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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 83/7

3:00 p.m., January 7, 1983

W. B. Dale, Acting Chairman

Executive Directors	Alternate Executive Directors
	A. B. Diao, Temporary
	C. Taylor
	H. G. Schneider
	A. Le Lorier
	M. Teijeiro
R. D. Erb	C. Dallara
M. Finaish	T. Alhaimus
A. H. Habib	Jaafar A.
	T. Yamashita
R. K. Joyce	M. Casey
	J. R. N. Almeida, Temporary
G. Laske	
G. Lovato	
R. N. Malhotra	
	J. E. Suraisry
	S. El-Khouri, Temporary
J. J. Polak	T. de Vries
	H.-S. Lee, Temporary
	A. Yasseri, Temporary
	J. M. Jones, Temporary
M. A. Senior	
	L. Vidvei
Zhang Z.	

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

Also Present

Asian Department: B. B. Aghevli, N. L. Happe, G. R. Kincaid, R. J. Niebuhr. European Department: B. Christensen, O. J. Evans, A. Knobl, W. E. Lewis, P. J. F. Nyberg, K.-W. Riechel, H. Ungerer. Exchange and Trade Relations Department: M. Guitian, S. Kanesa-Thasan. Fiscal Affairs Department: G. Blöndal. Legal Department: Ph. Lachman, A. O. Liuksila. Middle Eastern Department: A. K. El Selehdar, Deputy Director; F. Drees, S. H. Hitti. Research Department: G. I. Brown, N. M. Kaibni. Advisors to Executive Directors: S. R. Abiad, J. Delgadillo, L. Ionescu, M. A. Janjua, P. Kohnert, I. R. Panday, P. D. Péroz. Assistants to Executive Directors: M. Camara, L. E. J. Coene, T. A. Connors, G. Ercel, G. Gomel, M. Hull, M. J. Kooymans, P. Leeahtam, W. Moerke, V. K. S. Nair, J. G. Pedersen, G. W. K. Pickering, M. Z. M. Qureshi, D. I. S. Shaw, H. Suzuki, P. S. Tjokronegoro, A. A. Yousef, Zhang X.

1. AUSTRIA - 1982 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1982 Article IV consultation with Austria (SM/82/225, 12/6/82; and Sup. 1, 1/6/83). They also had before them a report on recent economic developments in Austria (SM/82/227, 12/9/82).

Mr. Schneider made the following statement:

> My Austrian authorities greatly appreciated the discussions with the staff team during the 1982 Article IV consultation last October because they rightly focused on important policy issues as well as on policy options in an environment of extreme economic uncertainties and recession in the industrial world. These discussions and the staff's assessment of the developments in and prospects for the Austrian economy are well reflected in the informative and concise set of papers.
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> Austria belongs to those smaller industrial countries with open economies that depend heavily on developments elsewhere. As a consequence, the room for maneuver for Austrian policymakers is limited. They are clearly not in a position to create an upswing in the Austrian economy but can only attempt to ward off or at least to dampen the negative repercussions from abroad.
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> In this context, the Austrian authorities pursued their principal policy objectives of maintaining high employment and price stability in a flexible manner. As the record shows, they were relatively successful for a number of years, but with the unexpectedly long recession it seems that the objective of maintaining full employment has recently been put in jeopardy. It is clear, in order to meet this objective, that at least a moderate rate of real growth is required. But in a period of international recession or stagnation, Austria has not been in a position to revive economic activity on her own. A modest recovery of demand and production early in 1982 tapered off around midyear, and the end of the extended period of recession is still not in sight.
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> In its latest forecast of December 1982, the Austrian Institute for Economic Research has further revised downward growth projections, as had been expected in the staff report; the new projections are:

	1981	1982	1983
	(changes in per cent)		
Real GDP	0.0	1.0	0.5
Private consumption	0.7	1.5	0.5
Gross fixed investment	-2.0	-4.0	0.5
Exports of goods and services	7.8	-0.5	-2.0
Imports of goods and services	1.0	-1.5	-1.5
Trade balance (in billions of schillings)	-78.1	-64.9	-62.0
Current account balance (in billions of schillings)	-21.4 1/	+0.1	+4.2
Consumer prices	6.8	5.5	4.2
Unemployment rate (in per cent of dependent labor force)	2.4	3.7	4.6

1/ Revised by Austrian National Bank.

As a consequence of this prolonged recession, unemployment has risen steadily, reaching unusually high levels by Austrian standards. This situation is of prime concern to the Government, which has taken a number of measures, such as the two employment programs, to cushion the impact of the recession on employment. In this respect, some of the measures of the Government might not be considered by everybody as most conducive to structural adjustment. But as a result of experience, especially in the 1920s and 1930s, human considerations have always been an important element in the approach to employment problems. This has not only been the policy of the Government with regard to the public sector, but is also reflected in the employment policies of the private sector, which never applied a "hire and fire" policy.

It could be argued that this approach might have delayed the needed adjustment. But it also made an important contribution to maintaining the social partnership, which is one of the pillars of the Austrian decision-making process. Despite temporary strains, understanding still exists between the social partners on the basic elements of current economic problems, as demonstrated by another moderate wage round last autumn. All contracts renewed thus far for large groups in industry provided for increases in earnings (Ist-Loehne) of 4.4 per cent, thereby remaining below the current inflation rate. Taking into account the declining inflation rate, the effects in 1983 of the 1982 tax reform as well as the wage drift in certain sectors, it is expected that, on average, real purchasing power will be maintained in 1983.

Turning now to the more positive aspects of the present situation, Austria has succeeded in achieving a marked deceleration of inflation as well as an approximate balance in the current account.

As a result of a cautious monetary policy in combination with declining import price inflation, the annual inflation rate decelerated to 4.6 per cent in October. Over the past six months, Austria registered the lowest inflation rate of all OECD countries except Japan.

As to the balance of payments, it is expected that the current account will be back in equilibrium in 1982 for the first time since 1969. This improvement is largely due to a reduction in the trade deficit and a simultaneous increase in the surplus on services. A similar result is to be expected for 1983 as well. A balanced current account for 1982 means an improvement of about S 22 billion over 1981.

With respect to the causes of this distinct improvement, it is impossible to quantify the different elements involved, such as gains in competitiveness, structural improvements, or the low level of economic activity. Nevertheless, the impression is that structural adjustments have played an important role in this improvement. It is assumed that this is especially true for the small and medium-sized enterprises, which seem to be able to adjust rather quickly but where no statistical evidence is available. On the other hand, a re-emergence of a current account deficit cannot be excluded entirely in the event of a sharp recovery in economic activity, although such a recovery does not seem likely in 1983.

Despite the fact that the scope for a domestically oriented monetary policy is limited by the hard-currency policy as well as interest-sensitive capital movements, the monetary authorities have been successful in reducing the rate of inflation by pursuing a cautious but flexible monetary policy. In maintaining a close relationship between the schilling and the currencies of the European Monetary System, particularly the deutsche mark, monetary policy not only made an important contribution to the adjustment process but at the same time created a climate conducive to the smooth functioning of the social partnership.

In view of the current slack demand for credit, and the improvement of the balance on current account, the monetary authorities have recently eased their restrictive stance aiming at a further reduction in the level of interest rates, which is still considered to be too high in real terms.

One of the central issues, however, remains the federal budget, where the deficit has proved to be persistent. In this respect, while the deficit is still low in comparison to other countries, Austria encounters difficulties similar to those faced by many other European countries. Whereas the medium-term target for the federal deficit of 2.5 per cent of GDP, as announced in 1978, was more or less met in 1981--the deficit amounted to only 2.6 per cent of GDP--the net deficit in 1982 once again increased to over 4 per cent of GDP owing to lower GDP growth and higher unemployment than had been expected.

The federal budget for 1983, meanwhile enacted by Parliament, aims in principle at maintaining the deficit at the same level in nominal terms as in 1982 and, given the overall slack in economic activity, stimulating demand at the same time.

However, the likely outcome is surrounded by a number of uncertainties: the rate of GDP growth, the development of unemployment, the lagged effects of the two employment programs, and the magnitude of flows of receipts resulting from the "1983 Tax Amnesty." The difference of opinion on possible outcomes of these measures, as pointed out in the staff report, underlines the unusually high degree of uncertainties in 1983. If, however, revenues should turn out to be lower than expected, the Austrian authorities would be ready to contemplate a cut in expenditure. There could be a review of the dynamic features on the expenditure side of the budget, including the social security system. In this regard, the main aim of the Government is to assure the financial stability of the system in the long run. However, no drastic expenditure-cutting measures are envisaged, since these could jeopardize the social partnership in Austria as well as be self-defeating in a period of low growth. It is the basic intention of the Government to keep its share in GNP relatively constant in the medium term.

Given the state of the Austrian economy, it would be difficult to pursue a consolidation of the federal budget at this time. Under the prevailing circumstances, it seems preferable to try to alter the structure of expenditure by concentrating on constraining the dynamics of expenditure growth.

In conclusion, it seems that Austria's economy, which was severely hit by the crisis of the 1930s, has proved to be one of the more robust in the current period of stagnation. However, this is no reason for complacency. Under present circumstances, an economic policy strategy has to be followed to enable the economy to endure even a protracted period of stagnation. The Austrian authorities are determined to pursue such a strategy in a pragmatic way within the existing limits.

