Okubo, P. Pêterfalvy, D. I. S. Shaw. Assistants to Executive Directors: H. Alaoui-Abdallaoui, J. R. N. Almeida, M. B. Chatah, Chen J., L. E. J. M. Coene, G. Ercel, I. Fridriksson, G. Gomel, V. Govindarajan, J. M. Jones, A. K. Juusela, E. Landis, J. A. K. Munthali, G. W. K. Pickering, E. Portas, M. Rasyid, J. Reddy, D. J. Robinson, A. A. Scholten, Shao Z., A. J. Tregilgas, Wang C. Y., M. A. Weitz.

1. REPORT BY MANAGING DIRECTOR

The Chairman said that, while attending the Annual International Monetary Conference of the American Bankers' Association in Philadelphia on June 4, 1984, he had met with the senior international bankers and officials who comprised the Advisory Committee for Mexico, and had reported on Mexico's economic progress during 1983 and 1984. He had explained that the Government's adjustment program was being fully implemented and had emphasized that the impressive turnaround in the balance of payments and reserves indicated that Mexico would not require recourse to new money for 1985. This was a remarkable achievement, reflecting the strong balance of payments position following two years of severe adjustment.

However, a major problem still existed, the Chairman explained, stemming from the intense concentration of amortization payments in 1985-90, when Mexico would have to pay an average of $12 billion a year. Mexico's total debt payments would absorb such a high proportion of its export earnings that the economy would be unable to develop and expand. The solution he had proposed was a medium-term one, namely, multiyear restructuring of Mexico's debt, addressing the problem of the 1985-90 "hump." Such a solution would considerably help Mexico in regaining normal market access. Ad hoc crisis management did not provide lasting solutions to debt problems; it was important to show that the system was able to apply medium-term solutions on a case-by-case basis, as he had advocated and as the Board had suggested on a number of recent occasions.

A second reason for using a medium-term approach, the Chairman stated, was the need to demonstrate to debtor countries that good performance would be recognized in the treatment of their debt by creditors. Given the quality of economic performance by countries such as Mexico during the adjustment process, treatment of the debt problem on an annual basis appeared inappropriate. The banking community must be seen to be receptive to, and to recognize the linkages between rescheduling and adjustment. He had also pointed out the importance of providing incentives to countries whose adjustment was in an early stage or had not yet been implemented; those countries should appreciate that pursuit of the type of stabilization policies the Fund was trying to promote was beneficial.

His presentation to the Advisory Committee had been well received, the Chairman commented, and it clearly complemented ideas already held by many of the bankers. The following statement had been made public on June 5, 1984:

> Senior representatives of the commercial banks forming the Advisory Committee for Mexico met yesterday in Philadelphia to receive a report from the Managing Director of the International Monetary Fund covering Mexico's performance in the second year of its program with the Fund. On the basis of the substantial progress Mexico has made under its adjustment program, the Advisory Committee

has agreed to negotiate with the pertinent Mexican authorities specific arrangements for a rescheduling of its public sector debt on a multiyear basis compatible with its medium-term financial outlook. This multiyear approach should facilitate Mexico's plans for an early return to normal market access.

The details of the terms of the proposed negotiations had not been discussed, the Chairman added. It was not appropriate for the Fund to interfere in the finer points of creditor/debtor negotiations, but he had urged the bankers to be aware that stringent terms and conditions exacerbated balance of payments difficulties, and to recognize quality of performance in negotiating specific arrangements. Concerning the period of the rescheduling of repayments, he had advised them to consider at least the four years from 1985 to the end of 1988. He had urged that the debt be restructured on a realistic basis, compatible with the medium-term financial outlook of the country and the possibility of spontaneous financing. The Mexican authorities, with whom close contact had been maintained both prior to and during the launching of the new initiative, were pleased with the results of the meeting of the Advisory Committee.

The timing of the negotiations was difficult to predict, the Chairman said. The economic subgroup of the Advisory Committee, as part of its normal procedure, would visit Mexico at the beginning of the second week in June 1984 to review the economic situation and the medium-term prospects.

The Executive Directors took note of the Chairman's statement.

2. YUGOSLAVIA - STAND-BY ARRANGEMENT - WAIVER AND MODIFICATION OF PERFORMANCE CRITERION

The Executive Directors considered Yugoslavia's request for a waiver and modification of a performance criterion under the one-year stand-by arrangement approved on April 18, 1984 (EBS/84/118, 5/29/84).

The Director of the European Department stated that the staff had been informed on June 5, 1984 of price increases for petroleum products and railroad tariffs in excess of the minimum that would have been required by the end of June under the terms of the stand-by arrangement.

Mr. Polak made the following statement:

The stand-by arrangement that was approved by this Board on April 18, 1984 provided for a substantial liberalization of prices, which was intended to undo the effects of the price freeze introduced in late 1983 and to go beyond this by raising the area free of price controls, which had been 45 percent of output before the freeze, to 55 percent of output. This action was to be taken on May 1 and the first drawing made conditional on this performance criterion being met.

> It is a reflection of the widespread and persistent fear of inflation by the Yugoslav authorities and, even more so, by the Yugoslav public, that this performance criterion was not fully met. Although the 55 percent target was implemented, a one-month notification period for price increases was at the same time introduced for a portion of the products affected, and a number of new products were brought under direct price control. This action blocked the first drawing. The staff then immediately entered into discussions in Belgrade; this led to supplementary measures by the Yugoslav authorities, and to the supplementary letter of intent that is now before the Board.
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> The most important of the measures is that the notification requirement will apply for a short transitional period only, until the end of August 1984. With these changes, and with other performance criteria fulfilled, the staff is of the opinion that the program is back on track.

Mr. Joyce said that he had initially hesitated to support the waiver, since it had come so soon after approval of the stand-by arrangement, and since the first purchase had been subject to certain performance criteria that apparently had not been met by the deadline of May 1, 1984. However, closer inspection had revealed that all the performance criteria apart from the price liberalization had in fact been met. He wondered whether there had been a misunderstanding between the staff and the authorities. Why had it proved impossible or undesirable for the authorities to implement the arrangement as originally agreed? After all, the price freeze had finally been lifted on May 3--May 1 and 2 having been public holidays--and the authorities had then taken steps more pronounced in their impact than those originally envisaged, clearly showing their commitment to the program. Furthermore, as much, if not more, would be achieved under the new measures as under those originally negotiated.

The freeing of prices for natural gas, oil, and oil derivatives instead of the prices for fertilizer, wheat, flour, bread, edible oil, and milk was welcome, Mr. Joyce stated. It would give a greater impetus to structural reform than the freeing of basic food prices, despite the latter's intrinsic importance.

The introduction of the one-month lag between notification of, and the actual increases in, prices on some products was understandable, Mr. Joyce said, given the fears of inflation noted by Mr. Polak. However, the authorities' intention to abolish the lag by August 31, 1984, by which time people would be reassured that inflation would not accelerate, was welcome.

The proposal to move forward by one month the midterm review under the stand-by arrangment was also welcome, Mr. Joyce said, as it would be useful in allowing the Fund and the authorities to identify at an early date any prospective deviations from the performance criteria. He supported the proposed decision.

Mr. Laske stated that he supported the proposed decision, although he had reservations about granting a waiver and agreeing to a modification so early in the life of a stand-by arrangement. The basis for approving the arrangement had been a firm commitment by the authorities to act promptly in specified areas, including the pricing system. That their intentions had been only partially fulfilled, thus stopping the first purchase, had been regrettable, but they had then apparently implemented a more radical price liberalization scheme than originally envisaged. Its complexity made the pricing system difficult to assess.

He supported the proposal to bring forward by one month the midterm review under the program, Mr. Laske said. The review should pay particular attention to price liberalization. He hoped that such early deviation from a program would remain an isolated incident.

Ms. Bush supported the proposed waiver and modification of performance criteria, although she regretted that the action was necessary so early in the program. The proposed pricing measures were adequate substitutes for the original commitments. The authorities' fear of an acceleration in inflation was understandable, and the temporary one-month notification period for price increases was acceptable. However, she emphasized the importance both of the authorities' cooperation in providing detailed information on price developments so that the staff could assess the way in which measures were being implemented, and of the prospects for greater market influence in the determination of prices in Yugoslavia. She, too, welcomed the proposal for advancing the date of the midterm review.

Mr. Jayawardena accepted the proposed decision. The announcement on June 6, 1984 of the liberalization of Yugoslav energy prices bore witness to the determination of the authorities to persist in implementing the agreed adjustment policies.

Mr. Zhang said that he accepted the draft decision. The original conditionality attached to the stand-by arrangement had perhaps been too severe.

Mr. Clark remarked that he was disappointed that a deviation from the provisions of the program had occurred within only two weeks of its approval. While he understood the reasons for the action of the Yugoslav authorities, he wondered why the problems had not been identified and resolved during the negotiations on the program. Fortunately, it had been possible to design a procedure to bring the program back on track. The midterm review would be of great importance, and he welcomed its advancement by one month; indeed, he would have been prepared to accept further advancement. Finally, he supported the proposed decision and stressed that it would be crucial to ensure that there was no further erosion of the measures or departure from their scheduled implementation.

Mr. Blandin said that he too regretted that a request for a waiver had come so soon after the stand-by arrangement's approval. However, since the program was back on track, the waiver was acceptable. The proposal for advancing the date of the midterm review was welcome.

Mr. Senior considered that the proposed decision was acceptable. Although the legislation recently passed by the Yugoslav Assembly did not completely meet the authorities' intentions expressed in the letter of intent, it would contribute to price liberalization. In particular, the prices of certain categories of goods previously subject to approval by the authorities had been freed, and the prices of certain services had been liberalized. In sum, the authorities had taken steps to meet the commitment expressed in their letter of intent.

Mr. Schneider remarked that he understood the complexity of the situation facing the Yugoslav authorities and had no difficulty in supporting the proposed decision.

Mr. Angeloni said that it would be useful to know how the shares of products subject to different prices had been calculated, and particularly the weights that had been used.

