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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 84/143

10:00 a.m., September 14, 1984

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

Executive Directors	Alternate Executive Directors
	W. B. Tshishimbi
	H. G. Schneider
	X. Blandin
	M. Teijeiro
	M. K. Bush
	D. C. Templeman, Temporary
M. Finaish	T. Alhaimus
H. Fujino	T. Yamashita
	B. Goos
J. E. Ismael	
R. K. Joyce	L. Leonard
A. Kafka	C. Robalino
G. Lovato	N. Coumbis
	A. S. Jayawardena
	S. El-Khouri, Temporary
	E. M. Ainley, Temporary
J. J. Polak	
A. R. G. Prowse	K. G. Morrell
G. Salehkhou	O. Kabbaj
	S. M. Hassan, Temporary
M. A. Senior	J. L. Feito
	A. Lindø
	T. A. Clark
	Wang E.

L. Van Houtven, Secretary
B. J. Owen, Assistant

Also Present

African Department: J. B. Zulu, Director; N. Abu-zobaa, E. A. Calamitsis, A. B. Diao, S. Schiavo-Campo. Asian Department: J. Thornton. European Department: L. A. Whittome, Counsellor and Director; U. Dell'Anno, M. T. Hadjimichael, L. L. Pérez, G. H. Spencer, S. M. Thakur, H. Vittas. Exchange and Trade Relations Department: M. Guitian, Deputy Director; S. Mookerjee, Deputy Director; G. G. Johnson, A. K. Mitchell. Fiscal Affairs Department: G. Blöndal, J. R. Modi, J. C. Tavares. Legal Department: G. P. Nicoletopoulos, Director; G. F. Rea, Deputy General Counsel; W. E. Holder, A. O. Liuksila, J. M. Ogoola, S. A. Silard, J. V. Surr. Middle Eastern Department: P. Chabrier, Deputy Director; J. G. Borpujari, F. Drees, S. H. Hitti, A. Kayoumy, K. Nashashibi, D. B. Noursi, S. Thayanithy, G. Tomasson, L. A. Wolfe. Research Department: P. R. Menon. Secretary's Department: J. W. Lang, Jr., Deputy Secretary; J. C. Corr. Treasurer's Department: W. O. Habermeier, Counsellor and Treasurer; D. Williams, Deputy Treasurer; K. Boese, M. N. Bhuiyan, W. L. Coats, D. S. Cutler, J. A. Gons, D. Gupta, T. B. C. Leddy, M. A. Lumsden, A. F. Moustapha, M. Sami, G. Wittich. Western Hemisphere Department: E. Wiesner, Director; S. T. Beza, Associate Director; A. Baumgarten, M. E. Bonangelino, D. S. Hoelscher, S. J. Stephens. Bureau of Statistics: J. B. Gupta. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: S. R. Abiad, A. A. Agah, K. A. Hansen, H.-S. Lee, G. E. L. Nguyen, P. Péterfalvy, D. I. S. Shaw, A. Steinberg. Assistants to Executive Directors: H. Alaoui-Abdallaoui, J. R. N. Almeida, W.-R. Bengs, J. Bulloch, M. Camara, M. B. Chatah, C. Flamant, D. Hammann, A. K. Juusela, A. Koné, E. Landis, K. Murakami, G. W. K. Pickering, D. J. Robinson, A. A. Scholten, Shao Z., S. Sornyanyontr, A. Yasseri.

1. MOZAMBIQUE - MEMBERSHIP - REPORT OF COMMITTEE

The Executive Directors considered the report by the Committee on Membership for Mozambique (EBD/84/243, Revision 1, 9/13/84).

The Chairman observed that the Executive Board of the World Bank was expected to consider Mozambique's application for membership in the Bank shortly.

Mr. Blandin expressed regret on behalf of Mr. de Maulde, Chairman of the membership committee, that he could not be present for the discussion. Mr. de Maulde hoped that the Executive Board would accept the Committee's recommendations.

Mr. Prowse asked for an explanation of the procedures remaining before Mozambique could become a member. His question arose because of the possible implications for the Joint Procedures Committee, for which Australia was the Reporting Member.

The Secretary responded that matters on which the Boards of Governors had to vote were normally dealt with in the closing plenary session, based on the reports of the Joint Procedures Committee that were presented by the Reporting Member. However, if it was ascertained that Mozambique wished to become a member in time to participate in the Regular Election of Executive Directors, to be held on the second day of the Annual Meetings, it would be possible to suggest to the Chairman of the Board of Governors that he call a special meeting of the Joint Procedures Committee following the opening session; the Reporting Member could then present a report to the Governors who would vote on the membership resolution during the afternoon session on the first day of the Meetings, which would permit Mozambique to sign the Articles of Agreement before the elections.

Mr. Hassan stated that the authorities of Mozambique had asked his chair to express their thanks to the Executive Board, management, and staff for the speedy and efficient way in which Mozambique's application for membership had been handled. Mozambique looked forward to membership in the Fund and to useful and fruitful participation in its activities, in full cooperation with all members of the international community.

Mr. Tshishimbi, followed by Ms. Bush, Mr. Kafka, and Mr. Lovato, remarked that they wished to restate the strong support for Mozambique's application for membership that they had expressed as members of the membership committee.

Mr. Polak added that he also strongly supported the application.

The Executive Directors agreed unanimously that the Executive Board should report to the Board of Governors that, pursuant to Section 21 of the By-Laws, the Board had consulted with the representatives of the Government of the People's Republic of Mozambique and had agreed upon the terms and conditions which, in the opinion of the Executive Board, the Board of Governors might wish to prescribe for admitting Mozambique to membership in the Fund.

The Executive Board thereupon approved, pursuant to Section 6(b) of the By-Laws, the following draft Resolution for inclusion on the agenda of the 1984 Annual Meetings:

MEMBERSHIP FOR THE PEOPLE'S REPUBLIC OF MOZAMBIQUE

WHEREAS, the People's Republic of Mozambique on May 3, 1984 requested admission to membership in the International Monetary Fund in accordance with Article II, Section 2 of the Articles of Agreement of the Fund;

WHEREAS, pursuant to Section 21 of the By-Laws of the Fund, the Executive Board has consulted with the representative of the People's Republic of Mozambique and has agreed upon the terms and conditions which, in the opinion of the Executive Board, the Board of Governors may wish to prescribe for admitting the People's Republic of Mozambique to membership in the Fund;

NOW, THEREFORE, the Board of Governors, having considered the recommendations of the Executive Board, hereby resolves that the terms and conditions upon which the People's Republic of Mozambique shall be admitted to membership in the Fund shall be as follows:

1. Definitions: As used in this Resolution:

   (a) The term "Fund" means the International Monetary Fund;

   (b) The term "Articles" means the Articles of Agreement of the International Monetary Fund, as amended;

2. Quota: The quota of the People's Republic of Mozambique shall be SDR 61 million.

3. Payment of Subscription: The subscription of the People's Republic of Mozambique shall be equal to its quota. The People's Republic of Mozambique shall pay 21.7 percent of its subscription in SDRs or in the currencies of other members selected from those currencies that the Fund would receive in accordance with the operational budget in effect at the time of payment. The balance of the subscription shall be paid in the currency of the People's Republic of Mozambique.

4. Timing of Payment and Subscription: The People's Republic of Mozambique shall pay its subscription within six months after accepting membership in the Fund.

5. Exchange Transactions with the Fund and Remuneration: The People's Republic of Mozambique may not engage in transactions under Article V, Section 3, or receive remuneration under Article V, Section 9, until its subscription has been paid in full.

6. Exchange Arrangements: Within 30 days after accepting membership in the Fund, the People's Republic of Mozambique shall notify the Fund of the exchange arrangements it intends to apply in fulfillment of its obligations under Article IV, Section 1 of the Articles.

7. Representation and Information: Before accepting membership in the Fund, the People's Republic of Mozambique shall represent to the Fund that it has taken all action necessary to sign and deposit the Instrument of Acceptance and sign the Articles as contemplated by paragraphs 8(a) and 8(b) of this Resolution, and the People's Republic of Mozambique shall furnish to the Fund such information in respect of such action as the Fund may request.

8. Effective Date of Membership: After the Fund shall have informed the Government of the United States of America that the People's Republic of Mozambique has complied with the conditions set forth in paragraph 7 of this Resolution, the People's Republic of Mozambique shall become a member of the Fund on the date when the People's Republic of Mozambique shall have complied with the following requirements:

   (a) The People's Republic of Mozambique shall deposit with the Government of the United States of America an instrument stating that it accepts in accordance with its law the Articles and all the terms and conditions prescribed in this Resolution, and that it has taken all steps necessary to enable it to carry out all its obligations under the Articles and this Resolution; and

   (b) The People's Republic of Mozambique shall sign the original copy of the Articles held in the Archives of the Government of the United States of America.

9. Period for Acceptance of Membership: The People's Republic of Mozambique may accept membership in the Fund pursuant to this Resolution not later than six months after the effective date of this Resolution, which date shall be the date of its adoption by the Board of Governors; provided, however, that, if the circumstances of the People's Republic of Mozambique are deemed by the Executive Board to warrant an extension of the period during which the People's Republic of Mozambique may accept membership pursuant to this Resolution, the Executive Board may extend such period until such later date as it may determine.

The Executive Board then took the following decision:

1. The Managing Director is directed to inform the Chairman of the Board of Governors and to advise all members of the addition to the agenda of the 1984 Annual Meetings of the draft Resolution on membership for Mozambique.

2. The Secretary is authorized to take such further action as he shall deem appropriate in order to carry out the purpose of this decision.

Decision No. 7807-(84/143), adopted
September 14, 1984

2. DESIGNATION PLAN AND OPERATIONAL BUDGET FOR SEPTEMBER-NOVEMBER 1984

The Executive Directors considered the proposed designation plan (EBS/84/188, 8/31/84) and operational budget (EBS/84/189, 8/31/84) for the quarterly period September-November 1984.

The staff representative from the Treasurer's Department said that Table 4 would be reissued to show actual use of currencies and SDRs under the operational budget for the quarterly period June-August 1984 (see EBS/84/189, Supplement 1, 9/14/84). There had been some additional transactions, and other transactions for which currencies had been earmarked that had not taken place. As indicated in EBS/84/189, the staff had been consulting with lenders to try to arrange means for the repayment of loans and the payment of interest within the framework of the currency amounts in the budget. That objective was being facilitated by the cooperative response of some lenders, especially Saudi Arabia.

An additional SDR 140 million had been used in designation (see EBS/84/188, Supplement 1, 9/14/84), the staff representative added. However, the usual recalculations based on the new SDR holdings of participants indicated that the changes were too minor to justify any changes in the designation plan proposed for the quarterly period September-November 1984.

Mr. Goos said that he could support both proposed decisions. His authorities welcomed the staff's efforts to reach an understanding with lenders on the means of payment for executing the proposed budget. Meeting the preferences of lenders might mean that the amounts foreseen on the transfer side of the proposed budget would be insufficient. In that case, appropriate adjustments should be made in subsequent budgets, as the staff had proposed.

Mr. Clark said that he welcomed the absence from the operational budget for the next quarter of any ad hoc limitations on the use of currencies of certain members.

Ms. Bush noted that the use of dollars in transfers under the existing budget had been somewhat in excess of the estimated $500 million. She hoped that the staff would continue to make efforts, both in meeting requested purchases and in repayments to lenders, to permit the Fund to contain the usage of dollars within the budgeted amount. She welcomed the responsiveness of lenders in that effort so far.

Mr. Finaish said that, like Mr. Clark, he had noticed the absence from the operational budget of ad hoc limitations on the use of currencies of certain small quota countries. Such limitations had been part of budgets since June 1982. As recently as February 1984, the Executive Board had concluded that those ad hoc limitations should continue to be applied; three members might have been eligible to benefit from them in the proposed budget for the quarter from September-November: Oman, which was in his constituency, Malta, and Singapore. The proposed gross transfers of their currencies amounted to between 13 percent and 18 percent of quota compared with an average of 3.5 percent of quota for other members included in the budget. On a net basis, the proposed sales of the currencies of those three members amounted to between 12 percent and 17 percent of quota compared to an average of 2-3 percent for other currencies. He hoped that such members would continue to benefit from ad hoc limitations in the absence of any reason for discontinuing the agreed procedure.

Mr. Ismael endorsed the statement made by Mr. Finaish.

Mr. Lovato added that, on behalf of his Maltese authorities, he also wished to support Mr. Finaish's position.

Mr. Schneider recalled that from time to time in the past he had expressed objections to the procedure permitting ad hoc limitations. He could support the designation plan and proposed budget without ad hoc adjustments on the use of certain members' currencies.

Mr. El-Khouri joined others in supporting Mr. Finaish's remarks.

Mr. Polak commented that he was not very much in favor of ad hoc adjustments, which might in future become less and less necessary. He had noted that at least one country--Singapore--no longer qualified. Perhaps the procedure was being overtaken by developments.