Extending his remarks, Mr. Schneider pointed out that the figures for real GDP, consumer prices, and the unemployment rate were percentage changes on an annual basis, whereas the figures for private consumption, gross fixed investment, and exports and imports of goods and services represented the contribution to real GDP in percentage points of each item. The complete set of figures was contained in SM/82/225, Supplement 1.

As to the activation of the contingency budget, the Austrian Institute for Economic Research had already anticipated the entire amount of S 6.3 billion in its December forecasts, Mr. Schneider continued. However, his authorities had indicated that, for the time being, the Minister of Finance intended to release only the stabilization tranche amounting to S 3.7 billion. Furthermore, the Cabinet of Chancellor Kreisky had already said that, well in advance of the general election in April, the Government would announce to the general public what sort of budgetary measures it would take if re-elected.

Mr. Laske observed that the staff had correctly pointed out that Austria was one of those industrial countries that, because of the openness and size of their economies, had only limited room for maneuver in formulating and implementating economic policy. Despite that handicap, the authorities had been successful in managing the economy under difficult, perhaps even detrimental, circumstances, an achievement for which they were to be commended. Austria had coped with the two oil price shocks more competently than most other industrial countries. Moreover, the authorities had re-established equilibrium in the current account of the balance of payments and had brought about a marked deceleration of inflation. Real growth of GDP had been sluggish during the previous two years, but in 1982 it had increased slightly, a record that had become the exception rather than the rule among industrial countries. Austria had not been spared the experience of its neighbors, as unemployment had risen since mid-1981 to a level that was high by national standards. It would be interesting to know to what extent the 1982 increase in unemployment had been affected by unfavorable demographic trends. In brief, a small increase in real growth had been accompanied by a marked decline in the rate of inflation and a significant improvement in the external current account.

As in practically all industrial countries, concern was warranted about fiscal policy in Austria, Mr. Laske considered. The medium-term objective for the government deficit of 2.5 per cent of GDP had not been met in 1982, mainly because of the lower than expected growth rate and the unforeseen rise in unemployment. Caution in applying fiscal stimulus to the economy was therefore advisable. The two employment programs begun in 1982 had not yet produced the hoped-for positive results and had further depressed tax revenue, thus exposing the budgetary position to additional strains. Therefore, it would be essential to contain the deficit by careful management on the expenditure side. Nevertheless, he understood Mr. Schneider's argument that drastic measures to cut expenditure could not be considered, since they might jeopardize the social consensus in Austria, which had been of vital importance in the authorities' management of the difficult economic situation.

What kind of measures, Mr. Laske asked, would be appropriate for keeping the budget deficit within a range that would pose no threat either to price stability or to the external balance? The authorities and the Fund staff seemed to agree that little scope existed for raising taxes, but there might be some areas in which a rationalization of tax policies could bolster revenue. For instance, the generous policy toward tax exemptions left one third of total income in effect untaxed. Could the staff provide further information on tax exemptions? Again, energy consumption was accorded privileged treatment, in that the rate of value-added tax was substantially below the rate applied to other kinds of personal consumption.

To hold down the budget deficit, strict control of spending appeared essential, Mr. Laske commented. While social security benefits were the most important element for the maintenance of the social consensus in Austria, social security spending should not a priori be left out of consideration when economies had to be made. Mr. Schneider had indicated that the authorities did not intend to spare social security benefits from an expenditure review if revenue failed to reach the level projected. Other industrial countries, including his own, were going through the same painful process.

The budget was also exposed to additional future burdens, Mr. Laske pointed out. For instance, the Government had agreed to assume the debt service of the nationalized industries, a decision that had two consequences. First, for many years ahead the budget would have to provide for an expenditure item that might make it more difficult to attain the target set for the budget deficit. Second, the industries supported by the Government, which he assumed were threatened with obsolescence, would be spared the need to adjust rapidly to technological advances and might thus increasingly become a drag on the entire economy.

He fully supported the hard-currency policy of the Austrian authorities, Mr. Laske said, for it had contributed to the large reduction in the inflation rate and had also helped Austria to achieve gains in international competitiveness. He did believe, however, that the competitive strength of the Austrian economy worked primarily on the export side, while the penetration of the domestic market by foreign suppliers had continued to increase in recent years, an impression bolstered by Table 1 in SM/82/227. The provision of subsidized export credits and export credit guarantees might have played an important role in the success of Austria's exports. The staff in its appraisal had injected a warning in that respect. The Austrian authorities should note that unfavorable trends might be disguised by the generally favorable external experience in 1981 and 1982.

The authorities' structural policies appeared to have contributed significantly toward maintaining a cooperative climate among government, business, and labor, Mr. Laske noted. There were two sides to the operation of the nationalized industries, which were important tools for the pursuit of such structural policies. On the one hand, those enterprises were expected to contribute to stabilizing employment. On the other hand, they were fully exposed to the forces of supply and demand and thus had to safeguard their competitiveness. That double focus might create problems at times when the economy was under strain, as it was at present. The task confronting the authorities was to keep a proper balance between the social benefits and the budgetary costs associated with those structural policies. In that connection, the staff had used the phrase "at considerable cost," perhaps implying that the labor market aspect of the structural policies had been somewhat out of proportion. Could the staff comment further on that phrase?

He could fully endorse the staff observation that wage moderation would enable Austria to maintain relatively high employment, even under the stress of a pressing need for adjustment, Mr. Laske concluded. The moderate wage settlements concluded recently were thus an encouraging sign, and they seemed to confirm that the social consensus was still holding.

Mr. Lovato said that he was in broad agreement with the staff appraisal. He shared the view that the Austrian authorities had achieved good results in 1982, especially compared with other economies, and in view of the weakness of world demand. Price increases had, however, accelerated markedly compared with 1981, both in the consumer sector and in the wholesale sector. With the improvement in foreign trade, the current account had come close to balance. The strengthening of the current account had reflected largely cyclical factors, but it was also affected by structural adaptation and improved competitiveness. Thus, Austria was well poised for the moment of an international economic recovery.

He did have some reservations about the way in which exports had been financed, Mr. Lovato continued. Difficulties with the debt servicing of countries that received Austrian exports could create some problems. After all, outstanding disbursements of the Kontrollbank amounted to S 120 billion.

The Austrian authorities could attain their objective of maintaining high employment with monetary stability, without any trade-offs, by applying a flexible and consistent incomes policy, Mr. Lovato considered. It was of course much more difficult to pursue that sort of strategy at a time of world recession, and there was a price to be paid in terms of a larger public sector deficit. The question was whether it was possible to solve the worldwide problem of public sector deficits with a policy of cutting expenditure and increasing revenue, assuming that every country was doing the same.

On page 5 of SM/82/225, the staff had indicated that the economic upswing in 1979 and 1980 had facilitated efforts to reduce the deficit, while on page 6 the staff had maintained that the unexpected weakness of economic activity in 1982 had led to a shortfall in taxes and social security contributions together with a sharp increase in unemployment compensation, Mr. Lovato noted. Austria's fiscal policies in a period of recession should give food for thought not only about that one country but also for the world economic outlook. Generally speaking, he shared the staff's concern that some decisions already taken by the Austrian authorities would build up expenditure in future years and that budget deficits were much easier to build up than to reduce; he was referring to structural deficits and especially to social security, which ought to be reduced. The practice of keeping social benefits unchanged in real terms should also be brought to a stop, as should the social objective of maintaining employment in a given sector. He would recommend a gradual reduction in subsidies to declining activities and a shift of resources to more productive sectors. Nevertheless, he did approve of the two employment programs decided on at the beginning of September 1982. First, they would revive economic activity, or at least contain any further decline. Second, the direct governmental outlays represented a bargain for the budget. Third, their being assigned to building roads and housing would improve Austria's infrastructure and therefore the medium-term and long-term productivity of the system. Fourth, the positive effects, both socially and economically, should be reached without putting any pressure on the balance of payments or on inflation.

While monetary policy had to be accommodating to some extent, Mr. Lovato went on, financing excessive public sector expenditure could risk crowding out the private sector, even though the savings ratio was increasing. Wage moderation was important for heightening competitiveness, decelerating inflation, and improving the current account balance. The Austrian authorities were to be commended for using exchange rate policy toward that end. In fact, by holding down inflation, the authorities should find it easier to reach a consensus with unions on a suitable incomes policy. He was confident that the social partners in Austria would have a reasonable attitude toward future settlements, and he hoped that there would be no reduction in working hours unless there were a commensurate decline in wages.

Miss Le Lorier welcomed an Article IV consultation that offered her the chance to commend national authorities for their achievements. In its appraisal, the staff had commented more on causes for concern than for success. It might be argued that, in carrying out its surveillance function, the Fund had to be essentially critical. However, the Fund should not be complacent with its thinking and language when defining suitable answers to current challenges.

Part of the impressive improvement in the current account had been caused by the diversification in Austria's export markets, Miss Le Lorier noted. The sensitivity of the external balance to cyclical fluctuations was attributed to Austria's relative propensity to import. The country's liberal trade policy should certainly be preserved; in any event, the authorities of a small open economy might have little scope for influencing import propensity. While the staff had indicated what further steps could be taken in the export-oriented sector, it had not provided a list of measures that could eventually lower Austria's import propensity.