The Director of the European Department replied that the staff had used the industrial producer price index in its calculations. The staff felt that it would not be advisable to advance the midterm review by more than one month because sufficient data would not be available. In addition, an earlier date would have created timing problems because of the 1984 Annual Meetings.

The Executive Board then took the following decision:

1. Yugoslavia has consulted with the Fund in accordance with paragraph 4 of the stand-by arrangement for Yugoslavia (EBS/84/65, Sup. 1, 4/19/84) and paragraph 24 of the letter dated March 20, 1984 from the Governor of the National Bank of Yugoslavia and the Federal Secretary for Finance of Yugoslavia attached thereto.

2. The letter dated May 25, 1984 from the Governor of the National Bank of Yugoslavia and the Federal Secretary for Finance of Yugoslavia shall be attached to the stand-by arrangement for Yugoslavia, and the letter dated March 20, 1984, attached to the stand-by arrangement, shall be read as supplemented and modified by the letter of May 25, 1984.

3. Accordingly, the date for completion of the review referred to in paragraph 4e of the stand-by arrangement for Yugoslavia shall be October 31, 1984 instead of November 30, 1984.

4. The Fund finds, in light of the letter dated May 25, 1984, that, for purchases before August 31, 1984, no additional understandings are necessary concerning the nonobservance of the performance

criterion relating to the intention regarding the price freeze referred to in paragraph 4a(i) of the stand-by arrangement and that Yugoslavia may proceed to make purchases under the stand-by arrangement.

Decision No. 7717-(84/87), adopted
June 6, 1984

3. SOUTH AFRICA - 1984 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1984 Article IV consultation with South Africa (EBS/84/95, 4/30/84; and Sup. 1, 6/1/84). They also had before them a report on recent economic developments in South Africa (SM/84/112, 5/21/84).

Mr. Peacey, the Principal Resident Representative from South Africa, made the following statement:

Consideration in June last year of the previous Article IV consultation reports focused on the persistence of inflationary pressures and, concomitantly, on certain features of the labor market in South Africa. In the process of discussions, particular attention was given to the need for further action to slow the rate of monetary expansion, constrain government expenditure, and relieve shortages of "skilled labor."

The South African authorities agree with the description of economic events in my country since then and with the broad thrust of policies enunciated in the staff papers under consideration by the Executive Board. It needs no stressing, therefore, that my Government not only shares the staff concern for these aspects of the economy, but also is indeed committed to meaningful adjustment in keeping both with the demands of, and the constraints inherent in, existing conditions.

All performance criteria embodied in the 1982 stand-by arrangement were complied with, despite volatile exogenous factors. In addition, my authorities also met their undertakings with respect to the remaining surcharge on imports and made an early voluntary repurchase of part of the amount purchased under the arrangement as approved by the Board on November 3, 1982.

In his recent budget speech, the South African Minister of Finance described the country's situation as "probably the most difficult set of economic conditions in South Africa since the Great Depression of the early 1930s." Present conditions contrast strongly, of course, with those prevailing at the commencement of the last year when hopes were high of a sustainable export-led recovery based on the rising gold price, higher non-gold exports resulting from the firm economic recovery which appeared to be under way in the United States and other industrial countries, a substantial net inflow of capital, and a strengthening rand.

With the passage of time, the net downside trend in gold price fluctuations, the emergence of a considerable lag in international demand, and the renewed severe drought conditions pervading southern Africa forced the authorities reluctantly to continue with a restrictive policy stance, and, in fact, to intensify the postbudget stance. Interest rates were permitted to harden substantially, assisting the financing of the larger than anticipated budget deficit before borrowing from nonbank credit sources. The general sales tax was increased from 6 percent to 7 percent with effect from February 1, 1984.

In 1983 there was a further reduction in the 12-month inflation rate (to 10 percent in February 1984), a marked reduction in the rate of increase of the broad money supply and in its velocity of circulation, and the transformation of the previous year's large deficit on the current account of the balance of payments into a modest surplus. Although there was considerable movement on the capital account of the balance of payments, there was only a modest net capital outflow, and the net foreign reserves accordingly showed little change. However, the current account of the balance of payments weakened in the last quarter of 1983.

The budget produced at the end of March 1984 was formulated to assist in applying a conservative "mix" of fiscal and monetary policies, including high interest rates, with a view to curbing aggregate demand and total expenditure, reducing the rate of inflation, and maintaining a sound balance of payments. The budget provided for an increase in total expenditure of 11.7 percent above the 1983/84 revised estimates, additional taxation as a result of the February 1984 increase, and a deficit before borrowing of just less than 3 percent of gross domestic product, financed by nonbank credit. At the same time the importance was stressed of close control over government expenditure, public debt management, reserve bank open-market operations, appropriate funding, and effective control over the money supply and aggregate demand.

Subsequent to the budget date at the end of March 1984, the authorities perceived a further serious deterioration in the underlying economic factors affecting the economy and on which the March budget was originally drafted. They decided, consequently, as also pointed out in the supplementary staff paper circulated, to announce at the earliest possible opportunity a further fundamental fiscal measure, namely, the increase in the rate of the general sales tax from 7 percent to 10 percent, but with the exclusion of certain basic food items, in order to reduce the budget deficit and hence pressures on domestic interest rates; safeguard the balance of payments; and halt the depreciation of the rand, and, in general, step up the fight against inflation.

Notwithstanding record high real rates of interest--in the case of the prime rate of banks, in excess of 10 percent--consumer demand remained exceptionally strong and was jeopardizing the fight against inflation, the health of the balance of payments, and the prospects for a sustained recovery later this year. It was necessary to act and act soon. The new higher sales tax will apply from July 1, 1984 and is estimated to bring in some R 800 million in additional taxation during the 1984/85 fiscal year.

In the international context it is notable that despite the demographically less developed nature of the South African economy compared with the more developed West, its economic difficulties do not stem from either domestic structural stagnation or from any undue foreign debt burden.

In the latter respect, the financial authorities have for some time felt that, although lending entities regard the country as having graduated beyond the need for concessional aid, the country should not place excessive reliance on foreign private sources of loan capital for long-term infrastructural purposes in view of the cyclical and other volatile forces inevitably affecting such markets.

Given these circumstances and the other volatile factors affecting the country's balance of payments position described in the staff reports, my authorities feel it imperative that the country's foreign reserve position be nurtured with due care, bearing also in mind that a period of substantial foreign debt repayments lies ahead.

As regards the "vexed question of priorities in state expenditure in a democracy whose base is now on the point of acquiring wider dimensions," my country's position was succinctly described by the Minister of Finance in his recent budget speech:

> It takes no great prescience to realize that the ever rising expectations of our growing population cannot be fulfilled within a reasonable time scale without our diverting ever larger slices of the available resources to problem areas. As long as we do not kill the goose that lays the golden egg--the productive sector--we can still afford this. The problem is to find a sustainable balance.

Hence, more than ever before, a system of priorities in the determination of expenditure must be devised to ensure: (i) that no more than a certain quantum of resources is diverted from the private sector for public sector and transfer payment purposes; and

(ii) that expenditures are rationally apportioned among the various layers of Government and, within each tier, among the functions for which each is responsible. Indeed, my Government is so concerned about this matter of priorities that it has established a mechanism to attempt to ensure that demands are only fulfilled within the constraints of available resources.

These observations attain greater significance when the rapid rate of urbanization in South Africa is also taken into account. According to recent World Bank figures, South Africa is only one of 16 countries in the world with seven or more cities of over 500,000 persons. Whereas in 1960, 44 percent of the South African population resided in four cities of this size, according to this source, this percentage had by 1980 risen to 53 percent, a noteworthy phenomenon bearing in mind the rapidly growing absolute figures.

Clearly the challenge must be met on as many fronts as possible. It is for this reason that the South African Government is not only upgrading socioeconomic standards in the existing urban areas, but is also engaged in a wide-ranging development policy embracing balanced regional and interregional economic planning. The establishment of the Development Bank of Southern Africa, the Small Business Development Corporation and deconcentration schemes are a few of the more notable facets of this policy. A further new feature of South African settlement is likely to be the establishment of scores of local authorities which will have to play a vital role in the creation, expansion, and maintenance of the socioeconomic infrastructure required to support the development of new urban and existing rural areas, with their rising populations.

As a result, increasing emphasis is to be given to developing the financial responsibilities of local authorities through a process of devolution of certain powers, currently the prerogative of the central parliament. Among the new powers to be assumed by these local authorities to augment their income will be the right to impose certain specified limited levies at the local government level.

To further boost the sources of revenue of those local authorities having insufficient status to approach capital markets in their own name, a Local Loans Fund has been established with independent borrowing powers. Capital raised in this way will be applied to the needs of these local authorities on a back-to-back basis.

At the same time, substantial progress has been made in the rationalization of central government administration which, together with the second and third tiers of government, including an increasing number of local authorities, will bear the brunt of the complex task of raising the welfare of the less developed sector of the economy.

It is imperative that these administrations should at all times be staffed by highly competent officials drawn from all sections of the population. For this reason, the Government has for some time been pursuing a policy of pay differentiation to attract suitably qualified personnel through improved remuneration of special skills within the public service as a whole. This is but one of the several market signals indicating pressure points in an economy poised to resume growth once circumstances permit.

In the monetary sphere, the longstanding Commission of Inquiry into the Monetary System and Monetary Policy in South Africa (De Kock Commission) is nearing the completion of its extensive task from which further substantial innovations on the monetary front may be expected.

In conclusion, I wish to express on behalf of my authorities, their appreciation to management and staff for the most efficient and helpful way in which the consultations with them have been conducted.

Mr. Mtei recalled that during the discussion of South Africa at EBM/83/87 (6/20/83), he had expressed doubt whether the policies of the South African Government provided a sound basis for sustained and stable economic growth. His doubts had been confirmed by developments since mid-1983; little economic adjustment had taken place, despite the Fund's agreement in November 1982 to support a stabilization program under a stand-by arrangement.