The staff representative from the Treasurer's Department explained that based on the record of previous discussions in the Executive Board, Executive Directors had appeared willing to accept for the time being the continuation of the practice of ad hoc adjustments. The staff had not interpreted that position as an instruction to continue to make such adjustments if they were unnecessary. The Fund's holdings of Singapore's currency were being reduced to the level at which there would be little use of the currency unless that use went below 10 percent of quota. The omission of ad hoc limitations on the use of the currencies of the other countries mentioned by Mr. Finaish was based at least in part on the fact that there had been scarcely any net use of those two currencies since the Executive Board had discussed the procedural issue. The Fund's holdings of one currency were higher than they had been at that time. It had therefore seemed timely not to propose an ad hoc adjustment, although the possibility was not ruled out for future budgets.

The Chairman, in response to a question by Mr. Finaish, said that he hoped the Executive Board had been reassured by the staff's explanation of why it had not resorted to the use of ad hoc limitations in the proposed budget although it had not precluded the application of the procedure in future.

Mr. Finaish recalled that the issue had been discussed at length, and both the amounts and the countries concerned were small. He had therefore thought that the procedure would be invoked in proposed budgets, unless the Executive Board took a decision to the contrary. In any event, it would be useful if, in future papers on the operational budget, the staff would explain the reasons for applying or not applying the procedure.

The Executive Directors agreed to accept the operational budget as proposed.

The Executive Board then took the following decisions:

SDR Department - Designation Plan for September-November 1984

The Executive Board approves the designation plan for the quarterly period beginning September 14, 1984 as set out in EBS/84/188.

Decision No. 7808-(84/143), adopted
September 14, 1984

Operational Budget for September-November 1984

The Executive Board approves the list of members considered sufficiently strong as set out in EBS/84/189, page 3, footnote 1, and the operational budget for the quarterly period beginning September 14, 1984, as set out in EBS/84/189.

Decision No. 7809-(84/143), adopted
September 14, 1984

3. IRELAND - 1984 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1984 Article IV consultation with Ireland (SM/84/206, 8/22/84; and Cor. 1, 9/20/84). They also had before them a report on recent economic developments in Ireland (SM/84/209, 8/31/84).

The staff representative from the European Department stated that some corrected and updated factual information had been received from the Irish authorities that did not however affect the substance of either the staff report or appraisal (see SM/84/206, Correction 1, 9/20/84). The authorities had also informed the staff that they were in the process of reviewing their forecasts for 1984 and expected as a result to revise upward the rate of growth in real GDP from 2 percent to about 3 percent. The revision reflected the stronger than previously expected performance of exports. In addition, the rate of inflation was now expected to be close to 9 percent rather than 8.5 percent, reflecting mainly the recent decision to reduce food subsidies, as well as developments in the exchange rate for the Irish pound. Taking into account the stronger export performance so far in 1984, the current account deficit was likely to be about 5.5 percent of GNP, or about half a percentage point less than had been projected earlier. The staff broadly agreed with those revisions which, to some extent, had been incorporated in the forecasts made in the context of the latest World Economic Outlook exercise.

Mr. Leonard made the following statement:

Background

Financial and short-term management of the Irish economy is conducted in the context of two broad objectives of national policy. The first is providing employment for a growing labor force, and the second is bringing living standards closer to general European Community levels by improving the structure of the economy and enhancing its performance. Unfortunately, growing tendencies toward internal and external imbalance in the later years of the 1970s and in the first years of the present decade jeopardized the longer-term pursuit of these objectives.

The emphasis of policy was accordingly shifted to the correction of imbalances and the restoration of a sound basis for rapid and sustainable growth in future years.

Adjustment measures by the authorities have focused on the reduction of the current budget deficit and overall public sector borrowing, especially external borrowing, moderating the level of pay settlements, lowering inflation, and narrowing the external payments deficit on current account. Significant progress under all these heads has been brought about since 1981 when adjustment was initiated.

The Irish authorities' view of economic developments in 1983 and of the appropriate policy response to them and to prospects in 1984 generally accords with that of the staff in its report for the 1984 Article IV consultation with Ireland.

Fiscal policy

In line with intentions put before the Board in the 1983 Article IV discussions, the current budget deficit was reduced by 1 percentage point of GNP in 1983, the Exchequer Borrowing Requirement (EBR) by 3 percentage points and the Public Sector Borrowing Requirement (PSBR) by slightly more than that. Action to contain the relative role of current public spending in the economy continued. Government consumption and subsidies were kept at about the same relative level as in 1982 but interest and transfer payments increased so that total current spending rose by about a further percentage point of GNP. An increase in taxation from about 40.5 percent to 43 percent of GNP, therefore, accounted for the reduction of the current deficit. At the same time, capital spending was reduced by nearly 2.5 percentage points of GNP.

The Government have adhered to their program of fiscal discipline in the 1984 Budget. In doing so, they sought to steer an acceptable course between two dangers. Too deflationary an approach would have undermined business confidence, compounded revenue problems, and stunted the ability of the economy to share in the economic recovery in Europe and the United States. On the other hand, premature or undue fiscal relaxation could have revived unrealistic expectations and run counter to the needs of sustainable growth in the future. The Budget, therefore, sought to consolidate the fiscal gains already made by further but modest decreases in the current budget deficit and public borrowing. Tight control over public expenditure was maintained and, in particular, public consumption as a proportion of GNP was reduced. Restrictions on the filling of vacancies in the public service continued and no provision was made for public sector pay increases as a result of any new pay round in 1984.

Charges for a number of public services were either levied or increased. Scope did not exist for reduction in the tax burden. Indeed, there was a marginal increase in order to effect a fairer distribution of taxation and to help persons on low incomes.

Provisional figures for revenue and expenditure in the first half of this year are in line with the provisions of the Budget. Nevertheless, as part of their medium-term intentions for expenditure the Government announced in August last a cut in food subsidies of about 50 percent with immediate effect. It is estimated to lead to savings of about £Ir 16.5 million in 1984 and of £Ir 46 million in a full year; the price effect will be to increase the cost of living by about 0.5 percent. The measure was taken in the light of a detailed examination of future prospects for revenue and expenditure which showed that even though the Budget was on track, the financial position of the State would be aggravated, especially by the growing burden of Exchequer debt service, unless radical measures were taken. The Government also announced two further measures which would result in savings of about £Ir 10 million a year.

Incomes policy

The omission of any provision in the Budget for a negotiated public sector pay increase reinforces the Government's recommendations for a general pay pause in 1984 to be followed by increases of not more than a few percentage points in agreements lasting 18 months. The private sector response to the Government's guideline is as yet unclear as no definite trend has emerged from the limited number of pay settlements that have been made so far. Recent settlements averaging about 9 percent for 12-13 month periods have tended to exceed the Government's guideline but have been significantly lower than the corresponding settlements in the preceding pay round. Moreover, about one fifth of the workers involved are covered by pay pauses averaging three months in duration. A further encouraging development in the spirit of the Government's guideline is that the recommendations of the Labour Court now have more regard to the financial position of individual enterprises rather than to any established trend in settlements. This was made explicit in a recent case, when the Court stated that increases during the round should relate more closely to the viability and prosperity of the individual firm than to any established average increase.

Monetary policy

Institutional factors and the openness of the economy limit the scope for monetary policy which is operated primarily to protect the exchange rate and to maintain adequate official reserves. Operational targets are mainly set in terms of guidelines for the extension of bank credit to the private sector. In setting those for 1983 and 1984, the authorities, in accord with the generally tight approach to demand management, announced modest limits of 11 percent and 10 percent, respectively. In the event in 1983, the low level of economic activity constrained actual demand even further so that the guideline was more than met. In the same year, an increased share of the EBR was financed by nonmonetary means, so that overall the rate of Domestic Credit Expansion (DCE) was markedly below that of 1982. DCE in 1984 could be lower again but how much is at present uncertain. The authorities envisage a figure somewhat in excess of 20 percent.

The trend toward the use of market-oriented instruments in the operation of monetary policy brought to the attention of the Executive Board in 1983 continues. Thus, the guideline for bank credit expansion to the private sector in 1984 was set as an indicative figure for the banking system as a whole without, as previously, ceilings for individual banks.

Supply side measures

Vigorous supply side measures have long partnered action to influence aggregate demand in overall economic management and are continuously reviewed and adapted to take account of changing trading conditions. At present, particular attention is being given to encouraging individual enterprise and initiative with the intention of broadening and deepening the indigenous industrial base alongside that provided by firms attracted from abroad. As part of this intention, incentives are being tailored to promote the growth in Ireland of research and development, marketing, design, and other capabilities which do not now exist to an adequate extent. The importance of attracting investment from abroad in the interests of growth and employment nevertheless remains a central objective of policy, and intensive effort to that end is continuing.

In the present rigorous control of public capital spending careful scrutiny is also made of the supply side importance of infrastructural expenditures and priority is given to those where the economic benefits promise to be greatest. In this regard, it is hoped that despite the curtailment of public investment, development of the potential of the economy will not be impaired and that the high incremental capital output ratio (ICOR) which has characterized past overall investment will be reduced.

Response of the economy to policy action

Many heartening features mark the response of the economy to the measures taken by the authorities. The volume and value of exports increased notably in 1982 and 1983 and are projected to increase further in 1984. The volume of imports actually fell in 1982 and grew only moderately in 1983; their rate of growth will be higher in 1984, but nevertheless, the marked improvement in the current external deficit, which has taken place since the high point in 1981, will continue in 1984 also.

Annual inflation in terms of the Consumer Price Index (CPI) has fallen from over 20 percent in 1981 to 10.4 percent in 1983 and is now expected to be 9 percent or less in 1984. The underlying rate is even lower but is masked by the price effects of changes in indirect taxation and the removal of consumer subsidies. The international competitiveness of Irish production, though hard to establish exactly, has also improved and appears to be healthy relative to the country's main trading partners.

While manufacturing production has been buoyant last year and this, the overall performance of national output, though improving, falls considerably short of national requirements. GNP growth was negative in 1983 and is forecast at about 1.75 percent in 1984. The corresponding figures for GDP are 0.6 percent and 2.5 percent. There has been a widespread fall in real incomes for some time past and the unemployment rate is expected to be of the order of 16 percent according to the latest estimates.

In spite of the pressing need for more growth, the considerable imbalances remaining in the economy continue to have the attention of the Government. A three-year national plan is at present being completed. Details are not yet available but it has already been indicated that reduction of the current budget deficit and of overall borrowing will continue over the plan period. At the same time, the current external deficit will be brought down further below the level expected this year.

My authorities are grateful for the thorough and comprehensive review of the economy made by the staff and have asked me to thank them for its work and advice.

The trade figures for July had just been announced, Mr. Leonard added, and they showed a surplus on the trade account of £Ir 116 million, the second highest monthly surplus ever recorded. For the period from January to July inclusive, there was expected to be a surplus of £Ir 51 million compared with a deficit of £Ir 342 million for the corresponding period in 1983. Although he could not yet say by how much, the current account of the balance of payments should also show an improvement.

Mr. Blandin commented that among the successes recorded by the Irish economy in 1983 and in early 1984 he would mention the slowing down of the rate of inflation to 9 percent from 21 percent in 1981, and the sharp reduction in the current account deficit over the past two years from 9.5 percent of GNP to 5.5 percent. The considerable advance in the process of adjustment was however somewhat shadowed by some less good news. Consumer prices remained high compared with those prevailing in Ireland's main trading partner countries; the ratio of current government spending to GNP, at 53 percent, was also very high; last but not least, unemployment was expected to increase further in 1984 and would affect 17 percent of the work force.

Against that background, the only realistic course was to pursue and strengthen the process of correcting underlying weaknesses in the economy, Mr. Blandin continued. In considering the medium-term prospects of the Irish economy, the main question therefore seemed to center around the size of the budget deficit and the measures that were most likely to reduce it. In addition, a steady improvement in Ireland's relative cost and price position would be needed to bring about the necessary gain in export earnings to provide the wherewithal for external debt servicing.

As far as the budget was concerned, the authorities' task did not appear to be an easy one, with public debt service absorbing one third of total tax receipts, Mr. Blandin continued. He shared the staff view that cuts in expenditure would be more appropriate than increases in taxes, which were already relatively high. Further curtailments in public service remuneration, in employment, and in social transfer payments--which had increased in the six years up to 1983 by a cumulative 62 percent in real terms--would be necessary. The intention of the authorities to implement measures aimed at restructuring taxes was welcome, although they should envisage a more fundamental tax reform in order to discourage tax evasion and to lessen recourse to the black economy. At the same time, while emphasis should continue to be placed on limiting the public sector deficit, other policies should be implemented with the objective of reducing inflation and improving external competitiveness. In particular, as outlined by the staff, it would be important to mobilize additional domestic financial resources through a more flexible interest rate policy. A restrictive wage policy could also play a crucial role; recent developments did not indicate clearly whether the official pay guidelines were being observed, and it would be of great interest to him to be informed of the latest developments.

Unemployment was the most disquieting structural problem of the Irish economy, Mr. Blandin noted. The authorities had relied heavily on an active industrial policy to tackle the problem, but their approach raised the sensitive issue of how to define an outward-looking development strategy in an open economy in which more than half of GNP was accounted for by trade. Inevitably, the result was heavy dependence on the rate of growth in foreign markets; the increasing competition from newly industrialized countries was a continuing menace, especially with respect to traditional goods, such as textiles, clothing, and footwear. Large-scale foreign investments, in spite of their merits, had not succeeded entirely in filling the gap between the demand for and the supply of jobs. The formulation by the Government of a new industrial policy geared to export-oriented technological investment demonstrated its apparent awareness of the flaw in such a development strategy.