On the slowdown in the inflation rate, she agreed with Mr. Schneider that the social partnership in Austria influenced both the stance of monetary and fiscal policies and the effects of those policies on the rate of inflation, Miss Le Lorier said. In the recent past, the Fund had placed great confidence in a rather mechanistic relationship between the supposed level of inflationary expectations and the stance of monetary policy. The state of the Austrian economy demonstrated that such an approach had to be heavily qualified when the specific features of any member country were considered.

The staff analyzed Austria's fiscal policy by referring to the voted budget, perhaps not the most valid reference, Miss Le Lorier commented. A more basic question was whether the budgetary outcome was adequate in the light of the cyclical evolution of Austria's economy, since the other countries were making conflicting efforts at adjustment. The staff had observed on page 15 of SM/82/227 that, because the economy had not grown from 1980 to 1981, a given balance--weighted or unweighted--had been more restrictive in 1981 than it appeared. On page 6 of the same paper, the staff had noted that when the authorities had decided to resort to additional initiatives during 1982, they had favored investment over consumption. The staff was skeptical about the efficiency of the incentives provided. Had they led to earlier starts on investment projects? What would their effect be on the profit margin of the industrial sector? However, the increase in the deficit did not seem to have impaired public confidence. To the contrary, Mr. Schneider had suggested that the deficit had contributed to maintaining the social partnership and would have the same effect in 1983 were further overshooting of the budget to occur.

The staff was concerned about the buildup of expenditure in the medium term that would result from decisions already taken by the authorities, Miss Le Lorier said. She herself had some difficulty in assessing the net cost of those decisions. For instance, what was the comparative advantage of the programs designed to fight unemployment vis-à-vis the increase in the cost of the unemployment insurance scheme that would otherwise occur? The staff had mentioned in Appendix II of SM/82/227 that, in order to conduct the necessary restructuring of nationalized companies, further capital infusions from the federal budget would be needed. Could assuming the redemption obligations of nationalized companies have the same effect as providing additional capital? The staff seemed to have drawn up recommendations about social benefits and taxes on the basis of general premises that were insufficiently precise, especially since the international comparison of fiscal indicators on page 21 of SM/82/227 gave no firm guidance.

She would have preferred more country-specific advice and fewer general recommendations, Miss Le Lorier went on. She did not mean that Austria was shielded from weaknesses or mistakes encountered by other industrial countries; it clearly was not, as could be seen from the information supplied on the budget. However, such difficulties did not have to be dealt with in an identical manner at all times or in all countries.

The risk of foreign lending was carried by the Federal Government through the Kontrollbank, Miss Le Lorier noted. Recent events in Latin America did not offer strong evidence that private banks were much better equipped than a public institution to perform that function. For the future, she was troubled by the staff's recommendation that the authorities should take a measured approach toward increasing Austria's exposure to economies in difficulty, as the authorities were unlikely to yield to a temptation to overshoot. Moreover, the Fund had entered into arrangements with some economies in difficulty only after having received reasonable assurances that official lenders as well as commercial banks would cover any possible shortfalls in the countries' balance of payments.

Furthermore, she was not aware that, during Article IV consultations, the staff was in the habit of making observations on the policies of the authorities in charge of monitoring lending risk in countries in which lending risk was borne by the private sector, Miss Le Lorier went on. Discrimination might arise among member countries in connection with institutional differences in the surveillance of foreign assets and liability management, a point on which she invited the staff to comment.

In conclusion, while she had no major difficulties with the analysis of the major policy issues, Miss Le Lorier remarked, the drafting of the staff appraisal did have the flavor of dogmatism. The evolution of the world economy and the specifics of each country should prevent the Fund from giving members the same advice that it had given some months previously.

Mr. Dallara expressed broad agreement with the staff appraisal. It was clear that the Austrian economy had performed admirably for many years. Throughout the 1970s, Austria's overall economic performance had been one of the most impressive in Europe. In 1982, the authorities were to be commended for following a generally effective exchange rate policy with supportive monetary policy, a liberal trade regime, and a relatively successful incomes policy. Austria's attainment of approximate balance in the current account in 1982 and the reduced rate of inflation were both notable achievements. Mr. Laske and Miss Le Lorier had singled out one statement in the staff paper to which he would also like to refer: in view of the size and openness of the economy, Austria's policymakers had only limited room for maneuver. Clearly, small economies were heavily influenced by external developments, but the authorities in Austria had recognized the influence of the world economy on their own economy and had generally been able to adjust their own policies in the light of world developments and the policies of their larger neighbors. The social partnership among business, labor, and the Government was central to Austria's ability to deal effectively with its economic problems. Yet Austria's success would appear to involve not only the unique functioning of the social partnership, but also straightforward, sound economic management.

The staff and other Executive Directors had raised valid concerns about the budgetary outlook, especially in the medium term, Mr. Dallara remarked. While the authorities had been relatively successful in lowering the fiscal deficit from 1979 to 1981, it had grown substantially in

1982 and was expected to grow further in 1983. Some of the increase was due to the recently enacted employment programs, and some might be defined as structural. In his view, the authorities should take action to reduce the deficit over the medium term. While they might wish to pursue a countercyclical fiscal policy, he wondered, like the staff, how effective the initiatives taken were likely to be and whether the authorities were building in problems for the future, thus incurring long-term economic costs that might exceed the short-term economic benefits. He fully agreed with the staff comment that international experiences suggested that budget deficits were much easier to build up than to reduce, even under cyclically favorable circumstances.

In the staff appraisal, there was some question whether some of the measures introduced to stimulate private investment had actually encouraged investment, Mr. Dallara went on. Presumably, the staff had been referring, inter alia, to the extensive system of interest rate policies and preferential rates used by the authorities. He would be interested in hearing the staff or Mr. Schneider comment more directly on the overall benefits gained by promoting structural adjustment through those types of policies compared with the potential cost of distorting economic activity. He was particularly concerned about export credits. At a time of global recession, it was especially important for all governments to work diligently to avoid any policies that might confer an unfavorable competitive advantage. It was thus important for all countries to honor the terms and conditions of the international arrangements on export credits.

There was a potential problem with Austria's foreign lending, much of which was government guaranteed and therefore had a direct potential impact on the budget, Mr. Dallara concluded. He joined the staff in urging the authorities to be cautious in extending Austria's role as a financial intermediary. Austria would indeed be prudent to weigh the budgetary and balance of payments consequences of its lending practices if the problem of delayed payment by foreign debtors should grow.

Mr. Taylor commented that Austria had made excellent progress in lowering inflation and improving the current account. However, Austria's traditional tendency to have a high import propensity had continued to be evident in 1982: import volume had grown by 2 per cent while domestic demand had risen by only 1 per cent, which were worrying statistics in relation to the overall weak state of activity in the economy. Perhaps the authorities should consider some move toward further structural measures in the interest of improving Austria's competitiveness, especially vis-à-vis the German economy, which accounted for a larger proportion of Austria's imports than exports.

As to the current account deficit, Mr. Schneider had maintained that the improvement in the current account balance had largely reflected structural imbalances, but, as the staff had pointed out, the improvement had also reflected the cyclical weakening of activity in Austria relative to that of its trading partners, Mr. Taylor continued. He agreed with the staff on that point but doubted the staff's interpretation that Austria had had a structural current account deficit in the late 1970s from which it had temporarily escaped. Rather, much of the large deficit in those years had been attributable to the fact that Austria had been late in moving into recession and had maintained relatively high levels of activity at a time when the economies of trading partners had already been weakening somewhat. Nevertheless, he accepted the staff's view that the current account deficit would tend to deteriorate worryingly in the future if the fiscal position were allowed to worsen and if the marginal propensity to import remained high. In short, he agreed with other speakers that adverse structural tendencies, both in the external sector and on the fiscal side, posed something of a threat.

There were some grounds for uneasiness regarding the fiscal position, Mr. Taylor considered. Like other Executive Directors, he sympathized with the authorities' wish to keep up a high level of employment and was pleased that they had managed fairly well at a time when other national authorities had done less well. He did however wonder about the wisdom of shoring up nationalized industries, many of which were in declining sectors. He had also been concerned by the staff's comments about the budgetary impact of the new job creation scheme initiated in 1982.

It would be helpful if the staff could provide estimates of the financial deficit of the public sector as a whole rather than simply the deficit of the Federal Government, Mr. Taylor recommended. When he was trying to assess the implications of a country's fiscal policy for monetary expansion in the external deficit, he found it helpful to see figures for the public sector taken as a whole. The practice might also help to develop better international comparisons. Could the staff comment on whether the rest of the public sector in Austria was tending to move into deficit?

The staff report indicated that interest rate subsidies and preferential credit rates were widespread in Austria, Mr. Taylor said. In fact, the staff had said that 40 per cent of all credit in Austria was granted on preferential terms, a practice that must surely have some implications for the allocation of investment in the economy. As the staff and Mr. Dallara had pointed out, the subsidized credit scheme would inhibit the flexibility of monetary policy. Could the staff or Mr. Schneider comment further on the significance of those pervasive credits in the domestic economy?