Public expenditure had been poorly controlled and had risen from 21.4 percent of GDP in 1980/81 to about 25 percent in 1983/84, Mr. Mtei observed. Significant overexpenditure under the 1983/84 budget had resulted primarily from defense expenditure, subsidies, a 12 percent salary increase, and the cost of implementing the Government's policy of occupational differentiation. Government expenditure had increased by 16 percent, compared with the program target of 8.75 percent. The upward trend in the public sector deficit, which had been 8.5 percent of GDP in 1982, appeared likely to continue in coming months.

He did not agree with the staff that the budget deficit had been the inevitable result of the drought and weak economic activity, Mr. Mtei continued, since many countries facing similar problems were persevering in their adjustment efforts and had been urged by the Fund to be more resolute in those endeavors. Moreover, many Executive Directors had stressed on previous occasions that sustained economic growth was achieved through structural changes and prudent financial policies rather than through fiscal expansion--a message that was clearly relevant to South Africa. South Africa did not have a rational medium-term fiscal strategy incorporating objectives for both the size of the budget and the distribution of public spending.

On monetary policy, Mr. Mtei observed that the private sector had faced growing competition for credit from the nonbank sector, resulting in a sharp rise in both nominal and real interest rates. For example, the prime overdraft rate had risen by 6 percentage points over nine months in 1983, reaching 20 percent by end-1983, 9 percentage points above the rate of inflation. Maximum lending rates had also increased markedly, to 26 percent. If maintained for an extended period, the high rates would undoubtedly retard investment and growth in South Africa and in other members of the Rand Monetary Area, which would be forced to raise their interest rates to prevent large capital outflows. Unfortunately, given the expected trend in the budget deficit, it was unlikely that the rates would decline; they would certainly contribute to inflationary pressures in the rand area economies.

In the external sector, the extensive import controls imposed to buttress the Government's import substitution strategy had resulted in resource misallocation, Mr. Mtei remarked. One indication of the pervasiveness of the controls was that imported consumer goods had accounted for only 5 percent of private consumption expenditure in 1983. In addition to increasing the cost of domestically consumed goods, the import-substitution policy had inhibited the development of export-oriented industries in which South Africa enjoyed a comparative advantage and, together with the structural impediments in the labor market, had led to a shift toward more capital-intensive domestic production. The policy had been misguided, given the surplus labor, the decline in the propensity to save, and the reduced access to foreign savings. To unleash the full potential of the South African economy, the authorities should accelerate the liberalization of its trading system.

High wages had played a key role in maintaining inflationary pressures, Mr. Mtei continued. The average remuneration per worker in the nonagricultural sector had increased far more rapidly than consumer prices. The problem of high labor costs had been a direct consequence of the Government's policy on education and training, which had accorded preferential treatment to a small portion of the population, leaving the majority with few marketable skills. Other factors contributing to inflation had been the high rate of protection, the rapid fiscal expansion, and the inappropriate monetary policy.

His overall opinion of the South African stabilization program, Mr. Mtei went on, was that little progress had been made. As for the suggestion that significant external adjustment had taken place under the program, he had explicitly stated his views during the discussion on the 1983 Article IV consultation with South Africa and the review of the stand-by arrangement. He had stressed that South Africa had been able to draw a total of SDR 795 million following the Executive Board's discussion in November 1982 of staff papers that had subsequently been proven to contain unduly pessimistic assessments of the economy. In fact, at the time of the

Board's discussion of the program, the balance of payments had been in surplus, as confirmed by the staff on page 3 of EBS/84/95; the implication was that the external payments problem had been more imaginary than real. Hence, the claim that the turnaround in the external position had resulted from successful implementation of the adjustment policies was not tenable.

The issue of South African labor market policy had posed some problems for the Fund, Mr. Mtei remarked, because the so-called structural rigidities in the market could not be explained by conventional economic models. Indeed, South Africa's problems differed fundamentally from those encountered in most other countries, on account of the Government's deliberate decision to promote racial segregation in the work force as a part of its apartheid policy. In its impact on the labor force, apartheid--which was endemic to South Africa--was an economic policy. The staff had tried to analyze the system and to draw certain conclusions, but, perhaps as a result of its limited knowledge of the economics of apartheid, or of its efforts to be diplomatic, it had made excessive use of euphemisms to describe the cause of the problems, and some words crucial to an understanding of the system had been omitted. What were referred to in the staff report as "informal impediments" and "sociological circumstances" affecting the geographical and occupational mobility of labor, were in effect legal constraints sanctioned by law.

Skilled labor shortages were a serious constraint on the economy, Mr. Mtei considered. It was revealing that, although the black population accounted for over 71 percent of the population and for over 66 percent of the economically active population, expenditure on education for that group was several times less than that for the white population, which comprised only about 17 percent of the total population and about 20 percent of the economically active population. The apartheid policies were the only rational explanation for the labor shortage.

The staff had cited Government "initiatives" to ease labor market restrictions and promote educational parity, Mr. Mtei remarked, but there was little evidence that the authorities had carried out those initiatives. In fact, it appeared that labor market constraints had intensified. New legislation restricting geographical mobility had been adopted as late as the beginning of 1984, influx controls remained in force, and black workers with residency rights outside the black homelands could not move from one municipal jurisdiction to another without meeting highly stringent requirements. Furthermore, the abolition of the last of the 28 statutory job reservations in 1983 was of minor significance, while the closed-shop principle, preserving the occupational color bar, remained in full force, and the social conventions underlying racial discrimination continued to be firmly embedded in the philosophy of the Government. In sum, the reforms had failed to address the fundamental economic issues in South Africa.

As to the problem of educational inequality, Mr. Mtei said that, although more nonwhite groups attended school than in the past, there remained a vast difference in the quality of education across racial groups; intentions to improve the system had not been acted upon. Furthermore, the reforms were to be executed in a highly indirect manner. The credibility gap between intention and practice was particularly evident in the relevant budget figures; while the stated objective was to increase expenditure on education by 23 percent a year in order to achieve racial parity by the turn of the century, budgeted expenditure on education for the black population showed a rise of only 5.75 percent in 1984/85.

As for the restrictions on geographical mobility, Mr. Mtei went on, he had been surprised by the explanation in the staff paper, which suggested that they were aimed at encouraging a dispersal of industrial activity. In fact, the statistics indicated that 51 percent of industrial production and 43 percent of GDP originated in areas accounting for only 2 percent of South Africa's land mass, and that only 13 percent of the total income of the black population was generated in the homelands. Economic activity was clearly highly concentrated, suggesting other probable reasons for the geographical restrictions. The restrictions were a sad commentary on the Government's perception of regional development policy, suggesting that the concept, as used in South Africa, did not have the customary meaning. Regional development was the term used to describe the settlement policy in the homelands, but the extent to which it had contributed to the efficient allocation of resources and sustained growth in South Africa was questionable. Such issues had not been clarified in the staff report and required comment. He also requested more information on the South African Development Bank and its role in the Government's regional development strategy.

Wage policy, Mr. Mtei stated, had imposed an unfair burden on black workers whose average remuneration in 1983 had been 23 percent of that of white workers. The wage policy, which had its origins in the same discriminatory laws and practices that had constrained labor mobility and prevented educational parity, lowered the morale of the black population.

The black unemployment situation was pathetic, Mr. Mtei said. The official unemployment rate for blacks in 1983 was 8.2 percent, compared with 1.6 percent for the rest of the population. Workers who had been unable to find new employment in white areas upon completion of their contracts and had been forced to return to the overcrowded and infertile homelands should be added to the official unemployment figures. The true black unemployment rate was markedly higher than the official one.

Overall, the South African labor situation was untenable, Mr. Mtei continued. Rapid changes in labor laws and practices were vital to South Africa, its neighbors, and the international community. The Fund staff should continue to monitor economic developments, particularly labor policies, so that the Executive Board would be in a position to judge the effectiveness of the Fund's surveillance of the South African economy.

South Africa's statistical reporting should be improved, Mr. Mtei considered. In particular, the staff should inform the authorities that data relating to Namibia had to be compiled and shown specifically, and not be lost in the official statistics, as was currently the practice. Such data would be helpful to Namibia when it gained independence. A second problem was the inconsistency between annual and quarterly data produced by the Reserve Bank.

He was reluctant to concur with the basic thrust of the staff's analysis and conclusions, which appeared to condone the policies of South Africa, which were repugnant to his authorities, Mr. Mtei said. For example, in the conclusion to Appendix I of SM/84/112, the staff stated that the Government was moving toward the objective of equal per capita expenditure on education and training between racial groups. He doubted whether many blacks and Asians in South Africa would share that view. Furthermore, that conclusion seemed to be inconsistent with certain aspects of the discussion in the body of the Appendix. For example, on page 78 of SM/84/112, the staff asserted that "a continuation of these relatively low rates of growth of education expenditure, as compared to the Department of Education projections, would imply an extremely long wait for the achievement of equitable education standards in South Africa." The statement was a clear prediction of the most likely long-run outcome. Moreover, the staff's assessment of South Africa's regional development policy bordered on approval. On page 75 it was noted that the authorities had announced the effectiveness of a new package of incentives for the development of designated industrial development of some areas and deconcentration of others. However, the so-called development points were mainly in and around the black homelands; the complex stratification of South African society made informed judgments on regional development policy difficult to reach.

The procedures for the presentation and discussion of staff reports on South Africa had become highly confidential to ensure the secrecy of the material contained in the staff papers, Mr. Mtei stated. The reasons for such precautions were not clear to him. It was possible that the South African authorities had requested confidentiality; if so, there could be complications for the Fund if other countries were to make similar demands. The careful upgrading in the confidentiality of papers concerning particular countries created an uneasy impression. The unusual feature of South Africa was its labor policy, which underpinned apartheid. According special treatment to a staff report for an Article IV consultation with South Africa could leave the misguided impression that the Fund supported its apartheid policies.