As for the eventuality of an exchange rate adjustment, a question that the staff had raised with the Irish authorities, he fully shared the official view that such action would, in the end, affect the rate of inflation adversely, Mr. Blandin said. Personally, he was dubious about a devaluation as the most effective way to improve competitiveness in the long term for an economy that was at the same time relatively small in size and very open. In conclusion, he broadly endorsed the staff appraisal, which adequately identified the main topics on which the authorities should focus attention. It was only fair to recognize that they had already given active consideration to those matters and that their firm commitment to the pursuit of adjustment policy could not be questioned.

Mr. Clark observed that the Irish authorities had made good progress since 1981 toward reducing the considerable internal and external imbalances in the economy. Further adjustment along those lines was needed. It was obvious, however, that the room for maneuver was tightly constrained by the very large fiscal deficit, the very high public sector and external debt, and the very high unemployment.

Despite some reduction, the overall Exchequer borrowing requirement (EBR) was still forecast to be almost 13 percent of GNP in 1984, Mr. Clark continued. Moreover, when borrowing by state-sponsored bodies and local authorities was included, the public sector borrowing requirement (PSBR) totaled 17 percent of GNP, higher than for any other member of the European Community. He recognized that those figures reflected, to some extent, the major role of public sector capital spending in the Irish economy, but deficits at such levels could clearly not continue.

As the staff had noted, the authorities' budgetary objectives for 1984 had been too modest, Mr. Clark added. Therefore, he welcomed the introduction in August of additional measures to constrain the growth of government spending. As Mr. Leonard had stated, those measures were expected to produce savings of about £Ir 56 million in a full year. During the Executive Board's discussion of the 1983 Article IV consultation report, his chair had welcomed the authorities' intention to eliminate the current budget deficit by 1987. The recent announcement that the target had been abandoned was therefore disappointing; instead of eliminating the deficit, the authorities apparently planned to limit it to around 5 percent of GNP by that time. The slippage was unfortunate for two reasons: first, because of the pressing need to bring government debt under control and to curb the rising burden of interest payments; and second, because the decision could have an adverse effect on financial market confidence and on the perception of the authorities' determination to deal with the fiscal deficit.

Decisions involving cuts in government expenditure were often difficult and delicate, Mr. Clark remarked. But he wondered whether the authorities could not make faster progress toward fiscal equilibrium in certain areas--for instance, that of social benefits. The real value of old age pensions, according to an OECD estimate, had risen by 40 percent between 1976 and 1982. Over the same period, the ratio of unemployment benefits to net disposable income had risen from 74 percent to 82 percent; meanwhile, real disposable wages had fallen by about 10 percent in the five years to 1983. He would be interested in Mr. Leonard's and the staff's comments on the possible need to review the balance between social benefits and earnings. The tax burden fell disproportionately on employees. Therefore, in addition to the measures suggested by the staff, the authorities might consider increasing taxes on property, on the corporate sector, and perhaps also on the self-employed.

The reduction in the monetary financing of the government deficit over the past few years was welcome, Mr. Clark went on, although the apparent reversal in that trend in the first half of 1984 suggested that the authorities' resistance to upward pressures on interest rates had made government securities unattractive to the nonprivate sector. The authorities had demonstrated greater flexibility in setting the objective for the growth of private sector credit by means of an indicative guideline for the banking system as a whole instead of a ceiling for individual banks. The official guideline of 10 percent on bank lending to the personal sector in the year to mid-November 1984 had also been retained, indicating perhaps that the authorities saw a need to direct lending toward the corporate sector. He had noted the declining trend in domestic credit expansion over the past year as well as the generally satisfactory evolution of private sector credit since 1981.

He had missed in the staff report the usual comprehensive medium-term balance of payments projections, Mr. Clark remarked, although the current account balance was shown up to 1990. Gratifying progress had been made in reducing the current account deficit from 15 percent of GNP in 1981 to 5.5 percent in 1983. However, the authorities would need to aim at a surplus on current account in order to stabilize and eventually reduce the level of external debt. He was therefore concerned that the deficit was forecast to fall by only three fourths of a percent of GNP in 1984, and to remain broadly unchanged in 1985 and 1986.

The overall export performance of the economy had been commendable, Mr. Clark observed. It was noteworthy that the main impetus had come from the establishment of large export-oriented firms producing goods with a high import content and low local value added. By contrast, exports of other manufactured goods, produced mainly by older indigenous companies, had languished. Concern over competitiveness seemed to be borne out by the conventional indicators. Despite the decline in inflation in Ireland since 1981, the rate remained well above the average for the European Community. Also, since 1981, the real exchange rate had appreciated substantially, on the basis of relative consumer prices, vis-à-vis Ireland's partners in the exchange rate mechanism of the European Monetary System.

He therefore endorsed the staff's assessment of the need for greater wage restraint, particularly in the public sector. The fact that an overvalued exchange rate affected the capital as well as the current account might be particularly relevant because Ireland placed great importance on attracting investment from abroad. He noted that Ireland's share of U.S. manufacturing investment in Europe had fallen from 2.3 percent in 1979 to 1.5 percent in 1982, despite the incentives offered by the Irish Industrial Development Authority to foreign investors. He would be interested to have the staff views on the appeal of such investment incentives in the current exchange rate environment.

Mr. Lovato said that it was apparent from the data that Ireland was making appreciable progress toward economic recovery and financial readjustment on both the domestic and external fronts. He agreed with the staff's general message that the progress must be consolidated, and he welcomed the authorities' intentions to persevere in their adjustment effort.

The picture emerging from the staff reports was one of an economy undergoing a deep process of transformation, involving the sectoral composition of output and the structure and direction of foreign trade, Mr. Lovato went on. Such a process brought with it the technical obsolescence of capital, costs related to the reconversion of manpower, and, in the presence of a rapidly growing labor force, increasing unemployment. However, in the midst of that transformation the economy had shown clear signs of vitality: industrial production had expanded rapidly, particularly in the area of capital goods; the technological content of the expanding sectors was high; and exports had grown briskly, particularly in the new industries.

The process of expansion and technical innovation had been triggered to a large extent by foreign direct investment, particularly from the United States, that provided a positive counterpart for the decline in the traditional industrial sectors, Mr. Lovato commented. Unfortunately, the expansion had failed to activate the rest of the domestic economy in a significant way; the demand for inputs had been largely satisfied by foreign producers, and even the service sector had not responded appreciably to the stimulus. Consequently, the overall impact on employment had been limited, the labor force released by the traditional sectors not having been reabsorbed in the new expanding industries.

The growth in the size of the public sector and its deficit in the 1970s had to be viewed against the background of those structural changes, Mr. Lovato observed. Unemployment compensation had expanded markedly in real terms, public sector employment had risen steadily as a percentage of total employment, capital expenditures related to industrial policy had increased, and demographic trends had boosted pension outlays as well as costs for health and education. Although he endorsed the staff view that growing public expenditures were a major factor in explaining developments in prices and the external accounts after the turn of the decade, he tended to view them largely as a consequence, rather than as a cause, of the difficulties in the real economy.

The fiscal stance in 1984, as Mr. Leonard had pointed out, continued to reflect a balance among the conflicting goals of reducing the deficit while limiting the deflationary effects of budgetary restraint, Mr. Lovato noted. A steady reduction in that part of the deficit attributable to current spending should continue to be an important priority of policy, particularly if a strong squeezing of capital expenditures was to be avoided. However, in order to reduce the constraints that the fiscal stance imposed on monetary policy, efforts should be devoted toward broadening the market for public securities. In addition, attention should be given to the structure of taxation, both with the purpose of enlarging the tax base, particularly in respect of property taxes, and to avoid very high marginal income tax rates that might reduce incentives and stimulate tax evasion.

The main policy challenge at present, however, came from the real domestic economy, where it was necessary to facilitate a further expansion of the most dynamic sectors, thereby transmitting the related beneficial effects to the rest of the economy, Mr. Lovato considered. First, external competitiveness should be carefully evaluated and managed, not in relation to the whole economy--for the reasons convincingly put forward in the report on recent economic developments--but rather to those particular sectors. Second, a liberal policy on direct investment should be followed. Finally, domestic suppliers should be given adequate incentives to increase their response to the demand for inputs originating in those dynamic sectors. In essence, those were the very supply-side measures to which Mr. Leonard had referred.

Overall, the Irish economy, though troubled by financial imbalances and structural difficulties, held out elements of promise, Mr. Lovato remarked. There was an evident need for a steady policy course directed toward fiscal restraint, productive stimulus, and the development of infrastructure. The forthcoming three-year plan mentioned by Mr. Leonard would constitute the appropriate framework within which to organize a consistent adjustment effort, and he looked forward to receiving specific information on the content of the plan.

Mr. Ainley said that he could endorse the main points in the staff appraisal. The Irish economy had been through a difficult period in the past six years, as all the main economic indicators showed. The overall position had, however, improved since 1981. To their credit, the authorities had moved to tackle two of the major weaknesses in the economy--namely, the rapid growth in government spending and excessive wage settlements. The results had been encouraging, and a moderate, export-led recovery was under way.

The short-term prospects were relatively good, Mr. Ainley continued, but the underlying imbalances remained, and they were large. In that respect, Ireland's position was similar to that of other, smaller industrial countries. If growth and employment were to recover on a lasting basis, there was no alternative to continued adjustment. That adjustment had to come primarily in the fiscal area, where the imbalances were most serious. In particular, the very large burden of public sector debt, both domestic and external, represented a substantial drain on present and future resources.

The authorities recognized the problems, and the 1984 budget contained a number of useful steps in the right direction, four of which were worth singling out, Mr. Ainley considered. He had in mind the improvements in expenditure control, the limits imposed on new employment in the public sector, the more stringent criteria applied to public investment projects, and the moves to improve efficiency in the state-sponsored enterprises. But the real question was whether the authorities were doing enough. Like Mr. Clark, he was disappointed that the authorities appeared to have abandoned the objective of eliminating the current budget deficit by 1987. He tended to agree with the staff that the time had come for Ireland--like other industrial countries--to re-examine its public services and welfare benefits to determine what it could realistically afford. The task would not be easy, but delay in addressing the issue would run the risk of adding to the fiscal problem. He also agreed with the staff that given the budgetary constraints, there was little room to reduce the high burden of taxation in the short term. However, he hoped that the authorities would find a way of using the scope for improvement that seemed to exist to simplify the tax system and broaden the tax base.

A sustained reduction in the fiscal deficit would help to contain the rise in domestic and external borrowing, which was already at extremely high levels, Mr. Ainley commented. He welcomed the authorities' efforts to finance an increasing part of the deficit by nonmonetary means. The introduction of new debt instruments should also make it easier to carry out a more flexible monetary policy. He shared the staff's note of caution on external borrowing; the debt service ratio would remain high in the period to 1990, even with no further borrowing, and sizable amounts of debt would have to be refinanced in the few years ahead.

Firm financial policies would have to be accompanied by other measures to promote new investment, which remained stagnant, and to improve competitiveness, Mr. Ainley said. Therefore, he encouraged the authorities to maintain their firm line in the current wage round. Continued wage moderation over the medium term was necessary to consolidate the recent impressive gains in productivity.

Continued wage restraint was also vital to enhance employment prospects, Mr. Ainley added. In that respect, the authorities had had some success in restructuring the industrial base and in promoting high technology manufacturing industries. But that strategy had not had the hoped for multiplier effects. He therefore welcomed the recent shift toward a more selective approach designed to broaden the base for future industrial development. It would be interesting to learn from the staff or Mr. Leonard whether any details of the three-year plan for 1985-87 were yet available.

It was surprising to find so little in the staff report about the agricultural sector and agricultural policies, Mr. Ainley remarked, and for two reasons. First, that sector played a major role in the Irish economy and accounted for over 20 percent of exports in 1983. Second, although there was a brief reference in the report on recent economic developments to the changed outlook for agriculture as a result of recent modifications in the Common Agricultural Policy (CAP), additional information might have been helpful since those modifications would presumably have an impact on the overall performance and prospects for the economy.

In conclusion, Mr. Ainley considered that the authorities were on the right track but that with an accelerated adjustment effort, the economy would be better placed to participate fully in the world recovery.

Mr. Schneider remarked that in spite of some encouraging improvements, the Irish economy was still plagued by serious imbalances whose correction, given their magnitude, would take a considerable number of years and would weigh heavily on growth prospects if the present policy approach was maintained. While structural reform seemed to have been successful, as witnessed by the expansion of new high technology industries, it had benefited only the external sector and had made hardly any contribution to improving the fiscal imbalance or to reducing the high level of unemployment. It could thus be argued rightly that the adjustment effort had been too timid to have much of an impact on either the budget or employment, beyond merely arresting their deterioration.