It was understandable in a relatively open industrial country like Austria that monetary policy should be devoted essentially to achieving an exchange rate target, Mr. Taylor considered. In passing, it had struck him as odd that monetary policy should have relied so heavily on foreign exchange swaps for the second year running to provide temporary liquidity in the domestic economy. He also wondered whether the steps taken to increase the scope of swap operations went far enough. He had noticed a reference elsewhere in the report to what the staff called the thinness of the domestic capital market. On the face of it, that observation was slightly surprising in a mature industrial economy with a well-developed financial system. Could the staff say whether there was more to be done to extend the array of monetary instruments available to the authorities and whether there might be a need for more or different kinds of longer-term debt instruments?

He was pleased that the staff papers included information on the size and composition of Austria's external assets and liabilities, Mr. Taylor remarked. In general, the Fund needed to extend its surveillance in that field, and he hoped that that sort of material and supporting analysis could become a more common feature of Article IV reports. The recent growth in other countries' debt to Austria, both in its size and in its geographical distribution, did give his authorities ground for concern. Much of that debt was government guaranteed or the responsibility of nationalized banks, which were already being financially supported by the Government. He had also noted the heavy concentration of Austria's external claims in the Council for Mutual Economic Assistance (CMEA) area. Admittedly, there seemed to be no mismatch of maturities between assets and liabilities, but there might well be some mismatch in the degree of risk and the degree of liquidity. The staff suggestion on the need for caution regarding any increase in Austria's exposure to the heavily indebted Eastern European countries was relevant. In conclusion, he endorsed the thrust of the staff appraisal.

Mr. Joyce said that the Austrian authorities were to be congratulated for the success of the policies that they had pursued over the previous few years and indeed for their most recent successes in reducing the rate of inflation and achieving a balance on current account in 1982. Admittedly, that improvement in the current account balance might have been largely due to cyclical and transitory factors, but it nonetheless represented an improvement.

Not only did the Austrian economy face difficult problems in 1983, but the room for maneuver of the Austrian authorities was extremely limited for a number of reasons, Mr. Joyce indicated. First, the economy was small and relatively open. Second, particularly close economic and financial links existed between Austria and the Federal Republic of Germany. The hard-currency policy that the Austrian authorities had rightly chosen to follow linked the Austrian schilling closely with the deutsche mark, a policy choice that limited the Austrian authorities' freedom of action, especially on the monetary front. Third, the importance of traditional export markets in Eastern Europe, at a time when many of the countries there were facing financial and economic difficulties, also limited their freedom of action. Fourth, perhaps the most overriding limitation on the authorities' room for maneuver was the traditional general stance of economic policy in Austria, particularly the importance given by the authorities and the people to maintaining high employment in a setting of price stability. Indeed, as Mr. Schneider had said, the achievement of those objectives was regarded as essential to the social partnership. As he understood it, that partnership was even more important in Austria than, say, the economic understanding reached at times by the social partners in the Federal Republic of Germany and in certain other countries.

Those same considerations often gave rise to expectations that could not be fulfilled; they could also lead to the implementation of measures, however attractive they might appear in the short run, that were not necessarily conducive to the longer-term strength of the economy, Mr. Joyce stated. For example, the staff had some question about the advisability of some of the fiscal incentives recently enacted to support economic activity, notably the two employment programs and some of the tax reductions and tax concessions. The staff was rightly concerned about the impact that those measures would have on the overall budgetary position in Austria, especially when the effects of the automatic stabilizers were taken into account along with the even greater slowdown currently expected in the Austrian economy; developments such as those would tend to push the deficit even higher than envisaged.

As the staff pointed out, the new measures locked the authorities into an expenditure pattern that might be difficult to reverse, Mr. Joyce continued. They almost certainly added to the budget deficit in the immediate future, and they promised to increase government indebtedness and hence the cost of debt service in coming years. He agreed with the staff that, under those circumstances, the Government should be urged to monitor expenditure closely and be ready to move on either the expenditure front or the revenue front should a further significant rise in the deficit appear likely. In that connection, the new projections by the Austrian Institute for Economic Research were much more pessimistic about growth and revival than the predictions underlying the budget itself. In the light of recent developments and those forecasts, were the authorities considering any further budgetary steps to contain the deficit?

He had been impressed by Mr. Laske's remarks that, even if the authorities generally had little scope for action on the revenue side, there might still be areas that warranted further examination and in which action could conceivably be taken, Mr. Joyce went on. He was unsure about the remark on page 6 of SM/82/225 that the elasticity of taxation with respect to nominal GDP appeared to have dropped in 1982, and he would appreciate any information on the reasons for the drop and whether the authorities expected it to continue.

The staff had also expressed concern about whether some of the employment and investment policies being pursued were likely to impede the structural changes required in the medium term, Mr. Joyce noted. The problem appeared particularly serious in the nationalized industries, many of which dealt with activities in which Austria might no longer enjoy as great a comparative advantage as it had previously. While he appreciated the need in social terms for disaster limitation measures, undue delays in effecting adjustments could prove costly in economic terms and indeed ultimately in social terms as well. Could Mr. Schneider say whether the authorities in Vienna had rethought the basic policy stance as a result of the staff's comments?

The promise of the Federal Government to take over debt redemption of nationalized industries was not reflected in the budgetary accounts, Mr. Joyce observed. Surely it would be helpful to both the policymakers and the public to ensure that the full burden of government spending, whether directly through government accounts or indirectly through the nationalized industries or parastatals, was fully expressed in some form of consolidated accounting. Was there any movement in prospect in that direction?

The authorities' objective of directing monetary policy toward holding down foreign and domestic inflationary impulses was commendable, Mr. Joyce went on. Nonetheless, he had two questions. First, the staff paper outlined the two techniques used by the authorities to maintain the exchange rate: direct market intervention, affecting foreign reserves, and the maintenance of a stable differential between call money rates in Austria and in Germany. The paper went on to say that monetary policy was focused on interest rate developments geared toward exchange rate stability over the longer term, a remark that seemed to imply that some short-term fluctuations between rates of interest in Germany and Austria were to be tolerated. There seemed to be some inconsistency between the authorities' focus on extremely short-term interest rates, specifically the call money rate, for exchange rate purposes, and their view that interest rates should be geared toward longer-run exchange rate stability. Could the staff or Mr. Schneider provide guidance on that point? Second, there might be some merit in allowing interest rates to fall further so as to permit a greater degree of expansion in the general level of credit with a view to providing additional stimulus to the private sector. Such a move might be preferable to some of the direct employment measures taken by the Government. It would of course require an even closer review of the budget deficit.

He agreed with the authorities' concern about inflation and their reluctance to reflate, Mr. Joyce continued. Nevertheless, inflation in Austria had been lower than in almost every other industrial country at 5.5 per cent in 1982, and the rate was forecast to move down further to 4.2 per cent in 1983. Unemployment had risen sharply, and, in the absence of a marked improvement in the world economic situation, which seemed unlikely for 1983, many firms in Austria would find it impossible to provide a cushion through labor hoarding, as they had done in the past; indeed, the number of plant closures and business failures was increasing in Austria. Thus, more restraint on the budgetary side and more easing on the monetary side might be worth considering.

Austria's good export performance reflected in part the country's success in trading with socialist countries, financed by government-backed or government-financed export credits, Mr. Joyce remarked. Of course, every country extended export credits to stimulate its foreign trade, and the practice had become a key element, especially in dealing with Eastern European countries. Such credits entailed a cost to the Government and the economy when they contained a subsidization element. In Austria, the problem was compounded by the need to secure the necessary financing in capital markets located in Western Europe. There was an increasing degree of uncertainty attached to claims arising from those transactions with Eastern Europe. He joined the staff in urging caution in the matter.

Finally, the increase in Austria's development aid had not had a large grant element, Mr. Joyce said. In fact, it had taken the form of subsidized export credits. The Austrian authorities might wish to make some adjustment in the stance of aid policy to improve the extent and the nature of assistance to developing countries. In summary, Austria was going through a difficult time. The authorities were to be congratulated on the steps that they had taken and were taking. He urged them to watch developments extremely closely.

Mr. Alhaimus commented that the performance of Austria in coping with the prevailing recessionary conditions of the world economy was still commendable, despite the increasing difficulties encountered in some key areas of the economy. Particularly noteworthy was the decline in the rate of increase of consumer prices in 1982, when, as Mr. Schneider had indicated, Austria had registered the lowest inflation rate of all OECD countries except Japan. The adherence to the social partnership continued to be instrumental in maintaining price stability. The current account was expected to be in balance in 1982, following a large deficit in 1981, and might even register a surplus in 1983. Nevertheless, the impact of the world recession had been felt in some important aspects of the Austrian economy. Growth of real GDP had improved only slightly in 1982, and no further improvement was likely in 1983. The record level of unemployment had been particularly disquieting to Austria's policymakers, who traditionally gave priority to ensuring high employment. Regrettably, underlying conditions might exert inflationary pressures, and the improvement in current account might not persist if there were a sharp recovery in economic activity. Furthermore, it was unclear how much progress had been made in addressing Austria's structural problems, especially given the economy's reliance on basic production rather than more diversified and sophisticated products. Nevertheless, as a small open economy facing prolonged world recession and rising trade barriers, Austria's achievements were commendable.

An improved international environment would allow more room for maneuver for Austria's policymakers, Mr. Alhaimus considered. In fact, some signs already appeared in the form of lower rates of price increases of imported raw materials, which had contributed to a reduced rate of inflation. Moreover, the high levels of world interest rates, which created difficulties for the monetary authorities, were on a clear downward trend.