Mr. Polak said that the staff report had described the severity of South Africa's long-run structural problems and the volatility of its economy in the short run. However, the economic shortcomings should not obscure the unusual dynamism of the economy during the 1980s: real GDP had been 20 percent higher in 1981-83 than in 1975-77, a remarkable achievement; and unemployment for the white population had been stable at just over 1 percent since 1977. Although the validity of the statistics was questionable, as noted by Mr. Mtei, it appeared that the black unemployment rate had fallen from 10 percent in 1977 to 8 percent in 1984. It seemed that Mr. Peacey's statement that South Africa was facing its most difficult set of economic conditions since the 1930s was an exaggeration, although the boom of the 1980s was indeed precarious, since it had been stimulated largely by gold prices, which were notorious for their large fluctuations.

Recent developments had exemplified the instability of South Africa's external position, Mr. Polak continued. In November 1982, the balance of payments position had been considered weak enough for the authorities to request and receive a stand-by arrangement, but by early 1983 it had recovered so markedly that there had been no need for any purchase beyond the first one, and by August an early repurchase had been possible. A further example of the volatility of the balance of payments was the contrast between the balanced current account forecast for 1984 in EBS/84/95, and the SDR 2.4 billion current account deficit--3 percent of GDP--predicted for the same year in the supplement issued one month later, based on first quarter data for 1984. Such unpredictability was of course understandable in an economy so heavily reliant on gold prices, and that kept the bulk of its reserves in gold. The balance of payments position was also highly vulnerable to fluctuating weather conditions.

The consequences of an unstable external position, Mr. Polak went on, were a highly volatile exchange rate, and sharp swings in reserves and interest rates, which, in turn, affected capital flows, investment, and domestic demand. The choice of an intermediate variable for policy purposes was difficult. For example, whether external shocks had their greatest impact on reserves or on the exchange rate would determine how various sectors of the economy, such as gold production or other export industries, would be affected.

It was not surprising, Mr. Polak said, that the South African authorities had not been highly successful in alleviating the short-run consequences of external shocks, since the fiscal and monetary policies required to do so would have had to be stronger and to take effect more quickly than was normally feasible. However, the excessive looseness of fiscal policy during the export boom of 1983 had been disappointing, and had resulted in large overspending compared with the 1983/84 budget; some expenditures had been related to drought relief and food subsidies, but the defense and salary overruns had also been large. Since monetary policy had been appropriately tight, the result had been a sharp increase in interest rates, as noted by Mr. Mtei. Subsequently, the authorities had recognized the urgent need for fiscal stringency, and were to be commended for increasing the sales tax by 3 percent in May 1984, following an increase in February.

Taking a longer-term view, Mr. Polak continued, it was clear that the policies of the early 1980s had not reduced the inflation rate below double figures. The cost of living index had risen by 12 percent in 1982, only a small drop from the 15 percent rate of 1981. The implication was that the medium-term policy had not been wholly successful, perhaps reflecting fundamental structural problems in South African policymaking, for example, the dichotomy in the market structure: economic policies might affect only a small section of the population, while market rigidities prevented the economy from adjusting to domestic or external changes in relative prices, thus increasing the cost of adjustment in terms of wasted resources. The structural rigidities were most evident in the labor market, as highlighted in Appendix I of SM/84/112, which painted a disturbing picture of the labor market.

The shortage of skilled labor had already slowed the growth of the economy, Mr. Polak said, and the projections suggested a still more pronounced shortage by the year 2000, together with heavy unemployment among unskilled persons. If the trend were to continue, about one third of the black economically active population, or 3.5 million people, would be unemployed by the turn of the century. At the same time, there would be a shortage of over a million skilled and managerial workers.

The staff had indicated that the South African authorities were aware of the problems in the labor market and had made some progress in improving occupational mobility, education, and training, Mr. Polak continued. However, under the authorities' basic approach to the unemployment problem, as set out in the 1983 White Paper on the Strategy for the Creation of Employment Opportunities, creating employment opportunities was not the task of the Government. They should instead be created "within the framework of a market-oriented system." However, the question remained how market forces could be relied upon to regulate the labor market, given the heavy nonmarket restrictions on labor mobility in South Africa. As the staff had concluded:

> The restrictions on geographical mobility are maintained for noneconomic reasons, in the sense that they are a reflection of the official policy of separate development. It is therefore not surprising that these restrictions have proved less responsive to considerations of economic efficiency.

The restrictions in the labor market remained a major policy issue in South Africa, and the staff should continue to study the problem as part of the 1985 Article IV consultation with South Africa.

Mr. Joyce said that he broadly agreed with the staff assessment of the economic policies of South Africa. Economic results in 1983 had been mixed. The external imbalances that had led to the stand-by request in 1982 had been overcome as a result of the recovery in gold prices and the reduction in imports, official reserves had increased modestly, and short-term external liabilities had been reduced. Moreover, the authorities were to be commended for complying with the performance criteria under the 1982 stand-by arrangement, for maintaining a flexible exchange rate during 1983, and for eliminating the import surcharge within the agreed timetable. Unfortunately, real output had again fallen in 1983, partly as a result of the drought, both measured and disguised unemployment had risen sharply, and inflationary pressures had remained persistent; if anything, South Africa's inflation had been higher than that of its main trading partners.

An important reason for South Africa's mixed performance, Mr. Joyce continued, was the large overshooting of the public expenditure and fiscal deficit targets. The increase in the fiscal deficit from 2.7 percent of GDP in 1982/83 to 3.8 percent in 1983/84 represented an important deviation from the objectives set out in the letter of intent for the 1982 stand-by arrangement. Although the drought and continued high unemployment rates undoubtedly explained in part the authorities' reluctance to pursue some of the original policy goals, it was regrettable that inflationary pressures, particularly in the wage sector, had not been more actively resisted by the authorities.

One implication of the substantially larger budget deficit, Mr. Joyce went on, was that the Government, while avoiding further bank financing of the deficit, had had to increase its debt to the nonbank sector. The result had been an increase in interest rates, which had weakened investment prospects and contributed to the slow growth of output. The authorities had recently introduced several measures designed to strengthen the fiscal position and to improve the overall policy mix, but they might not prove adequate to keep the budget deficit within manageable proportions. The authorities would be advised to take further corrective action to reduce the fiscal imbalances.

The staff had praised the authorities for having monetary policy bear the brunt of the stabilization effort, Mr. Joyce noted. However, it was the authorities' current view that none of the available monetary aggregates was likely to be a reliable indicator of monetary developments in the short term, and that monetary targets would be abandoned in 1984. He wondered whether the current firm monetary policy stance would be jeopardized by the absence of monetary targets.

Commenting on the structural weakness in the economy, Mr. Joyce said that the economic implications of South Africa's labor policies should be emphasized, particularly those restricting labor mobility and the skills attainment of black and colored workers. While the staff appraisal had said that some progress had been made in reducing labor market rigidities, information in the body of the staff report and in Appendix I of SM/84/112 suggested that progress had at best been very limited. Of particular note was the statement on page 11 of EBS/84/95 that "in reviewing developments since the last consultation, the mission found that statutory restrictions on geographical mobility have essentially been retained in new legislation introduced in early 1984." The retention of such laws did not augur well for the future; South Africa would be unable to fulfill its full potential as long as structural difficulties in the labor market persisted. Those difficulties should be dealt with promptly to prevent an escalation of skilled labor shortages, which would inhibit economic growth.

The authorities were trying to upgrade both their educational and manpower training programs, Mr. Joyce remarked, but their objectives were too ambitious to be consistent with the requirement for increased fiscal tightness, unless, of course, the authorities were to make offsetting savings in other areas of government spending. There were marked differences in the level of basic education of different racial groups, and highly significant and persistent differences in per capita government expenditures on their education. Given the sharpness of existing disparities, the projected increase of 5.75 percent in real terms in education expenditures for nonwhite children, compared with a 3.5 percent increase in total education expenditures, did not appear to signal a highly determined effort to address the problem. The slow progress in 1983 in the areas of education, manpower training, and occupational mobility was a cause for deep concern, and the authorities should aim for better results in 1984. The staff should vigorously investigate the issues of employment and education during the 1985 Article IV consultation with South Africa.

Mr. Angeloni noted that the South African economic situation in 1984 differed markedly from that prevailing during the 1983 Article IV consultation discussions. An unexpected improvement in the external accounts during 1983 had been followed at the beginning of 1984 by a sizable deterioration. Domestic demand, which had shown signs of a recovery in the second part of 1983 due to buoyant consumer expenditure, had been dampened by the continuing high level of real interest rates in mid-1984. On a more optimistic note, inflation, whose persistently high rate during the recession had been a major cause for concern at the time of the 1983 Article IV consultation, was expected to slow; that was particularly true of the rate measured by the GDP deflator.

As described by the staff, Mr. Angeloni continued, recent economic developments were the result of such factors as the vulnerability of the economy to gold price fluctuations, tight domestic financial policies, and adverse weather conditions. The staff also made extensive reference to South Africa's structural problems, which limited the medium-term prospects for balanced growth. In general, the staff's evaluation was acceptable; the emphasis on exchange rate flexibility and fiscal restraint in sound economic management was entirely appropriate.

South Africa's deep-rooted structural problems had frequently been the subject of discussion by the Executive Board, Mr. Angeloni commented. Labor market rigidities, a structure of production that did not correspond to the structure of comparative advantage, and a composition of public expenditure that favored sectors with relatively low productivity inevitably constrained South Africa's prospects for growth and balanced prosperity. The emphasis by the staff on the severity of South Africa's structural problems was justified, although most of the important causes and consequences of those problems fell outside the realm of economics.

On the conduct of economic policy, Mr. Angeloni commented that the transition to a regime of greater exchange rate flexibility in South Africa had been a major factor in increasing the autonomy of monetary policy. However, it was clear that much remained to be done to insulate the economy from fluctuations in the terms of trade. The income stabilization system, discussed in Appendix III of SM/84/112, was an interesting option, although it was possible that the greater stability in private sector incomes under such a scheme would be offset by increased instability in public finances, which would reduce the beneficial effects of the scheme on the financial markets. Moreover, effective stabilization required the calculation of the medium-term "equilibrium" price, a difficult task.