The prudent attitude of the Government in trying to avert too abrupt a deflation of the economy was fully understandable, with such high unemployment, Mr. Schneider continued. Yet in his view too much attention had been given so far to the correction of existing imbalances, and none to the possible effect on growth prospects. It was, however, obvious that the correction of the fiscal imbalance and the high unemployment would be greatly facilitated by a more favorable economic environment in terms of higher growth. That such growth could not be provided by exports alone had been amply demonstrated by events over the past two years. The strong contribution of the external sector had hardly been sufficient to compensate for the decline in gross domestic expenditure. More attention should be given to supporting specific sectors of domestic demand together with a further improvement of the external balance.

Despite a tremendous improvement in the external current account, in the order of about 8.5 percent of GNP over the years 1982 and 1983, the deficit remained high in proportion to GNP and was expected to improve only gradually toward the end of the 1980s, Mr. Schneider remarked. Therefore, he wondered whether the authorities should not keep an open mind on other measures to improve competitiveness than wage restraint, on which they had relied exclusively and which had so far yielded only marginal results. Indeed, it was far from certain that competitiveness in the more traditional sectors had improved at all, based on the evolution of investment and employment. He could agree with the staff that the conventional measures of external cost competitiveness did not seem sufficiently adequate to gauge the profitability of the export sector. Also, certain indicators of profitability reflected only developments for the manufacturing sector as a whole and tended to overstate the improvement in the traditional sectors that was due to large-scale shedding of labor. Further improvements in the latter sectors were needed to ameliorate employment prospects and the external imbalance. With unemployment at its present level, a balanced external current account would not be sustainable, and if domestic activity expanded sufficiently to absorb existing unemployment, the current account would deteriorate rapidly. The traditional sectors had been hit by the absence of significant wage moderation in 1982 and 1983; but according to the staff, the decline in real disposable wages had reflected increased taxation. There might thus be further room for decisive action in that respect.

More buoyant domestic activity would generate additional fiscal revenues, which would help to correct the fiscal imbalance but would not reduce the need for other corrective measures, Mr. Schneider added. Structural changes in the composition of budget revenue were necessary; he could not fail to note the low contribution of corporate taxes to overall fiscal revenue. A more balanced distribution of the tax burden would also have the advantage, as he had mentioned, of encouraging wage moderation. However, the main focus would have to remain on expenditure constraint and more particularly on the scaling down of public services and of the real value of transfer payments.

To conclude, Mr. Schneider believed that the Irish authorities had a long way to go to redress the imbalances of the economy. The more buoyant growth prospects that would greatly facilitate the correction of those imbalances could be enhanced by reliance on alternative methods of improving external and internal competitiveness, and by providing some stimulus to labor intensive sectors as long as the resulting expansion did not immediately spill over into increased import demand. The construction sector might be a suitable target for action. A continuation of the present gradual approach could mean that the adjustment effort would have to be maintained for a considerable number of years of low growth prospects.

Mr. Goos said that he agreed with the staff assessment and with the main thrust of its policy recommendations. The further progress made by the Irish authorities in reducing external and internal imbalances was a cause for satisfaction. Although the improved international environment might have made a contribution, the large distortions in the Irish economy at the start of the present adjustment course in 1981 suggested that the credit for the bulk of the improvements so far should go to the Irish authorities.

Nevertheless, Mr. Goos went on, the staff had demonstrated clearly that the state of the Irish economy was still far from satisfactory, and any relaxation in the adjustment effort would accordingly be premature. The adjustment effort should continue to focus on further reductions in the fiscal deficit and in the current account gap in relation to GNP. More generally, public indebtedness had reached such high levels that anything other than decisive efforts to increase public savings would offer little prospect of a sustainable turnaround of the economy. The policy prescription was harsh, in particular given the weak growth performance and the difficult employment situation, but it was bound to bear fruit in the medium term, and it seemed to be called for in order to safeguard Ireland's international creditworthiness.

The reductions in the budget deficit as well as in the Exchequer borrowing requirement could be described as rather modest, Mr. Goos considered. He had been particularly worried to note that current government spending was still on a rising trend. It was equally regrettable that the Government's commitment to eliminate the current budget deficit was at present uncertain, and he asked whether the staff or Mr. Leonard had any further information on the authorities' intentions. Press reports indicating that the Irish authorities were to aim only at reducing the public deficit to 5 percent of GNP by 1987 were puzzling. There should be room for them to pursue a somewhat more ambitious target.

As to the means by which the authorities could raise the target, Mr. Goos continued, he would join the staff in its assessment that too much emphasis had been placed so far on tax policy. Henceforth, it would be essential to shift the focus of fiscal restraint to expenditure, and in particular to the noninterest component of current spending. He fully recognized that that was easier said than done, especially in terms of getting the people's support for harsh policy decisions. After all, as the staff had noted in its report, over the next three years reductions in real expenditure of from 10 percent to 17 percent--depending on the rate of growth--would be required to eliminate the current budget deficit.

On monetary policy, Mr. Goos remarked, the substantial increase in the share of the Exchequer borrowing requirement that was financed from domestic nonmonetary sources was an encouraging trend that should be continued, as the staff had underlined.

Ireland's external public debt had risen significantly over recent years, leading to an uncomfortably high debt service ratio, Mr. Goos observed. Nevertheless, the maturity structure of the debt gave no grounds for serious concern; amortization payments were spread out fairly evenly over a long period of time. Furthermore, Ireland's creditworthiness remained good. If the Government fulfilled its commitment to cut current expenditure substantially in the medium term, recourse to external borrowing should be further lessened. He was confident that the Irish authorities would maintain their prudent foreign borrowing stance.

While Ireland's competitive position had strengthened in the recent past, Mr. Goos considered that the staff had made a convincing case in its appraisal for a further strengthening by means of greater wage restraint. However, he was not sure whether a reduction in direct taxation to increase disposable income would bring about a social consensus on general wage restraint. Owing to the tight fiscal position, any such tax reduction would have to be accompanied by a broadening of the tax base.

He understood the authorities' decision to aim at relative exchange rate stability, Mr. Goos remarked. Ireland's membership in the European Monetary System could be considered as a means of achieving a degree of price stability comparable to the development of prices in partner member countries, a position that was apparently taken by the Central Bank of Ireland. However, because Ireland's main trading partner did not participate in Europe's exchange rate arrangements, some exchange rate flexibility might not be inappropriate should Ireland's exchange rate policies come under pressure, which could not be precluded in certain circumstances.

Mr. Polak remarked that to some extent it could be said that Ireland had fallen victim to its very successful industrial policy. The volume of exports had grown vigorously over the years, by around 8 percent a year on average in the period 1977-83. The growth in exports had originated in particular from rapidly growing new industries with high productivity that, due to comparatively low labor costs and attractive tax regulations, also seemed to be quite profitable. The staff report gave the impression that that sector, which could afford large wage increases without losing its competitive edge, had acted as a wage leader, transmitting such increases to other sectors of the economy. As a result, the large traditional and labor-intensive part of the Irish economy had lost profitability and stagnated. The very buoyancy of exports aroused some fear that wage demands might not be contained in the economy as a whole. The staff had noted in its report that quite generous wage settlements had recently been granted in what it described as industries that could well afford to pay. However, he had been pleased to note from Mr. Leonard's statement that recently the recommendations of the labor court had had more regard for the financial position of individual enterprises than just to the trend in wages, a change that he hoped would find general acceptance. It would be helpful to have some comment from the staff on present wage transmission patterns in Ireland. Up to 1982, of course, the transmission of wage increases had been facilitated by the very accommodating stance of fiscal and monetary policies and had been aggravated by the immediate stimulus given to demand whenever the first signs of lagging growth appeared.

The devastating consequences of that demand policy, which was fortunately a policy of the past, had become painfully visible, Mr. Polak remarked. The total number of unemployed was as large as total employment in the manufacturing sector. It was difficult to foresee anywhere near sufficient growth in that sector to make a dent in unemployment, yet that was where real growth would have to be concentrated. Manufacturing accounted for more than a quarter of GDP and was the main source of exports. Unemployment was a grave and a long-term problem, and if it was to be resolved, wage moderation seemed essential, since fiscal retrenchment would have to continue. Yet notwithstanding government intentions to the contrary, nominal weekly earnings in manufacturing had continued to rise in real terms, and it was the trend in nominal wages that would have to be controlled because it was not enough for a country with a fixed exchange rate to be satisfied with negative real wage growth ex post.

Monetary policy was not sufficiently geared toward lowering inflation and improving the balance of payments, Mr. Polak observed. Although domestic credit expansion had recently slowed down, growth of 17 percent over the 12 months to May 1984 seemed high. Monetary financing of the budget deficit continued to weaken monetary policy significantly, and it had even picked up in the second quarter of the present year. In that context, he was concerned about signs that public foreign borrowing might exceed the already high target for 1984 of 5 1/2 percent of GNP or 8 1/4 percent of M-3. In addition, the medium-term debt scenario showed no further decline in the current account deficit in the balance of payments for 1985 and 1986. However, Mr. Leonard had indicated that the three-year national plan in preparation envisaged a further reduction in the deficit, which was indeed the appropriate approach.

He fully shared the view of the staff that, if anything, fiscal retrenchment would have to be reinforced, Mr. Polak continued. It was disquieting to observe a tendency, just when the first encouraging results of retrenchment were showing up, to back away from the target to eliminate the current account budget deficit by 1987. For that target to have been met, current noninterest expenditures in real terms would have had to decline by at least 10 percent over the three years ahead, and by even more, if the growth of GDP proved to be below the assumed rate of 4 percent a year. Even in 1984, current noninterest expenditures were expected to rise in real terms, compounding the task for future years. It seemed inevitable that all categories of current expenditure would have to be cut to contribute to the target, including social benefit payments, the real value of which had increased by more than 60 percent over the past six years, with more than half of the increase being due to rising benefit rates. He subscribed to Mr. Clark's observations on that point and hoped that the past increase in those rates would make it possible for them to be cut down in the few years to come. He would have liked to see a more comprehensive account of the structure and development of the social security system and its impact on labor incentives in the staff report on recent economic developments in Ireland.

Finally, Mr. Polak observed, the staff favored a redistribution of taxes away from the personal sector, presumably toward the corporate sector or at least toward its profitable part. He would be interested in the staff's view on whether the time had come for Ireland to cut back on the special tax facilities it offered to new industries. At the same time, some redistribution of the burden of personal taxation might be desirable; a value added tax of 35 percent seemed excessive and likely to encourage tax evasion.

Mr. Templeman observed that Ireland presented the case of an industrial country facing problems common to other industrial countries at a relatively early stage of industrialization and hence that were somewhat worse than average. A chronic budget deficit and high labor costs lay behind the stagnation of economic growth, rising unemployment, a still high inflation rate, and balance of payments and foreign debt problems of significant proportions. Fairly good progress had been made in some areas of adjustment, such as in reducing the inflation rate and the current account deficit of the balance of payments. But some economic imbalances were still very large, and adjustments would have to be pursued with vigor; to slow down the process would most likely result in a higher adjustment cost later.

The record of economic growth showed a steady decline in the growth of real GNP over the past four years, Mr. Templeman said. Although a moderate recovery seemed to be under way, it could be short-lived if fundamental problems were not resolved. Gross fixed investment had fallen in three of the past four years by substantial amounts, and the staff report showed a further small decline in 1984. The staff did foresee a possibility of some recovery in investment in 1985, but the prospects were still uncertain and the need for job creation was great, in light of the rise in the unemployment rate from about 7 1/2 percent in 1979 to the expected 16 percent or 17 percent in 1984. One positive development was the emergence of a modern high technology industrial sector with a good record of export growth and bright prospects. In addition, he would welcome any information that the staff or Mr. Leonard might have on reports of recent oil discoveries that might have commercial possibilities.

Efforts to mitigate the short-term effects of the high unemployment rate had concentrated on training and work experience for younger people and on the Enterprise Allowance Scheme, whereby funds normally allocated to pay unemployment compensation could be used by the unemployed to establish enterprises, Mr. Templeman remarked. An assessment of experience with the various schemes would be of interest. The study of the real wage gap in manufacturing, in Appendix I of the report on recent economic developments, concluded that a rather small share of the increase in the unemployment rate between 1979 and 1982 could be attributed to excessive real wages. He wondered how that finding related to the staff's emphasis on the importance of continued wage restraint.

As for inflation, Mr. Templeman said that he applauded the success to date in reducing the rise in the consumer price index from over 20 percent in 1981 to about 10 percent in 1983, with a further reduction expected to about 9 percent in 1984. However, that rate would still be significantly above the one prevailing in most of Ireland's trading partners and highlighted the need for wage moderation, so as to help deal with the employment problem and to preserve international competitiveness. He asked whether there was any new information on the status of ongoing wage negotiations.

On the balance of payments front, he had been impressed by the rapid increase in the volume of exports, which had grown at an annual average rate of over 7 percent in the past five years and were expected to exceed 11 percent in 1984, Mr. Templeman went on. In addition, the 50 percent cut in the current account deficit between 1981 and 1983 was encouraging, although it was in part a reflection of weak domestic economic activity and weak import demand. The sharp improvement in Ireland's competitive position in the past year was a positive factor, although he was aware of the caveat concerning the productivity growth derived from labor shedding. In that connection, he was a little concerned about an exchange rate policy aimed at keeping the rate as stable as possible. While too much exchange rate flexibility might tend to undermine the effort to achieve wage restraint and to reduce the budget deficit, setting exchange rate stability as a target could succeed only if inflation was reduced further through the use of other tools of economic management; otherwise, it was a risky business.