The percentage of official development assistance to GDP had doubled in 1981, Mr. Alhaimus noted, and Austria now contributed an above-average share of GDP to developing countries compared with other members of the Development Assistance Committee. Although most of the rise in ODA had taken the form of export credits and had a low grant element, he hoped that Austria's performance would improve, thus contributing to the flow of international trade. However, he had noted the staff's concern about Austria's role as a financial intermediary and the exposure of its commercial banks. He would appreciate further elaboration on that point.

Mr. Senior considered that Austria's economic situation and outlook were quite good compared with those of many other industrial countries. The performance of the economy had been particularly noteworthy in holding down unemployment and inflation as well as in achieving external balance. Given the great importance attached by the authorities to the rate of unemployment, he could understand Mr. Schneider's comments on the subject. Yet the so-called deterioration of the unemployment rate to 3.7 per cent had been mild compared with the rest of the industrial world. Austria's labor market prospects did not appear good, especially since, given the heavy weight attached by the authorities to the level of employment in the social welfare funds, employment would depend primarily on wage behavior rather than on government policies. Thus, Mr. Schneider's comments on the understanding among the social partners in the labor market were welcome. It was encouraging that all wage contracts recently renewed had provided for rates of increase below the current rate of inflation.

He agreed with the staff that the positive results on the external side were the result of depressed levels of domestic activity, together with an improvement in competitiveness, Mr. Senior said. He also agreed with Mr. Schneider that the economy's structural adjustments had played a large role in achieving external balance. Nevertheless, structural reform would have to be accelerated in order to reduce the high sensitivity of the external sector to cyclical fluctuations.

As Mr. Schneider had remarked, the authorities' room for maneuver in a small open economy like that of Austria was certainly narrow, Mr. Senior continued. All the authorities could do was attempt to synchronize movements in domestic monetary policy with movements in the international business cycle, waiting for recovery abroad to expand the domestic economy. It appeared justified for recent monetary policy to follow the reduction in worldwide interest rates, which were still high in real terms.

Beginning in 1975, the budget in Austria had recorded substantially larger deficits than it had previously, Mr. Senior concluded. He shared Mr. Schneider's view that the best course of action might be to concentrate on the structure rather than on the level of spending, which was quite resilient in the short run. An effort at reorienting the fiscal apparatus would have to be made if stability in public finances was to be achieved in the medium or longer run. A persistent effort in the fiscal field might turn out to be more effective than cuts in the budget, which frequently led to increases in other items of the budget rather than to a decrease of the overall deficit.

Mr. Vidvei commended the Austrian authorities for their economic policy. He supported the remarks made by Miss Le Lorier on the analysis in the staff papers. The performance of the Austrian economy had been successful by international standards; the authorities had kept employment high and achieved a marked slowdown in inflation as well as approximate balance in the current account. On the negative side, growth had lately been sluggish, and unemployment had risen rapidly, although the rate remained low compared with that of most other industrial countries. Altogether, Austria represented one of the few bright spots in a dark international environment.

In its latest forecast, the Austrian Institute for Economic Research had lowered its growth estimate for 1983, Mr. Vidvei noted. Together with the activation of the contingency budget, the slower growth rate was expected to raise the federal deficit from 3.9 per cent of GDP to 4.8 per cent, a development that might turn out to be worrisome and that underscored the need to keep the fiscal deficit under close review. It also indicated the extent of the difficulties encountered by a small open economy in trying to pursue over several years an economic policy that differed from the main thrust of policy followed in most other countries.

On incomes policy, he had been pleased to learn from Mr. Schneider's statement that the outcome of the wage negotiations in autumn 1982 had been moderate, Mr. Vidvei said. The social partnership had indeed contributed greatly to positive developments in the Austrian economy. It was heartening that at least one country could say with conviction that an incomes policy, under a system of social partnership, had functioned well. As the incomes policy really worked, the authorities should not be too concerned about the present fiscal deficits. The issue did, however, deserve further analysis. The hard-currency policy had contributed considerably to encouraging moderation in nominal wage demands by keeping down inflation for some years.

In conclusion, he had been glad to hear Mr. Schneider say that human considerations had always been an important element in the approach to employment problems in Austria, Mr. Vidvei remarked. The Austrians were to be commended for that basic approach to economic policymaking and for their outstanding ability to find solutions to problems. The Fund staff and management appeared to have taken a somewhat too critical view, having made several general and not particularly helpful statements on the performance of Austrian economic policy. If an Article IV consultation was to be helpful, there was a need for more thorough and undogmatic analysis, as Miss Le Lorier had indicated.

Mr. El-Khouri commented that the Austrian economy had performed well in 1982 in the face of difficult international economic circumstances. The inflation rate had declined, and the current account position had improved. While the growth rate had been modest and there had been some rise in unemployment, Austria's position remained satisfactory in comparative terms. The authorities were to be commended for their successful management of the economy.

As several speakers had pointed out, the smallness and openness of the Austrian economy made it particularly vulnerable to developments abroad, Mr. El-Khouri said. Given the great uncertainty about the world economic outlook for 1983, the Austrian authorities would have to proceed on a pragmatic basis. It was encouraging to learn that the authorities would be ready to contemplate a cut in budget expenditure if revenue should turn out to be lower than expected.

The most recent demonstration of the successful social partnership in Austria had been the moderate wage round in the autumn of 1982, Mr. El-Khouri went on. He understood why the authorities would not wish to pursue policies that might jeopardize that partnership. He had the impression from Mr. Schneider's statement that the Austrian authorities believed that some of the policies about which the staff was less than enthusiastic were in fact necessary to maintain the successful social partnership. Finally, the authorities were to be commended for doubling official development assistance in 1981. ODA flows as a percentage of GDP had risen to 0.48 per cent in 1981. He hoped that Austria's budgetary difficulties would not prevent the authorities from improving on that good record even further.

The staff representative from the European Department noted that in many respects Austria was different from other Western European countries because of its geographical location and its historical ties with countries in both Eastern Europe and Western Europe. Another feature was the emphasis of Austrian policy on social objectives, especially high employment. Mr. Joyce had correctly observed that the achievement of those objectives was essential for the working of the social consensus. The Austrian people tended to look not for confrontation but for consensus.

The Austrian authorities were sometimes ready to forgo a short-term gain in the hope of long-term gains, the staff representative explained. Their judgment had so far been proved correct. One Director had in fact asked whether the authorities should occasionally consider detaching the schilling from the deutsche mark as the main point of orientation and depreciating the schilling somewhat further. In previous consultation discussions, the staff had sometimes offered the view that depreciation of the schilling would be one way to improve competitiveness. However, it appeared that trust in the Government and its economic policies might be eroded if certain established lines of policy were bent for a short-term gain.

One Director had asked whether there were demographic factors behind the rise in unemployment, the staff representative recalled. Up to the present, those factors had not had any influence, but they might do so in a few years' time. Emphasizing structural policies, Directors had also asked how to measure the balance between the gain in employment from providing assistance to ailing industries and the cost involved in higher unemployment payments. While no detailed study had been made of the question, most of those ailing industries were located in regions in which virtually no other jobs could be provided. In the province of Styria, nationalized industries employed 30 per cent of the labor force, and those industries were ailing. The Government was aware that efforts would have to be undertaken to bring about industrial adjustments.

Some questions had been asked about the elasticity of taxation and what measures could be taken in the tax field, the staff representative noted. There had been a fall in the elasticity of taxation, partly because the number of business failures had increased, a development that had affected tax revenue faster than GDP. The Austrian authorities felt that measures to change taxes could be considered. For example, Austrian workers benefited from 13-month and 14-month salaries. Those extra months' salaries were not taxed at present but might be in the future.

Reference had been made to the high level of social expenditure in Austria, the staff representative said. While in the longer run something would have to be done, in the short run, owing to legal commitments, it might be very difficult. The problem for the authorities was not so much that the deficit had temporarily increased but rather that the Government's indebtedness over the longer term had risen. In the past ten years, the federal debt as a percentage of GDP had tripled, so that the burden of debt service on the budget had become worrisome. The structural aspect of public expenditure gave cause for concern. There had to be a change from consumption expenditure to investment expenditure, a question closely tied to the need for restricting nationalized industries instead of merely supporting them for a time.

Directors had asked about the strong use of foreign exchange swaps to influence domestic liquidity, the staff representative remarked. The authorities had used that instrument out of necessity. But in recognition of the need to broaden the range of instruments, the room for conducting open market operations had been considerably increased in 1982. While not in a position to say whether the ceiling was high enough, he trusted that the authorities would be flexible enough to provide the room that was needed in order to use the instrument as effectively as possible.

With respect to the thinness of the capital market, the staff representative said, it should be kept in mind that Austria was essentially a credit-based economy dependent on the international banking system and that there were only a few Austrian companies large enough to approach capital markets abroad. Although Austria had a high personal savings ratio, people did favor passbook savings accounts and were reluctant to acquire other instruments, an attitude fostered by the fluctuations in the effective yield of long-term paper.