The major difficulty facing the authorities, Mr. Angeloni continued, appeared to be the choice of a consistent monetary and fiscal policy mix. In 1983, the interaction of the fiscal deficit with stringent monetary policy had produced a dramatic increase in real interest rates that had dampened domestic demand and inflated the real cost of public debt servicing. In 1984/85, the growth in projected expenditures had forced the authorities to seek new revenues through indirect taxation; the resultant likely increase in inflation could have been avoided by recourse to other sources of revenue. It would have been useful to know whether the effect of the sales tax on inflation had already been accounted for in the inflation forecasts in Table 5 of the staff report, and what considerations had prevented the authorities from adopting a less inflationary means of increasing revenues, such as the personal income tax or more selective forms of indirect taxation. It would also be helpful to know whether it would be possible to lower real interest rates from their unsustainable levels under the current policies and projected deficit/GDP ratio.

Mr. Tvedt agreed in general with the staff's assessment. Due mostly to an inappropriate fiscal policy stance in 1983, serious imbalances requiring prompt correction had emerged. However, the most serious problem continued to be the severe rigidities in the labor market, which harmed the growth potential of the South African economy, caused inflationary pressures due to the scarcity of skilled labor, and resulted in a highly skewed income distribution. The authorities had made efforts to relieve some of the rigidities, but they were only in the first stages and a great deal of progress had yet to be made. The staff should continue to emphasize strongly the serious implications of the labor market constraints in future consultations with South Africa. If they were neglected, South Africa might be unable to maintain a satisfactory and noninflationary growth path.

Mr. Clark commented that South Africa had made significant progress in 1983 in reducing the external, if not the fiscal, imbalances in the economy. It was also notable that, while the authorities had drawn only the initial tranche under the stand-by arrangement, they had continued to conduct their policy consistent with the performance criteria. The voluntary early repurchase in August 1983 had been particularly welcome.

However, the improvement in the external current account position had proved short-lived, due to the impact of the drought and falling gold prices, Mr. Clark continued. Fiscal imbalances persisted, putting strong upward pressure on interest rates that could have serious consequences not only for South Africa, but also for the other members of the Rand Monetary Area. Inflation remained high, and serious structural problems continued to exist in the labor market. Tight fiscal and monetary restraint, together with measures to eliminate labor market rigidities, would be necessary if the modest level of real economic growth forecast for 1984 and the near future were to be maintained in the longer run.

The improvements in public expenditure control were welcome, Mr. Clark went on, especially in view of the substantial expenditure overruns in past years. Fiscal control, together with the further increase in the rate of sales tax scheduled for July 1984, would be essential if the central government deficit was to be kept below 3 percent of GDP.

Recent increases in public sector wages had been extremely high, Mr. Clark noted. The authorities' desire to attract and keep suitably qualified personnel was understandable, but more fundamental changes in the labor market were required. Furthermore, the staff had been right to warn of the dangers of encouraging similar pay increases in the private sector, where unit labor costs had increased substantially in recent years, with potentially serious implications for the competitiveness of non-gold exports and the prospects for sustainable growth in the medium term.

He welcomed the inclusion in 1984 of statistics on private sector debt, which was nearly two thirds of the total debt, Mr. Clark commented. While external debt was just under 30 percent of GDP, the high proportion of short-term debt in the total, and to a lesser extent the large debt service ratio, which had remained at 20 percent throughout the 1980s, were worrying. The improvements in the maturity structure of the external debt recommended by the staff would be desirable.

The continuing shortage of skilled labor, combined with the high level of unemployment, which was concentrated in the black population, highlighted the severity of the structural problems faced by South Africa, Mr. Clark stated. Appendix I of SM/84/112 gave a clear presentation of the issues; elimination of the structural problems was crucial if growth was to be sustained and unemployment reduced. In particular, it was apparent that the extension of educational and training opportunities to the whole population was a necessity. Within the overall budget, therefore, education and training for the black population should continue to be a priority. A change in social perceptions and a reduction in the informal restrictions referred to on page 73 of SM/84/112 must be an important accompaniment to direct government action in the longer term.

The sharp decline in the personal savings ratio, presumably associated primarily with the trend path of real disposable income, seemed to have persisted despite the rise in real interest rates, Mr. Clark observed. A further comment on the extent to which the behavior of savings might dampen a revival in activity would be useful.

Ms. Bush said that two principal problems faced the South African authorities: the immediate need to decelerate the rate of inflation and to preserve the recent strengthening of the balance of payments position; and the need for structural changes in the economy to improve the growth potential through the full utilization of human and natural resources in a more efficient and open economic setting. South Africa had already achieved moderate success in adjusting to the sharp worsening in the current account in 1981 and 1982--recording a small surplus in 1983--despite the adverse effects of the drought and other external factors on exports. However, real economic growth had been negative in both 1982 and 1983, and the rate of inflation and the increase in unit labor costs in the non-agricultural sector had remained relatively high.

Concerning the monetary sector, Ms. Bush observed that the rate of growth of net domestic credit and of the money supply had decelerated since 1980, and real interest rates had become positive during 1983. In the fiscal area, however, the pattern was less encouraging. The ratio of the central government deficit to GDP had risen to 3.8 percent in 1983/84, from 2.7 percent in 1982/83. Furthermore, it appeared that the overall public sector borrowing requirement was higher still, about 9.5 percent of GDP, and that it would rise to about 11 percent in 1984/85. In fact, the staff report contained very little information on the public sector deficit, although there was some additional information in SM/84/112. She asked the staff to explain the reason for the lack of information and to comment on the significance of the large public sector borrowing requirement. She also asked for comments on the apparent need for more contingency planning for the budget.

On the budgetary accounts, Ms. Bush noted the rapid rise in the rate of increase of revenue from the tax on personal income, the need for greater wage rate moderation, and the need to give priority over the longer term to expenditures designed to raise the educational and skill levels of the labor force. The personal income tax had grown at an average annual rate of growth of nearly 41 percent since 1980. It would be useful to know whether that high figure reflected a high marginal tax rate that might have created a disincentive for personal savings, which had fallen in recent years.

Commenting on the Government's wage policy, Ms. Bush said that the authorities' desire to attract workers was understandable, but the expected 11 percent rise per capita in real terms in the Government's pay bill under the 1984/85 budget seemed excessive and was likely to lead to an upswing in private sector wages. The authorities had cited the scarcity of skilled labor as the principal factor in the upward pressure on wages. The larger pool of skilled workers that should result from a better educated population would increase the supply of competent individuals available to the Government and should simultaneously reduce the need to respond to such scarcities by excessively large real wage increases. The authorities should be urged to accord a high priority to raising the level of general education of the labor force and to the teaching of job-related skills, to increase the growth potential of the economy, and to improve the economic welfare of the entire population.

As for the balance of payments, Ms. Bush commented, it was apparent that the volume of exports had declined since 1980, and that there had been a sharp compression in the volume of imports since 1981. Furthermore, there had been a large net outflow of private capital--approximately SDR 1.3 billion--in 1983, and the current account had moved back into deficit late in the year. The supplement to the staff report indicated that the deficit had increased in the first quarter of 1984. In addition, the dominance of short-term debt in total foreign debt, and sharp fluctuations in the terms of trade had made the balance of payments highly volatile. The external developments underlined the importance of appropriate interest rate and exchange rate policies. The authorities appeared to be following an exchange rate policy that allowed the exchange rate to be determined primarily by market forces, but the real effective appreciation of the rand in 1983 suggested that South Africa had suffered some loss of competitiveness, a conclusion that underscored the need to reduce domestic inflation. She wondered whether the latest balance of payments developments were still consistent with the effort to achieve balance in the current account in 1984, and, if not, whether further measures were needed.

The shift away from import substitution policies toward export growth in the trade and payments system and related policies was welcome, Ms. Bush said, and she hoped that present negotiations to gain South Africa's accession to the GATT code on export subsidies would be successful. In addition, she favored the gradual substitution of price-related measures, such as tariffs, for quantitative limits on imports as protective devices. Although the staff had indicated that the share of imports exempt from controls had risen from 25 percent in 1978 to 33 percent in 1984, two thirds of imports were clearly still subject to such controls.

The information in the staff reports clearly indicated persistent limited labor mobility with respect to both occupations and geographic areas, and wide disparities in wage rates, levels of training, and education within the labor force and among different groups in the economy, Ms. Bush went on. As her chair had noted during the 1983 Article IV consultation, the removal of labor supply rigidities was necessary for both economic and noneconomic reasons. The growth of the capital/output ratio, the rising capital/labor ratio, and persistent problems resulting from the shortage of skilled labor had important implications for the economic outlook. If South Africa was to improve its long-term economic growth prospects through a strategy aimed at greater economic efficiency and the attainment of an increasingly diversified mix of exports that could withstand exposure to world competition, it would need to take full advantage of the human resources available to it. While some progress had been made in allocating resources to the education and training of unskilled labor and in reducing restrictions on labor mobility, a great deal had yet to be achieved. Rapid and substantial action to remove labor market and educational rigidities would improve the economic welfare of the population while allowing the country to avail itself of its full economic potential.

Mr. Grosche noted that the economic performance of South Africa since 1981 had been mixed. Having moved into surplus in 1983, the current account had returned to a deficit position in 1984, reflecting in part the effect of the gold price decrease and the severe drought. However, disappointing domestic policies had also played a part; in particular, the authorities had shown an inability to maintain fiscal restraint and to reduce inflation.