The most striking feature of the fiscal situation was the steady rise in relation to GNP of both the tax burden and expenditures, to 50 percent and 60 percent respectively, Mr. Templeman observed. While the Exchequer borrowing requirement had been reduced in 1983 to about 13 percent of GNP, compared to over 16 percent in the two preceding years, the outcome had been simply to return the ratio to the same, equally unacceptable level it had reached in 1979 and 1980. Furthermore, the overall public sector borrowing requirement, after peaking at over 20 percent of GNP in 1981 and 1982, was still in the 17 percent range. Also, the heavy reliance on foreign public borrowing to finance the deficit had contributed to a high ratio of total public debt to GNP and to a rather large foreign debt burden. Notwithstanding the authorities' good intentions of shifting the relative burden of adjustment from reliance on taxation to expenditure reductions, 1983 was the first time in many years that expenditure constraints had made any contribution to reducing the ratio of the deficit to GNP.

The cut in food subsidies in the August "mini-budget" had also been a positive step, Mr. Templeman remarked, although the savings would be a rather small 0.1 percent of GNP. He strongly supported the staff's emphasis on a reduction of the personal income tax burden as soon as possible. The staff had pointed to some modest but useful steps that might be taken, for example, to simplify the income tax by reducing the proliferation of exemptions, allowances and other loopholes--by broadening the indirect tax base and, especially, by introducing or increasing charges for some government services. The latter action could have the salutary effect of impressing on the public that such services were not cost free and of discouraging excessive demand for them. Nonetheless, expenditure control was the key issue. The fact that one third of tax revenues were being pre-empted for interest payments was symptomatic of the problem. The steady growth of the wage bill until about one year previously, when hiring limitations and wage restraint had begun to have some effect, also called for attention. More efficient public investment would be helpful as well. Finally, the steady growth of government transfer payments--by 62 percent in real terms over the past six years--raised the fundamental issue highlighted by the staff--namely, the need to develop a political consensus on the level of public services and social welfare benefits for which the nation was willing to pay. Until that question had been answered, it was difficult to see how much further progress could be made in reducing the budget deficit.

Mr. Lindå noted that since the policy shift in the middle of 1981, the Irish authorities had worked to adjust the economy mainly by seeking to reverse the deterioration in the public finances and to hold back the expansion of domestic income. So far, the effort had produced encouraging results. The budget deficit and, notably, the Exchequer borrowing requirement had been brought down, and the current external deficit had fallen sharply in relation to GDP.

Nevertheless, the imbalances in the Irish economy, by international standards as well, were still substantial, Mr. Lindå observed. The public sector deficit remained very large, the corrections made so far having been concentrated mainly on higher taxes and a reduction of public investment. Like many other countries with rapidly growing interest payments on public debt and substantial transfer payments, Ireland had encountered major rigidities in budgetary management. However, the major part of the recent increase in real transfer payments was in fact due to real increases in benefits other than unemployment benefits. Hence, he tended to concur with the view that, in addition to a rationalization of public capital spending and a restructuring of the tax system, the improvement of the fiscal balance would also have to be based on spending cuts relative to GDP in the noninterest component of current public expenditures.

As for monetary policy, Mr. Lindå continued, the authorities should indeed be encouraged to maintain the significant progress achieved over the past two years in raising the share of domestic nonmonetary financing of the Exchequer borrowing requirement. As in 1983, the authorities should also continue to allow interest rates to respond to that policy, thereby improving the control of domestic liquidity expansion and enhancing private capital inflows.

Except for one year, exports had advanced at a fast pace since 1979, Mr. Lindå commented. However, the current external account had stayed in substantial deficit, and the prospects were for no change in the relative size of the deficit in 1985. Given the necessity of correcting the deficit and the authorities' reluctance to adjust the exchange rate--a reluctance that he well understood in the circumstances--he could fully support the staff view that greater wage restraint was needed to improve competitiveness and hence employment. For several years, hourly earnings in Ireland had risen substantially faster than in its main trading partners, and it would appear necessary to reverse that development.

The staff representative from the European Department said that in attempting to increase the share of nonmonetary financing of the Exchequer borrowing requirement, the authorities were constrained by the relatively thin market for government securities in Ireland. Apart from the banks, the market consisted of a few institutional investors whose ability to buy government securities was determined essentially by their inflow of contractual savings, which was not very sensitive to changes in interest rates. It was felt, therefore, that large increases in interest rates might be required to induce a significant increase in sales of government securities to the domestic nonbank sector. Nevertheless, the increase in real interest rates in 1982 and 1983 had made a significant contribution in raising the proportion of the Exchequer borrowing requirement financed by domestic nonmonetary sources. In the current year, uncertainties about the trend in international interest rates and their implications for domestic interest rates had inhibited sales of government securities to the nonbank sector, and the domestic funding program was still behind target. Thus, it seemed that the authorities should be considering adjustments in domestic interest rates to ensure that they met their objectives for the year.

Referring to wage developments in the current round of negotiations, the staff representative stated that little could be added to the information provided by Mr. Leonard. Taking into account all the wage settlements that had been reached so far, the average rate of increase was about 9 percent, compared to the figure of 10 percent mentioned in the staff report for the initial settlements. The Government had sought a lower increase in its guidelines. One encouraging development mentioned by Mr. Leonard was the increased attention being paid by the labor court in its recommendations to the financial position of individual organizations rather than to any established trend. Clearly, the large wage increases granted by firms with a good profit position were having an effect on wage developments in the rest of the economy, especially because the settlements in the dynamic sectors tended to take place rather early in the round of wage negotiations. Nevertheless, the impact varied, the size of the wage settlements having shown some differentiation.

The results of the attempt in Appendix I of the report on recent economic developments to provide some estimates of the real wage gap in Irish manufacturing industry should be interpreted with considerable caution, the staff representative explained. Such a measurement posed significant difficulties. The estimates would depend partly on the choice of the base year and on the assumptions made about the best method of calculating a warranted real wage; the staff had opted to assume that any decline in the terms of trade should be distributed evenly between wage earners and profits, and there was room for argument about whether or not that was a reasonable assumption. Even greater care should be taken in interpreting the estimated effects of the real wage gap on developments in unemployment.

The preparatory work on the National Plan was reportedly nearing completion, the staff representative commented. The final decisions had not yet been reached, but from the official statements that had been made so far, the Government was apparently leaning toward accepting the recommendation of the National Planning Board that only the structural component of the budget deficit should be eliminated by 1987 rather than the total deficit. The staff continued to believe that a more rapid pace of fiscal retrenchment would be desirable.

The authorities had taken some steps with a view to reducing unemployment benefits. Nevertheless, the relation between wage earnings and unemployment benefits was unlikely to have improved because disposable wage incomes had fallen markedly in recent years. He had taken note of Mr. Polak's suggestion that a more detailed analysis should be included in the report on recent economic developments of the structure and development of the social security system and its impact on work incentives.

The incentives offered by the Irish authorities to foreign investment were generous by international standards, and on the whole they had been successful in attracting such investment, the staff representative explained. There had been a slowdown in multinational investment in Ireland in the past few years, but the reasons were not entirely clear. One significant factor in the slowdown had been the international recession; another factor was that the type of investment attracted to Ireland had declined in relative importance. Despite that slowdown, supply factors were not constraining the growth of exports at present and they were not expected to do so in the near future; the prospects beyond the two years immediately ahead were more uncertain and would depend to a large extent on whether or not foreign investment and investment in general recorded a sustained recovery. In that connection, it was encouraging that investment in machinery and equipment was likely to stage a recovery in 1984. It might also be worth mentioning that the Industrial Development Authority had an excess supply of factory space, which seemed to suggest that investment and export capacity could be increased quickly if the outlook for export demand remained favorable and the prospective rate of return on capital income became attractive.

In referring to the need for an early redistribution of the tax burden, the staff had had in mind not only a larger contribution to total tax revenue from the corporation tax, the staff representative explained. The authorities were not inclined to change the present corporation tax for the manufacturing sector because they felt they had committed themselves to a rate of 10 percent until the year 2000. Nevertheless, there was scope for increasing the effective rate of the corporation tax in the economy as a whole by reducing or eliminating a number of exemptions of which there was an abundance. The share of property taxes in total taxes had also fallen from about 12 percent in the early 1970s to only 3 percent or 3 1/2 percent at present. A variety of options were being considered, in the context of the preparation of the National Plan, and the authorities' choices remained to be seen. Obviously, it would be useful if the tax burden on wage earners could be reduced, thereby enhancing the scope for pay restraint. The authorities had stated on a number of occasions in the recent past that additional revenue, whether its source was new taxes or measures to combat tax evasion, would be used primarily to reduce the tax burden on wage earners.

The top rate of the value added tax was high in Ireland, the staff representative added, and it was the source of certain distortions, including the diversion of trade from the Republic of Ireland to Northern Ireland. As indicated in the staff report, a broadening of the indirect tax base was desirable in itself.

Although it was true that the fact that the United Kingdom was not a participant in the exchange rate mechanism of the EMS had some implications for Ireland's exchange rate policy, the staff representative commented, it should be noted that the size of bilateral trade flows between the two countries was not an entirely reliable basis for assessing the relative weight of the pound sterling in the effective exchange rate of the Irish pound. If allowance was made for competition in third markets or for the best available estimates of trade elasticities, the relative importance of the pound sterling declined significantly; in fact, effective exchange rate calculations based on the multilateral exchange rate model indicated a rather low weight for the pound sterling.

Developments so far in 1984 suggested that the medium-term debt scenario prepared by the staff might have been a conservative one, the staff representative remarked. Higher figures could be used for exports in 1984, and perhaps also in 1985, and the time path of the projection of the debt service ratio would be affected. More generally, however, the scenario was intended to provide some idea of underlying trends in the debt position and the debt service ratio; no attempt had been made to incorporate likely cyclical variations from year to year in exports or the other determinants of debt flows.

The commercial viability of recent oil discoveries had not yet been established, the staff representative from the European Department commented. The authorities expected to know more within the next 12 to 18 months.

Mr. Leonard noted that the Government had recently modified its position with respect to the elimination of the fiscal deficit by 1987. The National Planning Board had differentiated between the structural and the cyclical components of the deficit and had recommended that the structural deficit should be eliminated by 1987. The Prime Minister had recently stated that the overall fiscal deficit would be reduced to 5 percent of GNP over the National Plan period, but the Government's general intention to eliminate the deficit remained strong. The Prime Minister had also expressed a firm intention to ensure that the service of public debt did not increase as a proportion of gross national product.

Certainly, the authorities did not intend to let expenditure as a proportion of GNP rise, Mr. Leonard continued. In that respect, it was important to distinguish between supply services and Central Fund services. Cuts in supply services in real terms were already being made and they would continue. As Directors had mentioned, the social welfare component of supply services was large. The National Planning Board had stated explicitly that the social welfare system would have to bear part of the burden of reducing the budget deficit, and he expected that the National

Plan would reflect the Planning Board's position. Nevertheless, it should be borne in mind that the growth of real benefits over the past several years had started from a very low base. Moreover, a recent social survey indicated that one in three persons benefited in some way from social welfare services. The Government would have to be very careful in the way in which it cut services and benefits that could hardly be regarded as generous.

While taxes in Ireland were high as a proportion of GNP, they were higher in some other European countries, Mr. Leonard commented. The problem in Ireland was the narrowness of the tax base. Certain measures had already been taken to broaden the base, and there was scope for eliminating tax expenditures resulting from various exemptions. However, owing to the tight curtailment of real incomes over the past several years, the Government would again face great political obstacles in limiting such exemptions, although it recognized that it would have to do so. Under the Irish tax system, a very high proportion of revenue--close to three fifths or two thirds--was derived from indirect taxes. Increases in those taxes had been a major factor keeping up the high rate of inflation. The underlying rate of inflation had been falling, and the cost of living index would have fallen, too, had it not been for such indirect taxes.

If the measures announced by the Government in August, including the elimination of subsidies, appeared likely to effect only small expenditure savings in 1984, Mr. Leonard remarked, it was because the purpose had been to meet difficulties foreseen for 1985. They could, however, help to give a better outturn than expected in the budget for 1984. The measures had also served to prepare the public to expect tighter rather than easier policies under the National Plan.

Until the end of the 1970s, when the system had been abolished, a property tax had existed in the form of rates levied on land and dwellings, Mr. Leonard recalled. Charges for the services of local authorities were now being introduced that might be seen in effect as the equivalent of the old rates. Such charges were proving helpful to the local authorities in meeting their financial commitments.

While Ireland might in the longer term need to have a balance of payments surplus in order to be able to service its foreign debt, a deficit on current account had for many years been appropriate, Mr. Leonard explained. In managing an economy with a strong need for development, it would hardly have made sense to allow a substantial net inflow on capital account to lead simply to an accumulation of reserves. But in future, whether or not Ireland could afford to run a current account deficit would depend upon the extent of autonomous capital inflows as well as the need for reserves.