With regard to the apparently longer-term aim of securing a close link between the deutsche mark and the schilling, and the focus on call money rates in Austria and in Germany, he believed that there was no inconsistency: the Austrian authorities looked carefully at the call money rate but used a flexible approach, the staff representative commented. The point was proved by the fact that the exchange rates of the deutsche mark and the schilling had not always moved in tandem.

The question of the gains or costs of selective credit policies came up in a number of countries, the staff representative stated. Although no quantitative measurement was available, in the Austrian context, with a strong emphasis on nationalized industries, historical traditions, and a central role for the Government, the authorities wished to set certain national priorities; selective credit and interest rate policies were one way of doing so. There was also concern that those practices might remove some of the authorities' room for maneuver.

As for the Austrian export credit system, he was not certain whether it led to international distortions, the staff representative continued. Austria had always relied on an export credit system, and in present circumstances the distortion would occur only if Austria moved much faster than other countries in expanding export credits or changing conditions. As for lending to Eastern European countries, Austria's share of trade with those countries was between 10 per cent and 12 per cent, twice the figure for Germany. It was natural that close economic ties had been accompanied by the extension of credits to Eastern European countries, for both economic and political reasons, such as ensuring the continued availability of energy supplies. The Austrian authorities might wish to use a measured approach in dealing with their country's role as a financial intermediary. Specifically, the staff appraisal had noted that the question was a matter for concern, but it had gone on to indicate that some increase in exposure might be necessary for dealing with the difficulties that had arisen with certain heavily indebted economies. The authorities were fully aware of the international effort to ease the debt burden of those countries, but there had been a marked increase in lending to them in the previous two years. The recommendation for caution did not mean that credits had to be cut back, but rather that the authorities might want to examine the rate of increase.

One Executive Director had asked whether there had been any particular reason for the sharp deterioration in Austria's current account in the late 1970s, the staff representative remarked. Cyclical factors had played an important role, and better competitiveness in the early 1980s had improved the current account. Some structural adaptations in the economy might also have made a positive contribution; however, they were difficult to quantify because they had occurred primarily in medium-sized industries and had been the subject of a great deal of circumstantial evidence brought forward by the Austrian authorities and described to the staff.

Being a small open country, Austria was dependent on imports, the staff representative from the European Department concluded. The country simply could not produce everything that its people wanted; in years when there were large increases in income, consumer demands tended to concentrate on goods not made in Austria, such as automobiles or certain electronic equipment. There were efforts under way through structural adjustments to broaden somewhat the range of goods offered by the Austrian economy to its own citizens and, in that way, to fight import penetration. As for the diversification of export markets, advantage had been taken of an increase in purchasing power by the OPEC countries. There had thus occurred a certain diversification of export markets that might prevent future changes in the cyclical position of Austria from being such a burden on the current account.

Mr. Schneider said that his Austrian authorities were well aware that budget deficits of the size experienced in 1982 and probably 1983 could not continue indefinitely. Achievement of a reasonable growth rate would greatly help to reduce the deficit, which was not least the result of slow growth. A step-by-step approach would be applied, because too rapid a change would have negative repercussions on spending, and would lead to higher unemployment payments. Discussions were currently going on between the authorities to determine what should be done if the budget deficit exceeded the expected level for 1983. Chancellor Kreisky would announce his policy intentions before the general elections. The Minister of Finance had recently given an interview in which he had mentioned a number of measures to reduce tax exemptions and adapt the social security system. As the staff representative had said, there might be an increase in taxation on the 13-month and 14-month salaries that were paid in Austria. Doubts had also been raised by some Directors about the usefulness of the two employment programs. The authorities had indicated that the program introduced in January 1982 had shown no effects in 1982, because of administrative delays, but they were still hoping that the program would have some positive effects. The second employment program was aimed more at the medium term, up to 1985.

The investment subsidy scheme introduced at the end of 1981 had been rather successful so far, Mr. Schneider considered. It had been initiated to promote technology-intensive production that incorporated a positive balance of payments effect. A study by the Austrian Institute for Economic Research had shown that the firms receiving subsidies under the scheme had outperformed the firms rejected for subsidies as well as the industry average. The budgetary contributions for nationalized industries were not merely a holding operation but should provide the necessary breathing space for reorganization as well as structural adjustment. While there was greater overall capacity in the steel industry, one obstacle to adjustment was the relatively low mobility of labor, especially in Styria, where the need for structural adjustment was greatest. Being conservative, the Austrians were reluctant to move.

The question had been asked by Mr. Taylor whether the increase in the swap ceiling had gone far enough, Mr. Schneider continued. The increase had to be seen in conjunction with the change in the minimum reserve requirement. Up to the present, commercial banks had to keep the reserve requirement for five working days, so that they were free over the weekend; however, with the increase in swaps, the period for keeping the minimum reserve requirement had been extended to seven days. Judging by the magnitude of the swaps, the Austrian National Bank considered that the increase in the ceiling to S 15.65 billion was sufficient for the time being, but the monetary authorities were ready to increase it further should it prove too low in the future.

A number of remarks had been made on the Austrian export financing system, Mr. Schneider recalled. As for subsidized interest rates, the Kontrollbank, which was in charge of export financing, tried to keep the cost of Austrian export goods competitive in international markets. That objective was of prime concern because of the thinness of the capital market in Austria and because it was difficult for small and medium-sized enterprises to compete on their own. Another reason was that the equity/capital ratio on average was rather low in Austria, meaning that risk capital was rather scarce. However, in 1982 the financial transactions by the Kontrollbank had decreased considerably. Since its rates were determined by a mix of past rates and present rates, and since international interest rates had been declining, the Kontrollbank had charged higher interest rates than commercial banks.

Some concern had been expressed about the exposure of Austrian banks to Eastern Europe, especially within the Austrian export financing system, Mr. Schneider went on. As the staff had pointed out on page 49 of SM/82/227, Austrian banks were heavily involved in lending to Czechoslovakia, Poland, and Hungary. It should, however, be kept in mind that Austria had many historical links with Eastern Europe dating back to the time when Austria had been the center of an empire of 52 million people that included Hungary, Czechoslovakia, and parts of Yugoslavia, Poland, and Romania. At present, Austria shared 46 per cent of its borders with three Eastern European countries--Czechoslovakia, Hungary, and Yugoslavia--and had always tried to maintain good neighborly relations with countries to the east, a policy that had meant closer ties in trade and financing. Under the circumstances, that relationship did not permit a sudden cut in financial flows, because relations with those countries were not only economic but also political matters of high significance for Austria. Nevertheless, the feeling that the overall volume of financing should not be allowed to expand sharply was in line with what was being generally advocated at present, not least within the Fund itself. Finally, Austria had tried to secure supplies of coal from Poland and supplies of natural gas from the U.S.S.R.; the bilateral payments balance between Austria and the U.S.S.R. favored the latter country.

Miss Le Lorier, referring to general Fund policy, wondered whether the Fund could be discriminating among member countries that undertook to manage foreign assets and liabilities within differing institutional frameworks. Many countries carried out financial intermediation as they borrowed and lent abroad, although on various scales. In its appraisal of foreign lending risk management, should the Fund be dependent on the respective role of the private and public sectors in those member countries? The next review of Fund surveillance activities over external debt should bring an answer to the question.

The Acting Chairman made the following summing up:

Directors noted with satisfaction that the performance of the Austrian economy compared favorably with that of most industrial countries. They commended the authorities for their economic management and for the success of the Austrian social partnership. They noted in particular the substantial improvement of the current account in a period of slackening foreign demand. This reflected not only a shift in Austria's relative cyclical position but also an improvement in competitiveness as well as structural adjustments.

Directors welcomed the decline in the rate of inflation, which was partly a result of low increases in import prices but also more recently of wage moderation. The policy of maintaining a close relationship between the schilling and other currencies with relatively stable purchasing power, particularly the deutsche mark, has contributed to Austria's favorable inflation performance.

The recent gradual relaxation of monetary conditions, in line with developments abroad, was considered to be beneficial to the investment climate and was not expected to jeopardize recent progress in lowering the rate of inflation. In this connection, Directors suggested that the authorities keep the range of instruments and their use under review.

Directors shared the concern of the authorities over the stagnation in growth and the rapid rise in unemployment, even though the latter remained significantly below the average for industrial countries. However, most Directors felt that in view of the size and openness of the Austrian economy, the present bleak outlook for a recovery abroad did not leave much room for the pursuit of an expansionary economic policy.

Many Directors expressed uneasiness about fiscal policy, but some others considered that the report was more critical than was warranted on this aspect of policy and that it was not sufficiently specific. The unforeseen rapid widening in the federal deficit in 1982 was not solely the product of automatic stabilizers but also a result of discretionary stimulating measures, including employment programs. In this context, Directors noted the priority attached by the Austrian authorities to the maintenance of high employment as an essential aspect of the social consensus that, in turn, has been crucial for the achievement of a successful incomes policy. They also noted the readiness of the authorities to contemplate a cut in expenditures, including social security outlays, should budget revenue turn out to be lower than expected.

Finally, there was a difference among Directors in their comments on the foreign lending operations of Austria, which are conducted mainly with the support of guarantees by the Federal Government. Such lending has expanded strongly in recent years and is financed in large part by government-guaranteed borrowing abroad. A few Directors questioned whether advice should be given by the Fund on this matter, while others advised a certain caution on various aspects of Austria's practice in this field.