The deteriorating trend in public finances was a cause for concern, Mr. Grosche remarked. An important question was whether the brunt of fiscal adjustment could be borne by reducing fiscal expenditure, with the possible exception of public sector pay. Although overexpenditure had not been unusual in South Africa, it was possible that the fiscal problem was due to overoptimistic budgeting rather than excessive spending. It could even be argued that further increases in government spending, particularly on education and manpower training, would be necessary to take full advantage of the country's growth potential. Chart 14 on page 42b of SM/84/112 did not suggest that public expenditure had accounted for an excessively high portion of GDP, at least in comparison with the situation prevailing in the late 1970s. It therefore seemed appropriate to improve the fiscal situation through increasing tax revenues and, possibly, user charges. The recent decision by the authorities to increase to 10 percent the general sales tax rate, with effect from July 1, 1984, was encouraging, but there remained doubts as to whether the budget target for 1984/85 could be met, and there might be a need and scope for additional increases in revenues, particularly since, as was evident from Chart 8 on page 10a of the staff report, taxation in several sectors of the economy had decreased substantially in recent years.

Since 1981, when inflation had peaked at 15.2 percent, only moderate reductions in the rate had been achieved, Mr. Grosche commented. It was possible that inflationary pressures would regain momentum despite a slowing in the growth rate of the money supply and high real interest rates. Two factors seemed responsible for the acceleration in inflation. First, it was possible that real interest rates were not yet high enough to dampen inflation and inflationary expectations, in which event a further tightening of monetary policy might be called for. Second, it was also possible that the country was facing a cost-push inflation, in the sense that excessive wage increases were promptly transmitted into price increases, perhaps as the result of a lack of competition in the private sector. Further comment on the reasons for the increase in inflation would be helpful.

On a more technical aspect of monetary policy, Mr. Grosche noted that the authorities did not appear to have developed an indicator to monitor monetary developments. The choice of the most appropriate indicator to measure central bank activity and to provide information on the link between the money supply and the real economy was by no means easy. Nevertheless, the abolition of credit controls and the deregulation of interest rates should clarify the policy aims of the monetary authorities.

As he had indicated earlier, Mr. Grosche continued, labor market policies were not consistent with the realization of the country's growth potential. Some progress had obviously been made in relaxing the rigidities in the labor market, but more remained to be done; the staff's recommendations in that respect were welcome.

The reduction in quantitative controls and easing of exchange controls in 1983 had been beneficial, Mr. Grosche stated, although high barriers to consumer goods still existed. The flexible exchange rate arrangements in operation since 1983 had been working effectively. The maturity profile of the external debt should be lengthened, since the average maturity was excessively short at present, although over the medium term the debt seemed manageable.

Mr. Suraisry said that, as the staff had mentioned, the balance of payments for 1983 had been much stronger than had been projected under the stand-by program. The trade balance had been SDR 3.6 billion instead of SDR 1.5 billion, the current account had registered a surplus of SDR 213 million against the program's projections of a deficit of SDR 1.4 billion, and earnings from gold had been about SDR 2.25 billion above the program projections. The staff projections had obviously been unusually inaccurate. It was of paramount importance, for various reasons, that the staff projections should be as accurate as possible. Of course, the volatility of gold prices had undermined their validity, but the Fund had the technical expertise to overcome forecasting problems. Second, despite the deterioration in 1984 of the external position, South Africa was capable of making further early repurchases under the stand-by arrangement, and it should be urged to do so in order to accommodate the need of other members to use Fund resources.

As to financial policies, Mr. Suraisry recalled that, during the 1983 Article IV consultation, the Executive Board had expressed its concern over the failure to contain government spending in 1982/83. It was disappointing to note that government expenditure was still rising, and that the deficit in 1984/85 was likely to be substantially higher than in 1983/84. The authorities' claim that the inability to restrain government spending had been due to the drought was not convincing. Many member countries, some with Fund-supported programs, had cut government spending under even more difficult conditions. The staff's belief that "another sizable increase in real government spending in 1984/85 seems... to be virtually unavoidable" was a cause for deep concern. The authorities' behavior was unjustified; at a time when inflation and interest rates were high, government spending should be checked. That it had grown was evidence of the Government's inability to correct the economic imbalances. Further evidence was the Government's decision to increase the public sector pay bill by 27 percent at a time of double-digit inflation. It was doubtful that such action would serve the Government's objective of attracting qualified personnel; rather it would aggravate the shortage of skilled labor, setting the stage for further increases in the pay bill and exacerbating inflation. The Government undoubtedly understood the consequences of raising the public sector pay bill, but the action was the inevitable outcome of wrong policies.

It was clear, Mr. Suraisry continued, that the problems of the South African economy stemmed from supply bottlenecks that had persisted over the years and were aggravated by misguided policies, despite full knowledge of their negative impact on the economy. The solution for the Government was to abandon its racist policies by extending technical training and educational opportunities to the black population and by removing all impediments to geographical mobility. It appeared that, although the authorities had intended to act to increase geographical mobility, nothing had been achieved. The staff had already noted that "the mission found that statutory restrictions on geographical mobility have essentially been retained in new legislation introduced in early 1984." Like Mr. Mtei and other Executive Directors, he urged the staff to follow developments in that respect closely.

Despite some liberalization, Mr. Suraisry went on, the trade sector was heavily protected, as indicated by the fact that 67 percent of total imports were subject to controls and by the low ratio--5 percent--of consumer goods imports to private consumption expenditure in 1983. He had been surprised to note that the trade system had included severe restrictions since 1948, suggesting that there had been a misallocation of resources in the economy ever since. An aggressive set of measures designed to liberalize the trade system was therefore needed if the market-oriented strategy announced by the authorities was to be implemented and economic efficiency was to be increased. However, even that would be insufficient, since the economy would remain distorted and economic performance would remain below potential unless the authorities made fundamental social and economic changes addressing all rigidities, including those in the labor market. Only then could sustainable growth be achieved. The South African economy suffered from long-term problems that could not be addressed by the short-term remedies applied so far.

Mr. Tshishimbi commented that, when the Executive Board had reviewed developments in South Africa in 1983, there had been broad agreement that the Government's labor market policies had been responsible for the chronic shortage of skilled labor, which, in turn, had not only contributed to strong inflationary pressures, but had also exacerbated South Africa's balance of payments difficulties and impeded economic growth. The authorities had been urged to increase markedly government spending on education and manpower training, especially for the lower-income groups, and to ease restrictions on the geographical mobility of labor, but little progress had been made; apparently the Government was only mildly concerned about the structural problems. In his opening statement, Mr. Peacey had said that "despite the demographically less developed nature of the South African economy compared with the more developed West, its economic difficulties do not stem from either domestic structural stagnation or from any undue foreign debt burden." In the light of the staff's analysis of South Africa's economic problems, which confirmed their structural character, he had difficulty in accepting Mr. Peacey's conclusion.

Despite the constraints on the staff analysis and the Byzantine South African sociopolitical situation, the staff's evaluation in the staff reports was revealing, Mr. Tshishimbi commented. Although he did not entirely agree with the content and specific language of the staff conclusions, he welcomed the staff's effort to expand its analysis of the causes of South African economic difficulties and encouraged the staff to pursue and improve the quality of its analysis in future Article IV consultations. The expanded coverage of the labor market was particularly welcome. He asked the staff to evaluate the reliability of data on the labor market situation in South Africa.

South Africa's labor market suffered from severe structural imbalances, Mr. Tshishimbi said. It seemed paradoxical that a country with an active population of about 10 million persons, which could grow by 50 percent before the end of the century according to official projections, should experience an unemployment rate of nearly 10 percent together with shortages of skilled labor throughout the country. The simple explanation was that blacks accounted for two thirds of the active population and had a particularly low level of education compared with other racial groups and the average of the population. As noted somewhat apologetically in the staff report, only 10 percent of the economically active population in South Africa had received an education equivalent to a high school diploma in the United States. In fact a close scrutiny of the national averages showed that less than 1 percent of the black segment of the active population had reached high school. Consequently, in order to meet its labor requirements, South Africa resorted to importing highly expensive skilled labor from Europe instead of investing on a large scale in the education of its own population. The number of unemployed blacks, estimated at 3 million in 1984, was expected to rise to 5 million by the end of the century, a figure equivalent to more than 70 percent of the active population. High unemployment among blacks, combined with a relative decline in the share of other racial groups in the total active population, would exacerbate the shortage of skilled labor and worsen pressures in the already tight labor market.

The staff report noted that in recent years black workers had made some progress in obtaining and performing more skilled work, Mr. Tshishimbi continued, primarily through training given by foreign firms under the so-called Sullivan Principles laid down by their respective governments. Efforts by individual firms had produced limited results, but the South African Government did not consider the creation of employment opportunities to be a prime task of government. It was stated on page 73 of SM/84/112 that "employment practices in the government service, both at the national and local level, have not been conducive to improving the occupational status of nonwhites and, indeed, changes have been more rapid in private industry."

As reported by the staff in both 1983 and 1984, Mr. Tshishimbi said, the deliberate exclusion of black workers from some employment categories still persisted, despite the recommendation by the Government Commission of 1977--which had investigated labor legislation and practices--that the job reservations be abolished. The actual changes had been nominal and job discrimination was now reflected in the "closed-shop principle" and the "scheduled-person concept."

The statutory restrictions on geographical mobility remained unchanged, Mr. Tshishimbi continued. The staff had indicated that the new legislation introduced early in 1984 retained the substance of the old restrictions. Under the law, black workers were unable to move from one municipal jurisdiction to another unless they were guaranteed employment at the point of destination, unless they would cause no displacement of local workers, and unless adequate housing was available, with the burden of proof in those respects resting on the worker. Other regulations on migrant labor made it difficult for black workers to change jobs, resulting in missed opportunities for on-the-job training.

It was stated on page 77 of SM/84/112 that the Government had indicated its long-term aim of providing each pupil with equal educational opportunities, irrespective of race, Mr. Tshishimbi said. Such educational parity, which he would welcome, would contribute to the attainment of the Government's other important objectives of an average rate of real GDP growth of 5 percent over the years 1984 to 1989 and a reduction in unemployment. However, in order for South Africa to achieve those objectives and to establish a basis for sustained growth, it would have to realize that education was an imperative and urgent priority, not a luxury.