The performance of exports continued to be good, Mr. Leonard noted. The issue of competitiveness was, of course, vital, although there were valid arguments for not accepting overt measures of competitiveness. As

Mr. Lovato had recognized, it was necessary to look at the performance of exports, sector by sector, rather than overall. In addition, competitiveness in Ireland was not only a matter of trends but a matter of absolute costs: the country's strong competitive edge in unit labor costs in many activities in the modern sectors of the economy was not however a factor that was given wide publicity because of labor market considerations. More generally, although the Government had set a wage guideline, there was always an element of bargaining in such matters. Although increases in pay had not been brought down to the government guideline, there had been considerable wage moderation in the past, and the competitiveness of Irish production should not be unduly affected.

An announcement should be made within the coming month or so about the three-year national plan, Mr. Leonard noted. That plan would be based largely on the detailed proposals drawn up by the National Planning Board; many of the practical recommendations in the Board's plan had found favor with the Government and were likely to be implemented.

As Directors had recognized, Ireland's creditworthiness was in no way at issue, Mr. Leonard observed. A reduction in borrowing was an integral part of government policy not because of any difficulty in financing deficits, but as a matter of prudent medium-term financial management. Although the recession in the United States had affected direct U.S. investment in Ireland, it could not have accounted for the relative slowdown of the pace of such investment. Ireland, however, had lost out to strong competition from other European countries in one or two large investment projects originating in the United States, and that could be an explanatory factor.

In addition to the specialized training schemes and other efforts to encourage individual initiative and enterprise, Mr. Leonard added, Ireland had a national training scheme which handled about 20,000 people every year. The scheme had been of great help in raising the level of proficiency, especially in manufacturing; there were also technical schools and higher level colleges of technology that were performing a major role. The problem was to expand the productive base sufficiently to enable all those who were trained to be employed. In that connection, it should be noted that a large part of the overall fiscal deficit arose from state capital expenditure, which had traditionally accounted for about 50-55 percent of overall investment every year. The expansion of private enterprise over the past 20 years should have enabled that ratio to be brought down, but it had not. For that reason, he was sometimes skeptical about the role of the market and private enterprise in increasing investment, even when the environment was propitious. Inevitably, the state had to try to make good deficiencies in the private sector but without inhibiting private sector activity. Training was a major tool that was being used, and along with other developments, especially the improvement of economic infrastructure, private enterprise should have sufficient incentive to take on a greater share of economic activities in the future.

As he himself had said in his opening statement, Mr. Leonard concluded, the elimination of the current budget deficit was a central issue. There would be no letup in setting the basic imbalances in the economy to rights; in the political judgment of the Government, some easing of the approach to reducing the deficit had been necessary in 1984 in order not to cut short the incipient recovery and to facilitate growth that would render the harder steps to be taken in the coming years more tolerable. Hope had to be placed in the judgment of the Government that, by nurturing it, confidence would be maintained throughout the remaining period of adjustment.

The Chairman made the following summing up:

Executive Directors commended the Irish authorities for the substantial further progress made since the 1983 Article IV consultation in redressing the large imbalances in the economy through measures to strengthen the public finances and to contain the growth in incomes. A notable reduction had been achieved in the external current account deficit and also in the rate of inflation. Directors noted, however, that economic activity had been weak and that unemployment had risen to a very high level by international standards.

Directors emphasized that, despite the progress made so far, the underlying position remained unsatisfactory and they urged the authorities to continue to pursue adjustment policies aimed at restoring the conditions for sustainable growth in output and in employment. Directors, in particular, expressed their concern that the current budget deficit and the Exchequer borrowing requirement were unsustainably high, that public debt had risen to well above 100 percent of GNP, an unparalleled level for an industrial country, and stressed that the main thrust of the adjustment policies must be a further correction of fiscal imbalances. In this context, Directors believed that the budgetary objectives set for 1984 were not ambitious enough and urged the authorities to speed up the pace of fiscal retrenchment so as to eliminate the current budget deficit within the next few years. Several Directors recorded their disappointment at the apparent abandonment of the target to eliminate the current deficit by 1987.

Noting the tightly constrained room for maneuver of the Irish authorities, given the substantial drain on budgetary resources to service the high level of public debt, Directors believed that delays in taking decisive action would increase the eventual costs of adjustment. In view of the undesirability of raising the tax burden, which was already uncomfortably high and impinging adversely on the incentives to work and save, Directors strongly emphasized that the corrective measures should henceforth focus on expenditure restraint, including restraint with respect to the Government's pay bill and spending on social welfare benefits. Several Directors noted with concern that social welfare benefits had risen by some 60 percent in real terms in the past five years and had become too high in relation to net after-tax wage earnings. Directors welcomed the authorities' recent decision to reduce food subsidies and their ongoing efforts to rationalize capital spending. The authorities were also encouraged to intensify their efforts at restructuring the tax system and broadening the tax base so as to make room for lowering the burden of taxation borne by wage earners.

Directors expressed satisfaction with the progress achieved over the last two years in reducing net official foreign borrowing and raising the nonmonetary financing of the Exchequer borrowing requirement. Some speakers noted, however, that the recent trend in sales of government securities to the nonbank sector suggested that increases in interest rates might well be necessary in order to ensure that the objectives set for the Government's domestic funding program in 1984 were met. Directors underscored the importance of a further slowdown in the rate of domestic credit expansion in order to strengthen the overall payments position and pave the way for the convergence of the inflation rate to the average of Ireland's main trading partners. Directors pointed out that Ireland's external public debt was very high by international standards and, while recognizing the generally favorable maturity structure of the debt and Ireland's excellent standing in international capital markets, they strongly encouraged the authorities to reduce further their recourse to foreign borrowing and to pursue a further improvement in the external current account.

To alleviate the costs of adjustment and enhance employment prospects, Directors stressed the need to improve further Ireland's competitive position. In that context, Directors commended the authorities on the renewed emphasis on promoting industrial development and employment creation through supply-side measures. But Directors regretted the fact that increases in nominal wage earnings continued to be significantly higher than the average of the main trading partners. They stressed, therefore, that tight pay restraint was necessary to improve competitiveness, and they expressed the hope that wage increases during 1984 would be broadly in line with the authorities' guideline. They welcomed the recent recommendations of the Labor Court which pay more regard to the financial position of individual enterprises rather than to any general trend in settlements. While noting the authorities' position on exchange rate policy, a number of Directors noted that the underlying external position remained weak, and they advised the Irish authorities to maintain adequate flexibility in the exchange rate policy, which could play a useful role in facilitating the shift of resources to the traded goods sectors and in mitigating the employment costs of fiscal retrenchment.

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

4. AFGHANISTAN - 1984 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1984 Article IV consultation with Afghanistan (SM/84/175, 7/19/84). They also had before them a report on recent economic developments in Afghanistan (SM/84/187, 8/2/84; and Cor. 1, 8/17/84). In addition, based on a recent communication from Da Afghanistan Bank, the staff submitted revised data on current invisible transactions that did not affect the analysis in the staff reports but that had resulted in slightly different entries for the current account deficit and errors and omissions than those provided in Table 1 of SM/84/175 and Tables 9 and 26 of SM/84/187. 1/ More up to date information on the rate in the bazaar exchange market indicated a further depreciation; the buying rate, which had been Af 113.90 per U.S. dollar on June 14, 1984, stood at Af 118.04 on September 3, 1984.

Mr. Salehkhou made the following statement:

I wish to thank the staff for its efforts during the consultation discussions and for its objective assessment, despite the lack of adequate statistical data on the economic conditions in Afghanistan.

The overall economic situation in Afghanistan has continued to reflect an environment marked by a lack of conduciveness to effective economic development. Economic progress has been particularly hampered by serious infrastructual bottlenecks, shortage of skilled manpower resources, and the deterioration of the financial position of the public sector. Such adverse factors have resulted from the unsettled domestic security situation and the associated problems, together with external problems that have generally affected the developing countries in common in the past few years.

Since 1978, the authorities have initiated fundamental changes, inter alia, in the direction of land reform. Under this program, about 30 percent of the cultivable land has so far been distributed. Many cooperatives have been set up and free irrigation is provided to farmers. Other measures include concessional agricultural credit and provision of seeds and fertilizers and other auxiliary measures. Yet, because of the mountainous terrain and other constraints, only a small portion of the total land area is cultivated, mainly devoted to crop production and livestock breeding. The development of agriculture is accorded high priority by the authorities and they hope that the measures which will be implemented will eventually succeed in strengthening agricultural production. Despite the

1/ See Table reproduced in Annex.

problems, the authorities are doing their best through food procurement and imports to provide essential food in the cities and the countryside at reasonable prices.

Economic growth accelerated in 1983/84 fueled by higher gas production. The industrial sector, however, did not perform well, with textile, sugar, and vegetable oil production being adversely affected. The problems range from damaged production facilities and transportation problems to shortages of agricultural raw materials and imported inputs. The authorities plan to promote industrial development and a large share of public capital expenditure is devoted to industrial development, together with tax exemption, concessional credit, and other privileges for new enterprises. For 1984/85, a major expansion of industrial output in the textile and food processing fields is envisaged. Private sector activities are allowed in all industrial areas other than heavy industries. Foreign minority participation is welcomed.

On monetary policy, the authorities have embarked on an expansion of the network of bank branches to attract deposits. Because there has been substantial expansion in domestic liquidity in the past two years, the authorities agree with the staff that there is a need for tight credit policies in the present situation. They plan to reduce the rate of credit and monetary expansion in 1984/85.

The budgetary position remains under pressure marked by the growing overall fiscal deficit and bank financing. The authorities are concerned with such developments and they are attempting to deal with the deficit by controlling the domestic security situation, by stressing self-help economic activities throughout the country in order to raise production and provide a boost to government revenue while limiting government outlays, and by seeking further aid from socialist countries as well as international development institutions. In this regard, they are disappointed by the unilateral suspension of aid by some foreign countries as well as international financial institutions.

Gas exports account for nearly half of total export value and the shares of other traditional export items, such as dried fruits, and carpets and rugs have fallen in the last few years. Despite an increase in gas exports, the total value of exports declined in 1983/84. The prices of gas exports--which are totally exported to the Soviet Union--are comparable to world prices, though allowance should be made for possible differences in quality. All other exports, except cotton, declined in value in 1983/84. The fall in nongas exports reflects both volume and price declines. In addition to the domestic problems and the recessionary trends in world trade, Afghanistan, like many other developing countries, ran up against trade restrictions imposed by certain countries. The Government aims at promoting exports and a number of measures have been taken, including incentives to exporters through a more depreciated exchange rate, the setting up of quality controls, and more intensive marketing activities. Afghanistan is keen to have good economic and trade relations with all countries in the world on the basis of mutual benefits; under that policy, trade and economic relations have been developing with the socialist as well as other friendly countries.

In the area of exchange rate, a significant share of convertible currency transactions is now effected at the more depreciated bazaar rate. The authorities share and welcome the staff recommendation that a more simplified and unified exchange rate will improve resource allocation and will be beneficial to the external sector. They think, however, that the simplification of the exchange rate system may not be an easy task at this stage and needs comprehensive examination; they hope to discuss the task thoroughly with the Fund, in order to find appropriate solutions. In this connection, the authorities have requested the use of Fund resources to alleviate their balance of payments difficulties, and it is expected that during the forthcoming Annual Meetings, joint discussions will be held to that effect.

Data gathering and statistical inconsistencies have posed problems, but the authorities are aware of the need to improve the quality as well as the timeliness of economic statistics. An expert from the Central Banking Department is currently assisting the authorities and his services have proved very valuable; it is hoped that further Fund technical assistance would result in yet more progress in this field.

Mr. Jayawardena said that his chair was in broad agreement with the staff appraisal and had no difficulties with the proposed decision. Definitive interpretations based on the available data were made difficult by the fragile nature of statistics in Afghanistan. In that respect, he welcomed the Fund's assistance and the authorities' efforts to improve those statistics.

Afghanistan, with a per capita income of about $160 and populated by 17 million people, was one of the least developed countries in the world, Mr. Jayawardena noted. The fact that it was a landlocked country compounded its economic problems by subjecting its economic relations with the rest of the world to an additional potential constraint--namely, relationships with neighboring countries. The Afghan economy was predominantly agricultural, although some industrial development had been fostered in recent times. The country was known to be fairly well endowed with mineral resources, much of which remained to be exploited.

The recent evolution of the economy had been heavily influenced by the country's security problem, Mr. Jayawardena continued. The resultant damage to the economy had been substantial, and was estimated at Af 35 billion during 1978-83, or about $300 million based on the free exchange rate. Net material product (NMP) had risen by 1.7 percent in 1982/83 to 4.5 percent in 1983/84, owing to continued growth of agricultural and industrial output, of 2.3 percent and 12.5 percent respectively. The recent development of natural gas seemed to account for the higher rate of growth in the industrial sector. The incentives restored to agriculture by the land reform had possibly been eroded by food subsidies, although the disruption of transport caused by the security problem had no doubt affected agriculture. Within those constraints, the agricultural sector had performed reasonably well. The same could not be said of processed crops--cotton and sugar beet--or of industry in general, except for natural gas, which within a short period had come to account for nearly one half of industrial output and budgetary revenue. Unless the security situation improved, the prospects of sustained exploitation of the country's natural gas resources appeared rather difficult, calling for prudent economic management in the coming years.