Mr. Dallara remarked that he had been somewhat puzzled that the staff had been unable to provide any indication of whether the extensive system of subsidized and preferential credit rates had any effect on the allocation or misallocation of resources. On page 10 of SM/82/225, the staff had said: "Questions arise as to whether some of the measures introduced to stimulate private investment have indeed led to new projects being undertaken, or whether their main effect has been to increase the segmentation in the capital market, and, in that event, to subsidize investments that would have been undertaken in any case." Could the staff correct him if his impression was wrong?

He also had difficulty with the staff's implication that only an intensification of Austria's export credit policies could be seen as having an adverse effect on Austria's international competitors, Mr. Dallara continued. To the extent that the export credit policies involved some degree of subsidization, they clearly could have a distorting effect on trade flows. In addition, such subsidization on the part of Austria and other countries led to budgetary expenditures that could not help but be seen as having some international impact.

The staff representative from the European Department responded that the majority of export credits were given at market rates. As Mr. Schneider had pointed out, the real problem for Austria had been that many industries were small ones that lacked easy access to the domestic capital market, which, in any case, was small, thin, and not particularly sophisticated. In any event, the subsidy element for exports was small.

Mr. Schneider added that the statement that 40 per cent of Austria's export credits were subsidized appeared impressive. However, it would be unwise to overestimate the magnitude of the subsidies; recently, the banks had changed to floating rates, so that the element of subsidization had decreased. All in all, the extent of subsidization of credit was limited.

The Executive Directors concluded the 1982 Article IV consultation with Austria.

2. SOCIALIST PEOPLE'S LIBYAN ARAB JAMAHIRIYA - 1982 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1982 Article IV consultation with the Socialist People's Libyan Arab Jamahiriya, together with a proposed decision concluding the 1982 Article XIV consultation (SM/82/228, 12/8/82). They also had before them a report on recent economic developments in the Socialist People's Libyan Arab Jamahiriya (SM/82/237, 12/23/82).

Mr. Finaish made the following statement:

> I would first like to thank the staff for the papers before us, which provide a fair reflection of the frank and wide-ranging discussions held with the authorities.

A principal objective of economic policy in the Jamahiriya in recent years has been to use its oil revenues to accelerate growth and raise the level of economic welfare of its people, while laying the basis for sustained development in the future. This policy has been reflected in large investments in socio-economic infrastructure and a substantial increase in productive capacity in the non-oil sectors, which have shown high rates of growth and an increasing share in GDP. At the same time, the institutional environment for the pursuit of the country's socio-economic objectives has undergone far-reaching changes, involving a large-scale socialization of the economy and transformation of political institutions with a view to broadening the participation of the people in economic and political decision-making and bringing about a substantial redistribution of wealth. This process continued in 1981-82; important developments during the period included the approval of the legal framework for a considerable reduction in salary differentials and an expansion of workers' partnership in administration and profits.

In pursuing the development objectives, the authorities have been mindful of two important considerations. First, growth financed with oil revenues would be sustainable in the long run only if the "dissaving" inherent in the sale of oil--a depletable asset--is matched, to the extent possible, by investment in physical or human capital. Second, the pace of the development effort should be in harmony with the rate of growth of the economy's absorptive capacity in order to avoid undue financial strains.

The country's development policies have been formulated within a framework of comprehensive national planning. During the five-year plan ended 1980, real growth in the non-oil sectors averaged about 12 per cent a year. The overall implementation rate under the plan was about 90 per cent. Growth in most of the sectors was broadly in line with plan targets, with value added in the industrial sector and in the electricity, gas, and water sectors increasing at rates of over 20 per cent a year in real terms. Growth in the agricultural sector, however, fell well short of the target, mainly reflecting fluctuations in weather conditions, the inadequacy of the country's water resources, and lead time involved in new projects. The plan for 1981-85 aims at maintaining the growth momentum built up during the previous plan; seeking to expand output in the non-oil sectors at over 10 per cent a year, it provides for a large increase in the level of investment. As in the previous plan, agriculture and industry together have been allocated about 40 per cent of the total planned investment, with a somewhat higher allocation for industry. An equivalent proportion has been allocated to economic infrastructure. Priority in the industrial sector continues to be given to export-oriented petrochemical and oil-refining industries, though a number of food and building materials industries are also to be established. Further investments are to be made in enhanced oil recovery projects and development of untapped smaller oilfields, as well as in gas gathering systems and gas exploration, especially in the western offshore areas, which are known to contain large reserves. Emphasis on the development of domestic manpower resources, with a view to reducing the country's heavy dependence on expatriate labor, has also been continued under the plan, with large allocations for education and vocational training. During the first year of the current plan, i.e., 1981, 96 per cent of the total investment allocation was actually spent, and output in the non-oil sectors increased by about 9 per cent.

Despite the rapid growth of the non-oil sectors, however, oil remains the mainstay of the economy. Oil receipts account virtually for all export earnings and for about 85 per cent of budgetary revenues. The level of the country's oil output has varied considerably over some years. From the historic high of an average of 3.5 million barrels a day (mbd) in 1970, output declined to average roughly 2 mbd over 1976-80, accounting for an estimated 3 per cent of global output. Output is estimated to have declined further in 1981 and 1982 to an average of 1.2 mbd and 1 mbd, respectively, with the level dropping to as low as 600,000 barrels a day at one point in early 1982. The sharp fall in the country's oil output over the past two years mainly reflects the depressed world demand for oil resulting from a prolonged international recession as well as the adoption of conservation measures and a large drawdown of inventories in major importing countries. Other developments included increased production by major non-OPEC oil exporters and, as noted in SM/82/237, the institution of an embargo on Libyan oil by the largest importing country (which used to account for over one third of total Libyan oil exports).

The sharp drop in oil sales has caused the country's oil income to fall by as much as one half between 1980 and 1982, with most of the fall occurring in the second half of 1981 and the first half of 1982. In view of the steep fall, which has considerably altered the financial picture from the one foreseen at the time of the formulation of the 1981-85 plan, the authorities have started a review of the size of the plan and its priorities. The rate of implementation of the plan dropped in 1982, and may drop further in 1983 as a consequence of the review.

Mainly as a result of the sharp fall in oil revenues, the large fiscal surplus of about 16 per cent of GDP recorded in 1980 was turned into an estimated deficit of 11.5 per cent of GDP in 1981. In response to this development, the authorities took several fiscal restraint measures under the 1982 budget. Total budgeted expenditure was reduced significantly from its

1981 level. The curtailment of expenditure was to be achieved through lower allocations for certain administrative expenses, tighter expenditure control procedures, a freeze on certain types of hiring, reduction in the cost of subsidies through substantial upward adjustments in the prices of a large number of commodities (including basic consumption items), and cutting back or delaying certain investment expenditures. The budget also provided for another sizable increase in non-oil revenues--which have grown at a healthy rate in recent years--through improved revenue collection as well as higher customs duties and excises, and a sizable increase in the domestic prices of petroleum products. However, it appears that, in spite of these measures, the fiscal deficit in 1982 may turn out to be higher than in 1981, due mainly to a further sharp fall in oil export receipts during the year.

Developments in the monetary area point to a continued deceleration of liquidity growth since 1979. Total domestic liquidity increased by 13 per cent during 1981, compared with 28 per cent in 1980 and 35 per cent in 1979. While liquidity growth in the country has mainly been determined by the level of public net domestic spending, the major source of increase in 1981 turned out to be non-Treasury bank credit, which registered a sharp increase. However, the expansionary impact of this development, and of the Treasury's increased recourse to bank borrowing as a result of the drop in oil revenues, was considerably offset by a sharp decline in the banking system's net foreign assets, reflecting the emergence of a large payments deficit. The large increase in non-Treasury bank credit resulted both from the higher working capital needs of existing public enterprises as well as from the short-term financing requirements of newly established enterprises. The authorities believe that the magnitude of the increase in 1981 reflected special circumstances, and that the expansion of credit to public enterprises would be much smaller in 1982. Credit measures taken during 1981 and 1982 to tighten commercial bank procedures for lending to public enterprises should contribute to this outcome. Available data for the first quarter of 1982 indicate a considerable further slowdown of liquidity growth during the year.

The change in the balance of payments position during 1981-82 closely mirrors the change in the fiscal position, as it mainly reflects the level of oil export receipts and the impact on imports and other external payments of changes in government spending. While the drop in oil sales led to a fall in export receipts by about one third during 1981, imports shot up by as much as 26 per cent in step with a large increase in government spending--both reflecting expenditure decisions taken prior to the year-end drop in oil receipts. As a result, the large external surplus realized in 1980 was reversed into a large deficit. Another contributory factor in this regard was a fairly sharp increase in foreign workers' remittances. The rate of import expansion was expected to slow down in 1982, partly on account of the planned containment of government expenditure growth. However, any such slowdown in import growth notwithstanding, the further substantial drop in oil receipts during 1982 and--to a lesser extent--another expected increase in foreign workers' remittances point to a continuing large deficit in the balance of payments. In these circumstances, as stated in the staff report, it is noteworthy that the country's foreign aid program has been continued.