Mr. Jayawardena said that he was in broad sympathy with Mr. Mtei, who had raised fundamental questions on the structure, design, and presentation of Fund programs. He was particularly concerned as to whether the staff had fully grappled with the real underlying economic problems in South Africa. The difficulties faced by the staff in raising political issues with the Government was understandable, but the Fund had to be fearless and highly objective in its assessments, irrespective of the size, power, and influence of a given country, or risk the loss of its credibility. He wished to be convinced by the staff that they had been as objective as possible.

Structural problems were the most important of South Africa's many economic problems, Mr. Jayawardena said; they appeared to permeate the whole economy. For example, fiscal policy continued to be excessively expansionary, despite critical comments by the Executive Board on previous occasions. The adjustment process appeared to be constrained by a heavy commitment to national security, the need for which was probably created by South Africa itself, and imprudent increases in wage rates at a time of widespread unemployment. Underlying the fiscal developments were the structural problems in the labor market. It was obvious that the turnaround in gold prices, rather than the strength of adjustment, had improved the economy in 1983, relieving South Africa of the need to use further Fund resources. That South Africa should continue to depend on the volatile gold industry for its salvation was questionable, especially since the price of gold was frequently determined by noneconomic factors. But it was equally unlikely that the non-gold sector would lead to sustained growth, because security problems had pushed South Africa toward an import substitution policy that did not reflect its own comparative advantage. The result had been to encourage the capital intensity of production and to discourage exports. Given the poor prospects for the non-gold sector, he wondered how the Fund was able to assure itself of the short-term and revolving character of the resources it provided to South Africa.

The structural rigidity of the labor market, Mr. Jayawardena continued, appeared to be at the root of every problem, and although the need to redress it had been repeatedly emphasized, no meaningful progress was evident. Fund assistance would be of no help until the labor market problems were faced, as had been noted when the South African program had been discussed in the Executive Board. Because the program had in his view been poorly constructed, he had had to deny it his approval.

That South Africa had been unable to come to terms with its labor problems also shed doubt on the temporary nature of its use of Fund resources, Mr. Jayawardena said. He was particularly concerned by certain remarks made by Mr. Robert McNamara, former President of the World Bank, to a South African audience in 1982, reported in Time magazine on November 1, 1982, to the effect that a "violent explosion" appeared inevitable within five to ten years unless South Africa's entrenched policies of racial injustice were reversed. The Fund should aim, first and foremost, at the structural problems if it was to continue to support South Africa and to refrain from recommending merely partial solutions. That approach would promote both the temporary employment of Fund resources and the long-term viability of South Africa. The problems faced by the staff in confronting the authorities with labor problems should be understood and appreciated, especially since the authorities appeared to be deeply committed to policies that aggravated the structural rigidities. But he doubted whether the Fund could postpone confronting the labor issue. The near unanimous view of the Executive Board on that matter was encouraging, and a forthright approach by the Fund during the 1985 Article IV consultation would be welcome.

He would also welcome a full and comprehensive analysis of the labor market situation at the next discussion of South Africa, and a full analysis of the impact of the situation on the noninflationary growth prospects of the economy, Mr. Jayawardena added. He asked the staff to simulate an alternative scenario of the economy's growth path under the assumption that labor market rigidities would be removed. It was likely that the authorities sincerely believed that the current policies were in their best interests, but it was in the interests of the Fund to demonstrate to them that they might be wrong. The proposed study might help to induce some change.

Mr. Zhang noted that GDP in South Africa had continued to fall in 1983, and that the small rate of increase projected for 1984 would not reduce the unemployment rate. As pointed out by the staff, the growth performance in South Africa would continue to be constrained by a number of structural factors--as well as by short-term factors--the most important of which were South Africa's long-standing labor policies that were practiced within the framework of apartheid and involved restrictions on labor mobility and a low level of education and technical training of the nonwhite population, resulting in chronic shortages of skilled labor. Indeed, it was doubtful whether those policies, if continued, could provide a sound basis for sustained economic growth.

In its 1983 report, the staff had rightly concluded that government policies had led to a costly misallocation of resources, Mr. Zhang continued, and that increased utilization of manpower resources required a relaxation of restrictions on labor mobility and an expansion of government programs in education and training--conclusions that had clearly been supported during the 1983 Executive Board discussion. However, it was indeed discouraging to read in the 1984 staff report that changes in such areas had been few and slow-moving.

With regard to geographical mobility, Mr. Zhang noted that statutory restrictions had essentially been retained in new legislation in early 1984. While there had been some easing in the legal impediments, the occupational color bar had essentially been preserved with the retention of the "closed-shop" principle, the low level of education of the black population, and the confirmation of prevalent social conventions.

In education, Mr. Zhang went on, wide margins persisted in per capita expenditure for whites and nonwhites. Despite the stated intentions of the Department of Education to reach educational parity between the race groups by the turn of the century, the budget allocations prepared by the Department of Finance for the fiscal year 1984/85 did not give the same impression. If current trends were to continue, there would be serious doubts concerning the attainability of the proclaimed goal and the seriousness of the Government's intentions. He wondered whether the staff had discussed the issue of budget allocations for education with the authorities.

The adverse consequences of the abnormalities in the labor market had been discussed during previous Article IV consultations, were well documented, and thus needed no further elaboration, Mr. Zhang remarked. However, in its report the staff was often equivocal in its evaluation of South Africa's policies. The Executive Board should give the staff clear guidelines for further consultations, particularly relating to the elimination of all impediments to geographical and occupational mobility in South Africa's labor market.

Mr. Finaish said that he shared many of the views and concerns expressed by Mr. Mtei and other Directors on the various distortions in the South African economy and, in particular, the structural problems of the labor market. The staff report had noted that the wage increases in 1983/84 had been designed to attract and maintain qualified personnel, a problem that was deeply rooted in the inadequate supply of skilled labor caused by South Africa's labor policies that established barriers against more than four fifths of the population. Adequate increases in qualified personnel could not be expected on a lasting basis without the elimination of the imposed restrictions on the labor market. As long as current labor policies persisted, public pay increases would not only continue to damage public sector finances, but would also fuel inflation. The adverse impact on competitiveness could be considerable, since the South African economy was not yet strong enough to take full advantage of the current surge in export demand.

It was encouraging to note that in 1984 the staff had continued the previous year's practice of reporting the developments in South Africa's labor policies, Mr. Finaish continued. He urged the staff to continue to devote adequate attention to that issue. It was clear that such labor policies were inconsistent with the realization of the country's growth potential and that the system remained unchanged with regard to geographical and occupational mobility, the large educational disparities, and the instance of unemployment. Some progress had been reported in Appendix I regarding the employment of skilled black workers, but it was due mainly to liberalization practices by foreign firms in compliance with codes laid down by their respective governments.

He regretted that South Africa had limited its early repurchase to SDR 50 million, Mr. Finaish went on, given the doubts which had been expressed in the Board on the requirement of need and the considerable improvements in both the current and overall balance of payments accounts in 1983, which had surpassed the program targets by wide margins.

Mr. Salehkhou said that he wished to associate himself with Mr. Mtei's observations. The economic performance of South Africa under the stand-by arrangement, particularly the overall external and current account positions, clearly supported arguments of many Executive Directors who had opposed the arrangement. During the discussion on the stand-by arrangement, his chair had expressed serious doubts concerning the actual severity of South Africa's external financing problem and whether it met the requirement of balance of payments need, particularly in view of the confidence it had usually enjoyed in international capital markets.

In addition, while South Africa's external position had strengthened significantly in 1983, moving the current account into surplus, Mr. Salehkhou continued, it was clear from the staff reports that little progress had been achieved in other areas of the stabilization program, particularly with respect to domestic adjustment. As emphasized by the staff, the poor performance in areas such as the containment of cost and price inflation, the reduction of the public sector deficit, the correction of the considerable deficiencies in the tax system, and the reform of the labor market had been the result of the relaxation of the adjustment process in 1983 and of the impact of adverse exogenous developments. However, it was undeniable that a deeper factor had also been responsible for the poor performance; namely, the failure of the policies under the program to address the economy's underlying structural distortions, substantially reducing its responsiveness to traditional monetary and fiscal instruments.

In South Africa, Mr. Salehkhou went on, it was difficult to separate political from economic and financial issues, since the former encompassed the whole spectrum of social, cultural, demographic, and labor factors, which had a direct bearing on structural economic policies. As he had remarked during previous discussions on South Africa, the Government's apartheid policy had an indisputable economic dimension that should be central to any objective analysis of the economy. He agreed with Mr. Mtei's comments on the staff's extremely cautious use of words in describing

South Africa's racial, segregationist policies and their implications for the labor market and the allocation of resources. More important, it was unacceptable that the basic thrust of the staff appraisal seemed to have given credence to the Government's discriminatory policies--which had been condemned by the international community. It was regrettable that the recommendation on two previous occasions by his chair for a staff report on coordination between the general policies of the Fund and other members of the United Nations family, with special emphasis on the General Assembly's resolution concerning South Africa's apartheid policy, had not yet materialized.

He had doubts about the procedure surrounding the circulation of the staff paper on South Africa, Mr. Salehkhou said. Although the paper emphasized the special character of the South African economy and government, that could not justify its special treatment, which could create an undesirable precedent and be interpreted as evidence of Fund support of South Africa's apartheid policy.

The staff representative from the European Department recalled that some Executive Directors had questioned the performance of the South African economy under the stand-by arrangement, suggesting that the degree of adjustment achieved had been small. Although he agreed that the turnaround in the current account position had overstated the extent of the adjustment achieved, owing to the impact of the rising price of gold, it was nevertheless clear that the non-gold trade account had also strengthened markedly. That development pointed to the success of the adjustment program in eliminating excess demand, which had been a primary cause of the external imbalance in 1981-82. Admittedly, the adjustment on the export side had not been satisfactory, but that was due mainly to the drought and the weak demand in some of South Africa's trading partners.