Owing to a sharp rise in expenditures, unmatched by a growth of revenues, the overall budget deficit had risen from 3 percent of NMP in 1981/82 to about 10 percent in 1982/83, financed by strong recourse to domestic bank borrowing, Mr. Jayawardena noted. Again, the lack of security had exerted a strong influence. Fortunately, the growth of expenditure would be curtailed in 1983/84, and the overall deficit was expected to be brought down to 7.6 percent of NMP. The purpose of certain unproductive subsidies, such as preferred food prices for public servants, could be better achieved through a wage increase. Moreover, the moderation of those subsidies could alleviate the disincentives to producers of lower food prices. On a related point referred to on page 10 of the staff report--a point concerning inappropriate costing practices in connection with concessional prices for electricity and coal and negative real interest rates on loans to public companies--he had been reassured by the staff that it had not been recommending a change in the accounting procedures of those enterprises that would have been contrary to normal practice. However, he agreed with the staff that such price distortions could lead to incorrect investment decisions. The recent elimination of petroleum subsidies, following the discussion of the issue during the Article IV consultation, had contributed directly to rectifying a clearly untenable and self-defeating policy.

Recommendations to improve government revenue should also be made cautiously, Mr. Jayawardena noted. As the staff had said, there would be no point in introducing new taxes if the security situation made tax collection difficult. Hence, the staff proposal to emphasize indirect taxes--especially import duties--was worth consideration.

Monetary policy appeared to be accommodating and to be largely determined by the demands of the public sector, Mr. Jayawardena observed; it also reflected the relatively small size of the official banking sector.

The Government had been responsible for the sharp expansion of credit in 1982/83; until recently, the impact of such an expansionary policy had been absorbed by the balance of payments, but with the deterioration of the external position and the decline in reserves, the resolution of the authorities to tighten credit policy was welcome.

However, judgments in that respect had to be tentative, Mr. Jayawardena considered, because the statistics did not capture an important segment of the credit market--namely, the money bazaar. The bazaar was a money market which not only provided domestic credit but engaged actively in foreign exchange operations financing international trade and service transactions. By all accounts, and against all odds, the market worked very efficiently, and the decision of the authorities not to interfere with it was ample testimony of their pragmatic approach to economic problems. The money bazaar was apparently the real money market, in which interest rates and exchange rates were freely determined. It would be useful to integrate the statistics on its operations with those on the official market in order to have a fuller picture of the monetary situation. It could not be concluded--based on a comparison of interest rates of 5-12 percent with a rate of inflation of more than 20 percent--that interest rates were negative. In fact, the official cheap money policy might be no more than a way of allocating credit by direction, whereas the money bazaar effectively determined the rates that mattered and the allocation and amount of actual loans. It would not be surprising if the cheap credit ultimately found its way to the traders in the money bazaar.

If further information on the extent and the characteristics of the money bazaar were not available, Mr. Jayawardena commented, a study of the market could perhaps be undertaken, with the help of the resident representative in Afghanistan, before the 1985 Article IV consultation. The authorities might consider formalizing that money market in order to introduce more competition into the nationalized banking system to help understand the real monetary phenomena, and lead to an improvement in monetary and exchange rate policies.

After several years of balance of payments surpluses, the external position had become adverse, and the country's own reserves were being run down to the limits, Mr. Jayawardena noted. The situation called for extreme caution because Afghanistan's access to financial markets had been reduced considerably in recent times. The unlimited credit provided under bilateral trade and payments arrangements with certain trading partners could worsen Afghanistan's debt service burden. The country might consider itself fortunate to have a relatively low debt service ratio--13 percent of NMP in 1984/85--and wish to keep it at a comfortable level; should peace return, there would be much to do by way of reconstruction and rehabilitation. Until only recently, highly concessional finance had been available, but Afghanistan's prospects of obtaining it in future were not promising. Therefore, the authorities would be well advised not to impair their borrowing capacity.

The complexity of the multiple exchange rate system was of concern to him, Mr. Jayawardena observed. Welcome moves had been made recently toward the unification of official rates and toward the development of a free bazaar rate. The widening gap between the official and bazaar rates deserved the attention of the authorities.

In sum, Mr. Jayawardena said, Afghanistan had been striving strenuously to adopt rational and pragmatic decisions in a difficult security situation. Thus, he welcomed Mr. Salehkhou's statement that the authorities wished to consult the Fund on the use of its resources. By keeping the channels of communication open, the Fund could encourage the authorities to take timely action to correct a difficult economic situation. The recent adjustment of petroleum prices was a clear indication of the value of the continuous dialogue between the Fund and a member country. Finally, he was glad to note that consultations with Afghanistan would be held on the standard 12-month cycle, especially as the security situation had led the Board not to take a decision on the timing of consultations with Afghanistan when it had concluded the 1983 Article IV consultation.

The Deputy Director of the Middle Eastern Department remarked that in referring to the need for proper costing on the part of public corporations, the staff had had in mind the need to ensure that the profits recorded were economic ones and not the result of undercosting of certain inputs, especially at a time when public corporations had begun to distribute up to 30 percent of their profits to their workers.

The precise size of the bazaar money market was unknown, the Deputy Director added, although it was clearly very large. One indication of the significance of the market was the fact that over 70 percent of liquidity was held in the form of cash. As for external transactions, the staff had estimated that about $200 million out of a total $700 million of exports were effectively carried out at the bazaar exchange rate. The bazaar was also supplied with funds in the form of emigrant remittances as well as of other transfers. In referring to the usefulness of maintaining the bazaar market, the staff had been suggesting to the authorities that they should try to take advantage of the existence of the market, rather than attempt to control it, by moving the official exchange rate toward the bazaar rate, thereby capturing a larger share of the transactions taking place in the bazaar.

The debt service ratio of 15 percent was calculated on total current external receipts both through the bazaar and through official channels, the Deputy Director of the Middle Eastern Department observed. Based on transactions through the official channel only, the ratio was a less comfortable 20 percent.

Mr. Salehkhou noted that the security situation in Afghanistan was perhaps the cause of all the difficulties that the staff had comprehensively covered in its report. Although Afghanistan was said to be a least developed country, its experience proved that it could be largely self-sufficient in normal conditions. The authorities had been doing their utmost to bring the country back to normal conditions, perhaps with less success than might be wished. However, the decision of the Fund to hold Article IV consultations had been helpful in obtaining better statistics. Moreover, the authorities had cooperated enthusiastically with the Fund to the extent of wishing to discuss the use of Fund resources at the time of the Annual Meetings.

The Chairman made the following summing up:

In their discussion of the staff report for the 1984 Article IV consultation with Afghanistan, Directors generally endorsed the views expressed in the staff appraisal. It was noted that in the past several years the performance of the Afghan economy had been severely affected by adverse security conditions and external developments. As a result, production had been depressed, the fiscal position had weakened, and pressures on domestic prices and the balance of payments had intensified. It was also noted that the Afghan authorities had taken a number of steps to encourage production and alleviate imbalances, including welcome substantial increases in petroleum prices. While agricultural output had been reasonably encouraging, economic prospects in general were difficult, given the reduced level of foreign reserves and the constraints which the present security situation placed on economic policy formulation and implementation and also on the efficacy of important policy instruments.

The authorities' intention to maintain agricultural producer prices at remunerative levels was welcomed. In order to reduce pressures on prices and the balance of payments, the main effort needed to be made in the fiscal field, and should include measures to increase revenues through, for example, increases in import duty rates and tighter spending discipline.

With respect to public enterprises, the importance of flexible pricing policies and proper costing procedures was stressed. Support in the public finance area was needed from more active credit and monetary policy geared to achieving a reduction of pressures on prices and the balance of payments. In this regard, the remarkable degree of efficiency of the free bazaar money and exchange markets was noted.

Balance of payments pressures were likely to remain strong in the near future, and the debt burden would have to be managed cautiously to prevent an increase in debt service. Directors emphasized the importance of simplifying the exchange rate system and noted the widening discrepancy between the official and the bazaar exchange rates.

Directors welcomed the steps taken to improve monetary statistics but felt that further efforts needed to be made to strengthen the statistical data base in other areas, in particular, public finance and balance of payments.

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

Mr. Salehkhou, referring to a matter raised during the consultation discussions, reported that the Afghan authorities had been disappointed at the attitude of some multilateral financial institutions to ongoing projects. They had been apprehensive about the possible increase in the debt service ratio, should those projects not be completed, and they had therefore offered assurance that they could guarantee the full safety of the projects so that those near completion could provide revenue for the Government and thus for the payment of foreign debt.

The Executive Board then adopted the following decision:

1. The Fund takes this decision relating to Afghanistan's exchange measures subject to Article VIII, Sections 2 and 3, and in concluding the 1984 Article XIV consultation with Afghanistan in the light of the 1984 Article IV consultation with Afghanistan conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. Afghanistan's present exchange regime involves exchange restrictions and multiple currency practices as described in SM/84/187. The Fund welcomes the transfer of most external transactions in convertible currencies to more depreciated rates, but notes that the present exchange rate structure is unduly complex. It therefore recommends a simplification of the exchange rate system with a view toward the eventual establishment of a unified exchange rate regime. The Fund welcomes the termination of a bilateral payments agreement with a Fund member and encourages Afghanistan to terminate the remaining agreement with a Fund member.

Decision No. 7810-(84/143), adopted
September 14, 1984

5. PANAMA - 1984 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1984 Article IV consultation with Panama (SM/84/205, 8/20/84). They also had before them a report on recent economic developments in Panama (SM/84/214, 9/4/84).

Mr. Kafka made the following statement:

My Panamanian authorities are in broad agreement with the staff report and would like to express their appreciation for the work done in connection with the Article IV consultation.

In June 1983, Panama undertook an economic program supported by an 18-month stand-by arrangement with the Fund. The main objective of the program was to strengthen public sector finances while aiming to reduce the overall deficit of the public sector from the equivalent of \$464 million--11 percent of GDP in 1982--to \$270 million--6 percent of GDP at the end of 1983.

Notwithstanding the less than favorable circumstances in the world economic environment which led to a decline in real output--the first in seven years--my authorities have acted decisively in their successful efforts to reorient the course of the economy. The deficit in 1983 was reduced to \$247.3 million, equivalent to 5.8 percent of GDP. Owing to this overperformance, Panama accumulated a margin of about \$23 million which, under the terms of the program of 1984, was allowed to be carried forward. The achievement of the quantitative performance criteria was accomplished through the implementation of a strict fiscal policy, i.e., tight control of expenditures and new revenue measures, together with an improvement in tax administration, which my authorities have adopted since the current stand-by arrangement was initiated.

Economic activity in Panama has remained sluggish in 1984. Output is now projected to grow by less than 1 percent, while the rate of inflation is expected to slow down to about 2 percent, compared with 3.4 percent in 1983. Revenues have increased less than anticipated, reflecting lower corporate income taxes and a reduction in income tax revenues from the oil pipeline due to both lower volumes and prices. Also, the continued weakness in the countries in the region has kept external demand for the services provided by the Colón Free Zone stagnant, thus adversely affecting Panama's public finances. In the face of these emerging revenue shortfalls, my authorities have already adjusted the budget by cutting expenditures. This action is indicative of my authorities' willingness and determination to comply with the program.

The performance under the stand-by arrangement as of June 1984 has been satisfactory; all quantitative performance criteria were met with margins.

Progress has also been made in the area of trade restrictions and price controls. Substantial numbers of quota restrictions have been replaced by tariffs and the remainder of the former will be eliminated by the end of this year; price controls are being lifted as a result of this replacement. Also, the adoption of the Brussels Nomenclature, in an effort to make customs administration more efficient, will be in effect by January 1, 1985.

The Government of Panama has expressed its intention to comply with the remainder of the program for 1984 with the same firm determination that it has shown so far.

My Panamanian authorities are aware of the importance of maintaining tight control over capital expenditures at levels agreed with the World Bank under the structural adjustment program. All disbursements under this program have been made. Further negotiations for another structured adjustment loan will be undertaken by the new administration that will assume office on October 11, 1984.

As for the remainder of the program, the outgoing and the incoming administrations have been in close contact and have agreed on the maintenance of the current economic program aimed at creating an appropriate climate of confidence in the economy's future.

Mr. Teijeiro observed that satisfactory adjustment of the Panamanian economy was continuing, in spite of negative external developments. The reduction in the current account deficit by more than 6 percent of GDP in 1983 reflected the resolution shown by the authorities in attacking the fiscal problem through revenue increases and expenditure reductions, mainly in capital expenditures.

The targets for the current year in the program under Panama's stand-by arrangement continued to be met at the end of June, Mr. Teijeiro noted. Developments such as the rise in dollar interest rates and the reduced use of the Colōn Free Zone had had unexpected consequences for the fiscal situation, thereby jeopardizing the program. The authorities had reacted promptly and introduced strong enough measures in early June to give every indication that the targets for the second half of the year would also be met. The authorities' determination to maintain the program, in spite of unforeseen difficulties, was commendable, as was their willingness to face up to the need for additional adjustment by reducing expenditure. The decision of the President elect to continue Panama's relationship with the Fund under a two-year stand-by program was gratifying. However, he wondered whether the structural measures to be implemented would not provide appropriate grounds for an extended arrangement.