Some Executive Directors had felt that the forecasting errors in connection with the stand-by arrangement had been large, the staff representative stated. However, it was important to keep in mind that the assumption made concerning the price of gold--which was primarily responsible for the errors--had not been a forecast in the usual sense of the word, but rather a deliberately pessimistic assumption, intended to ensure that sufficient adjustment would take place in South Africa's balance of payments even under extremely unfavorable external conditions.

On the sustainability of the external position following the stand-by arrangement, the staff representative noted that in the 1960s and early 1970s, South Africa had been able to attract autonomous capital inflows averaging nearly 3 percent of GNP, and thus to run a small current account deficit without experiencing external debt difficulties. More recently, the inflows had almost dried up; indeed, the authorities' main objective in lifting exchange controls on nonresidents had been to encourage a resumption of the capital inflows in the longer term. However, until it became evident that that was happening, it would be prudent to aim for balance in the external current account position. That consideration, together with the recent re-emergence of a deficit in the current account, suggested that some further strengthening of the external position was still necessary.

Some speakers had asked whether the staff's forecast for the current account outcome in 1984 was still valid, the staff representative went on. Given developments in the first quarter of 1984, the staff now projected a current account deficit in 1984 of 1-1.5 percent of GNP, less than the rate at which the deficit had been running during the first quarter of 1984, reflecting the expectation that the measures taken in recent months would have a dampening effect on domestic demand and the growth of imports in the second half of the year.

As to fiscal policy, the point had been made that there had been no adjustment under the stand-by arrangement, the staff representative said. However, it was important to make a distinction between 1982/83 and 1983/84. In 1982/83 there had been a considerable degree of fiscal tightening, almost entirely on the tax side, which had contributed greatly to the success of the overall adjustment effort. In fact, within South Africa, the tightening of fiscal policy had been criticized as excessive. In 1983/84, some easing of fiscal policy would arguably have been appropriate, since the external constraint had eased. Unfortunately, as noted in the staff report, the loosening of fiscal control that had actually taken place in 1983/84 had been excessive and had contributed to the deterioration in the external position and to the acceleration in the rate of inflation.

As to the effect of the increase in the general sales tax on the rate of inflation and whether recourse to other sources of revenue might have been more appropriate, the staff representative noted that the authorities recognized that the increase in the general sales tax (GST) could, as a side effect, raise the price level and have a regressive impact on the distribution of income. In fact, it was for those reasons that they had decided to exempt basic foodstuffs from the general sales tax; therefore, the increase in the GST was likely to raise prices by less than 1 percent. However, it was a long-standing objective of the authorities to shift gradually the burden of taxation from direct to indirect taxes in order to enhance incentives and efficiency. Personal income taxes were high and rising rapidly due to fiscal drag. There was some scope for increasing the effective rate of the corporation tax on some groups of companies and, as mentioned in the report, a number of measures to achieve that result had been taken in the budgets for 1983/84 and 1984/85. However, their effects on government revenue were not instantaneous and, given the urgent need to reduce the budget deficit, the resort to the GST had become almost unavoidable. The latest tax measures had clearly improved the prospects for lowering real interest rates during 1984, but whether they would prove sufficient was still uncertain. It was important to review developments regularly, and, if necessary, to take additional action. As several Directors had pointed out, the high levels of interest rates had adverse implications for neighboring countries, especially the other members of the Rand Monetary Area, a consideration that the authorities should bear in mind in framing their policies in the period ahead.

The borrowing requirement of the public sector as a whole had not been discussed in greater detail because the statistical information on the borrowing requirement of the public sector had been unavailable at the time of the discussions, and had become available only when the staff report was being finalized, the staff representative explained. It was hoped that the matter could be covered more extensively in the next consultation report. The large borrowing requirements of the public sector bodies other than the central government and the local authorities, had clearly contributed to the pressure on interest rates and had indirectly dampened private investment, but it was difficult to quantify those effects with a reasonable degree of precision.

As to contingency planning, the staff representative said, as indicated in the report, one of the main reasons for the chronic expenditure overruns in South Africa was the lack of provision in the initial expenditure estimates for a contingency reserve to meet unforeseen price increases and the costs of new policy measures. It was also desirable for the authorities to be prepared to take prompt action if circumstances during 1984 should warrant it. However, under present arrangements, the room for changing the stance of fiscal policy between budgets was rather limited.

Concerning the lack of quantitative monetary targets or guidelines, the staff representative noted that, given the apparent instability of the demand for money and the short-term volatility of the monetary aggregates, it clearly would not be advisable to adopt precise monetary guidelines. It would be necessary, first, to tackle the problems that had caused the monetary volatility, including the comparatively high cash and liquid asset requirements imposed on the banks and the legal ceilings placed on maximum lending rates. Another problem associated with the short-term volatility in monetary aggregates was the seasonality in government tax receipts and expenditures. The authorities had already taken some measures to reduce the seasonality, for example, by spreading bonus payments to civil servants evenly throughout the year, instead of paying them at a given date, as had been the practice. There had also been measures to increase the frequency of collection of company taxes, and other steps to reduce seasonality further were under consideration. The authorities were proceeding with the gradual phasing out of the liquid asset requirements on the banks and were exploring the scope for linking maximum lending rates to some market-determined interest rates. Obviously, that process of financial deregulation would continue to affect the behavior of the monetary aggregates for a considerable period.

One of the principal factors that had contributed to the fall in the personal savings ratio, especially since 1982, had been the weakness of agricultural incomes, the staff representative explained. Since the position of the agricultural sector was unlikely to improve in the near future, no short-term recovery in the savings ratio could be expected. The personal tax system was highly progressive, and it was conceivable that it had acted as a disincentive to saving, but the staff was not aware of relevant empirical studies. As for interest rates, evidence suggested that they did not have an important bearing on savings or borrowing by the private sector. It was therefore unlikely that the present high level of interest rates would stimulate a recovery in the savings ratio.

It was clear that, in principle, there were several solutions to the general problem of South African stabilization policy, the staff representative continued, though they differed in the extent to which they could insulate the economy from the effects of trade fluctuations. However, the real problems were of a practical nature, for instance, the formidable difficulty in detecting whether the price of gold and the terms of trade at any given time were above or below trend, or whether changes in them were temporary or permanent. Another practical problem was the difficulty in keeping government deposits "idle" in a stabilization account for any length of time.

As to labor market policies, the staff representative noted that there were a large number of legal and nonlegal changes taking place, making it difficult for an outsider to assess fully their significance. In the staff reports, an attempt had been made to provide a factual account of the changes that appeared to be the most relevant from an economic point of view. Many changes, such as those in education, appeared on balance to represent some progress, albeit at a very slow pace in comparison to the magnitude of the underlying problem. Furthermore, although the stated objectives of educational policy appeared to be appropriately ambitious, it was questionable whether they would be realized.

As for the language used in the staff reports to describe labor market policies, the staff representative continued, the staff had tried to report changes in a factual manner and to avoid judgment, except in the staff appraisal.

In the past, the staff representative said, the authorities' attempts to promote regional development had had unsatisfactory results. The present policy differed in some respects from previous policies. For example, the growth and concentration points had been defined in a different way, so that, although they were still close to the homelands, they covered adjoining areas; they were not restricted to the homelands. The types of regional incentives provided had also been changed, with a view to greater stimulation of employment opportunities than had been provided under earlier schemes. It was clearly too early to judge the success of the new approach. In the first nine months of 1983/84, the decentralization boards had approved 816 applications for industrial development of extension of facilities, compared with 559 approvals in the same period in 1982. If all projects were completed, the investment involved would amount to nearly R 816 million--about 7 percent of private investment in 1983--and would create about 51,000 new jobs. In practice, however, it was unlikely that all the approved projects would be carried out, indicating that the estimates should be treated as upper limits. Direct budgetary expenditure to promote regional development was a small part of the total cost to the budget; the main cost arose from tax incentives, which eroded the tax base.

The Development Bank of Southern Africa had been established by South Africa with the cooperation of the so-called independent states and had begun operations in mid-1983, the staff representative said. Its loans provided on concessional terms to participating governments, local authorities, and other agencies, were mainly to promote infrastructural projects. The Development Bank was not planning to lend directly to the private sector, although it might provide loans to development corporations that could, in turn, lend to private concerns.

The statement in the staff report concerning the standard of cooperation that the Fund's Bureau of Statistics had received from its correspondent in South Africa related to the type of information requested by the Bureau on a routine basis, and not to the quality of statistics in general in South Africa, the staff representative continued. There were obviously some deficiencies in official statistics, but they had not been discussed with the authorities during the staff's latest visit; the instructions to the staff to pay special attention to statistical issues had been given after the latest mission had returned to headquarters. The matter would certainly be addressed in the future. One statistical problem referred to in the staff report related to the quality of statistics on unemployment among black people. There was a built-in bias in the official statistics toward understating the level of black unemployment, owing in part to the requirement that employers should return so-called migrant workers to their homelands on the expiration of job contracts. As noted in the report, unofficial estimates of unemployment for black people that included the rural areas indicated that unemployment was substantially higher than the official figures suggested.

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

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/84/86 (6/4/84) and EBM/84/87 (6/6/84).

4. CAMEROON - 1984 ARTICLE IV CONSULTATION - POSTPONEMENT

The Executive Board notes the request contained in EBD/84/162 (6/1/84). Notwithstanding the period of three months specified in Procedure II of the document entitled "Surveillance over Exchange Rate Policies" attached to Decision No. 5392-(77/63), adopted April 29, 1977, the Executive Board agrees to extend the period for completing the 1984 Article IV consultation with Cameroon to not later than June 30, 1984.

Decision No. 7718-(84/87), adopted
June 5, 1984

5. ASSISTANT TO EXECUTIVE DIRECTOR

The Executive Board approves the appointment of an Assistant to an Executive Director, as set forth in EBAP/84/117 (5/30/84).

Adopted June 4, 1984

6. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors, and by an Assistant to an Executive Director as set forth in EBAP/84/119 (6/4/84) and EBAP/84/123 (6/5/84) is approved.

APPROVED: January 22, 1985

LEO VAN HOUTVEN
Secretary