Another reason for satisfaction with current developments in Panama was indeed the program of structural reforms that the new Government was determined to carry forward, Mr. Teijeiro went on. It was a most promising development strategy, based as it was on a reduction of the Government's role in the economy and the encouragement of the private sector, together with an open trading policy aimed at redirecting incentives in the industrial sector toward the generation of exports and employment. The support given by the World Bank to Panama in its endeavor was most helpful; the planned structural reforms could go a long way toward improving economic efficiency.

While the structural reforms were being implemented in the transitional period, one interesting issue that might surface concerned the consequences for the current account of a trade reform that would shift reliance from quotas to tariffs and from high tariffs to low tariffs, Mr. Teijeiro declared. In point of fact, a reduction in trade barriers would reduce the relative price of imports, inducing an increase in import volume. For a country having its own currency in circulation, such a trade reform might require a simultaneous devaluation to foster a compensating increase in exports. But devaluation was out of the question for a country like Panama that used the U.S. dollar as its currency. Consequently, the envisaged reform should rely on deflating domestic costs, particularly wages, to effect the necessary adjustment in relative prices. Moreover, domestic inflation would have to be lower than in the dollar area, implying that the real interest rate in Panama would be higher than in the dollar area in general. It would be helpful if the staff could comment on how the authorities visualized the problem, and in particular, whether they intended to proceed in a gradual or in a fast way with respect to trade reform, as well as on how policy with respect to the growth in government expenditure in nominal terms would be affected.

At the present stage, Panama's reliance on a debt management policy under which greater reliance was placed on official sources of financing was appropriate, Mr. Teijeiro considered. Nevertheless, the magnitude of Panama's external debt called for further efforts to reduce the fiscal and current account deficits.

Mr. Senior observed that it was satisfying to note that, despite a less favorable internal and external environment than had previously been envisaged, Panama's stabilization program in general, and fiscal adjustment in particular, had been implemented successfully. The depressed economic situation in the region, and high international interest rates, had affected economic activity in Panama and had thus made the correction of the fiscal imbalances more difficult. In 1983, GDP had declined for the first time in more than seven years, against a projected increase under the program. Notwithstanding those more adverse circumstances, the 1983 fiscal and external debt objectives had been fully attained.

He had also been pleased to note that even in face of the continued deterioration in the economic outlook expected for 1984, the strong fiscal adjustment initiated in the past year had continued so far, Mr. Senior continued. Not only had all performance criteria been met at the end of June--some of them with ample margins--but most important, the authorities had already introduced a series of expenditure and revenue measures to ensure that the objectives for the rest of the program period were met.

However, in light of the uncertainty surrounding the key assumptions underlying the revised projections for 1984, and in order to be fully consistent with the stated medium-term development strategy--which included a gradual reduction of the size of the public sector--he agreed with the staff that the authorities should stand ready to adopt additional fiscal measures if the need arose. In that respect, it seemed to him that there was still room for a further reduction in current and capital expenditures.

Finally, he wished to emphasize the role played by the supply policies being implemented in the fiscal, trade, industrial and agricultural areas, Mr. Senior said. With the support of the World Bank those policies had been essential in promoting progress toward the gradual reduction in the size of the public sector in Panama. Like the staff, he welcomed the authorities' determination to persevere in the structural effort envisaged in those areas.

Mr. Templeman considered that Panama was left in the situation of being without an independent monetary policy, because the U.S. dollar circulated in the country as the medium of exchange. Thus, the burden of macroeconomic adjustment fell on fiscal policy, implying that fiscal adjustment might at times need to be quite substantial to correct the imbalances in the external accounts. That appeared to be the situation currently facing the Panamanian authorities.

Specifically, while the decline in exports and the low GDP growth projected for 1984 had had an impact on government revenue, additional expenditure cuts beyond those made in June might be needed to compensate for those adverse developments, Mr. Templeman commented. The June measures, estimated to reduce total expenditures by B 74 million and to increase revenue by B 24 million, went far toward compensating for earlier slippages. However, the projections in Table 2 showed that current expenditures would still consume over 30 percent of GDP in 1984; the ratio had been creeping upward since 1981 when it had been 26.7 percent, while the share of both capital expenditure and public sector savings to GDP had been declining.

The reduction in capital spending was in line with World Bank recommendations to reorder the development program, Mr. Templeman observed. The end result was that the fiscal deficit, which had fallen substantially in 1983 to 5.8 percent of GDP, was projected by the staff to increase to 6.2 percent of GDP in 1984, in excess of the program target of 5.5 percent. In addition, one of the program's objectives was to increase public sector savings to 4 percent of GDP; the current projection was that it would reach only 2.3 percent of GDP in 1984, down from 2.5 percent of GDP in 1983. One area for possible action was public sector wage restraint, especially in light of the large 1983 increase of 7.2 percent in real terms in public wages, according to the report on recent economic developments. While no commitment to increase wages had apparently been made, the nominal public sector wage bill would still grow by 12 percent in 1984. Furthermore, whereas the deficit had originally been programmed to be fully financed from concessional external sources, the Government was expected to have to draw on balances previously built up with the National Bank, thus weakening its liquidity position.

The concern of his chair over the fiscal deficit went beyond its frequently voiced belief that expansion of the role of government in an economy hindered private sector development and thus influenced the prospects for growth, Mr. Templeman stated. Because of the openness of Panama's economy and its use of the U.S. dollar, those fiscal imbalances were not fully reflected in the rate of inflation or monetary aggregates. Instead, those imbalances tended to have a direct impact on the balance of payments, thereby leading to more foreign borrowing to compensate for the current account deficit, which was projected to reach 6 percent of GDP in 1984. The growth in external debt was detailed in Tables 4 and 5 of SM/84/205; it was projected to reach 83.3 percent of GDP in 1984. With the reduction in the proportion of commercial debt, the debt profile in 1984 was expected to improve, but large debt servicing payments would have to be met over the medium term, as shown by the projected increase in the debt service ratio to 49.5 percent in 1987. In that regard, he urged the authorities to continue their strategy of increasing reliance on bilateral and multilateral credits.

Mr. El-Khouri remarked that he was in general agreement with the staff's analysis and conclusions. Over the past year and a half, the Panamanian authorities had embarked on a courageous adjustment effort, which had led to a significant reduction in economic imbalances. The reduction in the fiscal deficit, which constituted the centerpiece of Panama's adjustment effort, had been substantial during 1983. The authorities had also implemented a number of structural adjustment measures relating to taxation, domestic pricing, and the import system. Furthermore, all the performance criteria under the stand-by arrangement with the Fund had so far been observed.

Nevertheless, Panama still faced difficult problems, Mr. El-Khouri continued. The debt situation over the medium term was a particular cause for concern. Despite the commendable efforts made in the recent past to improve the maturity structure of the debt, the debt service ratio was projected to rise from 32 percent of exports of goods and services in 1984 to an average of 48 percent in 1986-87. Clearly, adjustment efforts would have to be pursued for a number of years if a sustainable financial situation was to be attained.

Of particular importance was the pursuit of a prudent financial policy, since fiscal imbalances were directly reflected in pressures on the balance of payments, Mr. El-Khouri commented. In that connection, the objectives of the fiscal program for 1984 would have to be met. Because of the particular manner in which the quantitative criteria in the program had been formulated, the fiscal slippages during the first half of 1984 had not led to those criteria being exceeded. Nevertheless, keeping the overall fiscal deficit within the target for the whole year and strengthening the public sector savings performance by enhancing revenues and curtailing current expenditures, were still major objectives of the program in order to achieve domestic and external financial stability.

He encouraged the newly elected authorities, when they assumed office in October, to formulate a well-defined and realistic fiscal plan for the medium term, Mr. El-Khouri added. The task of external debt management would thereby be facilitated. Furthermore, such a plan, together with the successful completion of the present program under the stand-by arrangement, would prove helpful to the authorities in their negotiations with the Fund on a new program covering 1985-86.

Finally, Mr. El-Khouri observed, the substantial fiscal adjustment effort undertaken by Panama since the beginning of 1983 had entailed a significant reduction in the ratio of public sector investment to GDP. Unfortunately, private sector investment had also declined in relation to GDP. Gross domestic investment was estimated to be about 20 percent of GDP in 1984 compared to about 29 percent in 1982. As public sector investment outlays were expected to decline further in relation to GDP in 1985, it would be essential to create the right conditions for an increase in private sector investment, if the prospects for economic growth were not to be jeopardized. In that connection, he supported the structural adjustment efforts of the authorities that were aimed at increasing agricultural and industrial production. He noted that Panama had successfully implemented the policy actions related to the structural adjustment loan from the World Bank and that the authorities intended to request a new multiyear structural adjustment loan.

The staff representative from the Western Hemisphere Department noted that the staff had tried to engage in an in-depth dialogue with the authorities on the type of policies they should follow in the future. However, because of pending negotiations with the World Bank, the Panamanian authorities had not yet known the pace at which further structural reform was to take place; therefore, they had expressed the wish to discuss such issues in the framework of discussions on a stand-by arrangement.

Referring to the mix of current and capital expenditures, and recognizing that the capital spending program had been designed in collaboration with the World Bank, the staff representative from the Western Hemisphere Department remarked that the matter had been discussed with the authorities, who had accepted the idea that the savings performance should be improved, especially in view of Panama's need to amortize large debts in the future. In that connection, the staff had observed that, unfortunately, in the short term adjustments tended to take the form of reductions in capital outlays.

Mr. Kafka thanked Executive Directors for their remarks, which he would bring to the knowledge of his Panamanian authorities.

The Chairman made the following summing up:

In concluding the Article IV consultation with Panama for 1984, Directors expressed broad agreement with the thrust of the appraisal in the staff report. They noted the progress Panama had made to date in implementing the Fund-supported adjustment program adopted in early 1983. The public sector deficit had been reduced below the 18-month cumulative limit through June 1984, and Panama had complied with all the quantitative performance criteria of the program. However, Directors noted that fiscal performance had been significantly weaker than anticipated in the first six months of 1984. While welcoming the revenue and expenditure measures announced recently, Directors urged the authorities to take any necessary additional action to guard against slippages in the implementation of the program. Directors noted, with particular concern, the projected widening of the overall public sector deficit for 1984 to 6.2 percent of GDP for the program target of 5.5 percent of GDP.

Directors endorsed the authorities' medium-term objective of reducing the size of the public sector and of compressing the deficit with a view to reducing the external debt burden. In this regard, while it would seem best to place the principal emphasis on efforts to curb expenditures, measures to raise revenues would probably also be required. Directors encouraged the authorities to persist in their efforts to improve customs administration and to raise collections from social security contributions.

Directors observed that while there had been a slowing down in the rate of accumulation of external debt and some improvement in its maturity structure, Panama's debt service ratio remained uncomfortably high. Directors emphasized that a lasting solution to Panama's debt problem would require a progressive reduction in the overall financing requirements of the public sector so as to obviate the need for commercial borrowing.

Directors commended the authorities on their policy of encouraging the private sector to play a more dominant role in the economy. They also supported the authorities' strategy of rationalizing the structure of industrial and agricultural incentives. Directors noted that the replacement of quota restrictions with import tariffs should permit the authorities to phase out most price controls, but it was emphasized that the consequences of reforming trade policy for the balance of payments and the domestic price structure would need to be watched very carefully since Panama could not follow in present circumstances an independent monetary policy.

It is recommended that the next Article IV consultation with Panama be held on the standard 12-month cycle.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/84/142 (9/12/84) and EBM/84/143 (9/14/84).

6. BURKINA FASO - 1984 ARTICLE IV CONSULTATION - POSTPONEMENT

The Executive Board notes the request contained in EBD/84/241 (9/10/84). 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 Burkina Faso to not later than October 19, 1984. (EBD/84/241 and Cor. 1, 9/10/84).

Decision No. 7811-(84/143), adopted
September 12, 1984

7. FORTHCOMING ANNUAL MEETINGS - GOVERNORS' VOTE

The Executive Board approves the report of the Secretary (EBD/84/203, Sup. 1, 9/12/84) on the canvass of votes of the Governors on Resolution No. 39-3, with respect to forthcoming Annual Meetings of the Board of Governors. The Governors' vote on the Resolution is recorded as follows:

Total affirmative votes		854,474
Total negative votes		0
Total votes cast		854,474
Abstentions recorded	2,953	
Other replies	0	
Total replies		857,427
Votes of members that did not reply		71,731
Total votes of members		929,158

Decision No. 7812-(84/143), adopted
September 12, 1984

8. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 84/52 and 84/53 are approved. (EBD/84/237, 9/6/84)

Adopted September 12, 1984

9. EXECUTIVE BOARD TRAVEL

Travel by an Executive Director as set forth in EBAP/84/191, Supplement 1 (9/11/84) is approved.

APPROVED: July 10, 1985

LEO VAN HOUTVEN
Secretary