With regard to balance of payments management, the authorities have so far refrained from resorting to external borrowing, choosing instead to finance the deficits through a large drawdown of reserves. At the same time, they have enforced more strictly the import and exchange regulations. In the context of its centrally planned economy, import planning and central bank overall supervision of exchange regulations have been features of the system for the past several years. The authorities had permitted substantial relaxation to take place within this regulatory framework when foreign exchange receipts were plentiful. With the changed circumstances, it was expected that adherence to existing regulations would be enforced more rigorously. The only restriction subject to Fund approval that has been imposed is a reduction of travel allowance. This is a relatively minor restriction, and the authorities intend to relax it once again as soon as possible. The reported delays in making external payments have arisen out of technical considerations and are in the process of being resolved in consultation with the concerned parties.

While the external and fiscal deficits are likely to persist in 1983, the size of these imbalances is expected to be reduced, partly as a result of the tightened demand management and partly in anticipation of a rise in oil receipts. However, the authorities recognize that, in view of the continuing uncertainties in the oil market, it would be advisable to formulate policies for 1983 on the basis of cautious and conservative assumptions. As mentioned above, a review of development policies and priorities has already been initiated. It is noteworthy that the authorities have sought to tackle the financial imbalances mainly by internal corrective measures aimed at reducing the gap between receipts and expenditures, rather than by resorting to large-scale external borrowing. For the longer run, recent experience points to a vigorous pursuit of the objective of reducing the economy's dependence on oil, and thereby its vulnerability to fluctuations in oil revenues.

Mr. Suraisry said that he was in general agreement with the staff papers. Like many other oil exporting countries, the Jamahiriya had faced economic difficulties arising from a substantial decline in oil revenue.

The authorities had taken a number of adjustment measures to cope with that problem, but the fiscal deficit was likely to increase in 1982 because of the large decline in oil receipts. Among the elements contributing to a high level of aggregate domestic expenditure in 1981 had been the substantial amount of credit extended to public enterprises, the increase in which in 1981 had been significantly higher than the Treasury's recourse to domestic bank borrowing. The authorities had indicated that that development had been due to exceptional and pressing circumstances and was unlikely to recur. Nevertheless, it was encouraging that steps had been taken to contain the increase in credit to public enterprises in 1982.

As for policies in 1983, both Mr. Finaish's statement and the staff report indicated that the authorities intended to formulate policies on the basis of cautious, conservative assumptions, Mr. Suraisry observed. Their approach was wise, especially at a time of great uncertainty about world economic prospects. In that connection, the staff recommendations on the budget and credit policies to be followed in 1983 seemed appropriate.

With respect to the balance of payments, the authorities had chosen to draw down their reserves significantly during 1981 and 1982 rather than resort to external borrowing, Mr. Suraisry continued. That approach had major implications, since it was being followed at a time when the international demand for external borrowing was soaring. However, the scope for further reductions in reserves was limited, a feature that emphasized the need for the Jamahiriya to continue adjusting.

One important aspect of policies in the major oil exporting countries was the diversification of the productive base of the economy, Mr. Suraisry commented. The growth of the non-oil sectors in the Jamahiriya had been relatively high during the 1970s, so that the authorities had had some success in reducing the economy's dependence on oil. Nevertheless, the process was long and time-consuming, and the authorities should pursue their objective with vigor.

He hoped that the authorities would be able to continue with the process of exchange and trade liberalization that they had undertaken some years previously but had halted in the recent past, Mr. Suraisry said. They were to be commended for continuing their foreign aid program despite the financial difficulties that the economy was experiencing.

Mr. Malhotra noted that the Government of the Jamahiriya had been diversifying the economy. Under the 1976-80 plan, the non-oil sector had grown by about 12 per cent a year. In other areas, such as electricity, gas, and water, there had been much higher growth of about 20 per cent. Like many economies depending primarily on oil, the Libyan economy was confronted with a considerable decline in exports. He was glad that the Libyan authorities were adjusting rapidly to the new situation. The growth target set for output in the non-oil sector in the 1981-85 plan had been set at about 10 per cent. The authorities were contemplating some revision in the plan on account of the decline in resource availability. As noted by Mr. Suraisry, the authorities' reaction had been constructive in the sense that they were adopting policies better suited to the reduced availability of resources. They had avoided the temptation to resort to borrowing in the commercial sector and had preferred to draw down reserves. The rate of growth of the money supply had come down from high levels to as low as 13 per cent in 1981. If he had understood Mr. Finaish correctly, the stance of the authorities was to continue the policy of restraint in order to bring the balance of payments into better shape.

Mr. Yasseri noted that the economy of the Socialist People's Libyan Arab Jamahiriya had undergone fundamental institutional transformations in recent years. Fueled by high oil revenue, the country had embarked on massive economic and social programs that had concentrated on building a solid infrastructure, modern industry and agriculture, and an improved educational and social base. As a result, economic growth and per capita income had risen substantially within a few years. At the administrative level, the changes were manifest in worker participation, profit-sharing, and a system of self-government. At the same time, attempts had been made to diversify the country's economic base by making large investments in agriculture, housing, and other non-oil industrial and rural projects with the further increase in oil revenue brought about by the second round of petroleum price increases in 1979. In 1980, the authorities had decided to cut back production; capacity limitations and other constraints had resulted in a slower pace of budgetary expenditure, a rise in interest rates, and measures aimed at relieving port congestion and other bottlenecks. On the external side, the current account surplus in 1980 had doubled to almost 25 per cent of GDP. The oil sector had thus played a crucial role in the economic and social construction of the country.

In 1981, the Jamahiriya's crude oil output had fallen as a result of effective conservation efforts in importing countries, and it had again fallen slightly in 1982, Mr. Yasseri continued. In 1983, by contrast, oil production was expected to rise by 30 per cent. Furthermore, general conditions in the oil markets were expected to improve, and there were favorable prospects for additional production and exports of liquefied natural gas.

Recently, there had been further increases in investments in the non-oil sector, chiefly in agriculture, manufacturing, construction, and infrastructure, Mr. Yasseri noted. In 1981, agricultural output had grown by about 7 per cent, despite unfavorable weather and irrigation conditions; the output of most industries had also risen. Overall, in 1981, non-oil production had grown rapidly, raising the share of the non-oil sector in GDP. However, in 1982, developments in the oil markets had led to budgetary restraint measures, and new projects had been curtailed.

On the external side, oil market developments in 1981 and 1982 had sent the external account from a surplus into a deficit, Mr. Yasseri remarked. The authorities were well aware of the consequences of that development and had already implemented a number of measures to cope with it. Despite externally adverse conditions, the authorities had managed to maintain a relatively liberal trade and exchange system and to continue their economic aid program. In conclusion, he agreed with the staff's assessment and with the proposed decision.

Mr. Laske recalled that, several years previously, the authorities of the Jamahiriya had embarked on an ambitious development program based on growing export receipts from oil. For a number of years, the country had been able to forge ahead with vigor. Prolonged recession in the industrial countries and those countries' successful efforts to conserve energy had affected the Libyan economy in the opposite direction. In 1981, receipts from crude oil exports had begun to decline; for the first time in many years, the current account, as well as the overall balance of payments, had shown sizable deficits. In 1982, the deficits had not only increased but had become very large; they seemed unlikely to be reversed soon. From that state of affairs flowed important consequences. The authorities had already reacted in the middle of 1981 to the diminished flow of financial resources, and they had taken further corrective action in 1982. Unfortunately, the limited availability of data made analysis of the Libyan economy more difficult than it would otherwise be. For instance, when the discussions had been held in Tripoli, fiscal data for 1980 had still been termed provisional and for 1981, nine and one half months after the end of the calendar year, actual data had not yet become available. The data presented in the report were estimates, and he wondered how large the revisions would be that would have to be made later on. More generally, the authorities should devote increased attention to the more timely collection of data on fiscal developments, the ready availability of which ought to be particularly important in a centrally planned economy such as the Jamahiriya's.

The budget deficit for 1982 was likely to be very large if the supplemental expenditures--about which no detailed information was provided--were again to assume the level recorded in 1981, Mr. Laske said. He therefore endorsed the staff's recommendation for a comprehensive review of such expenditure and for its limitation to a predetermined level. To a large degree, prices in the Jamahiriya were set by the Administration. The statement on page 4 of SM/82/228 that domestic inflation had been moderate, at between 4-5 per cent in 1980, might thus be somewhat dubious. As pointed out by the staff on page 7 of the same paper, only the prices of commodities other than basic consumption goods reflected the relationship between supply and demand. Nevertheless, it was unclear whether administratively determined prices allowed producers to generate sufficient savings to finance investment in plant and equipment. As the staff had reported, the credit expansion in 1981 had been caused by the necessity to supply enterprises with working capital to enable them to carry out their functions. Could a distorted price structure be the reason? He would appreciate further comments by the staff or Mr. Finaish on that topic.

As to the external sector, he shared the staff's concern about the recent setback to the gradual liberalization of the Jamahiriya's exchange and trade system, Mr. Laske remarked. At the same time, he was worried about the delays that had occurred in external payments, delays that the authorities had explained as being caused by certain irregularities. He hoped that both those developments could be corrected in the near future.

Despite a deterioration in the Jamahiriya's external situation, the exchange rate of the dinar had not been adjusted for a long time, Mr. Laske said. Instead, the authorities had restricted the availability of foreign exchange for certain transactions such as foreign travel and capital transfers. Import entitlements had also been progressively reduced. Those actions suggested that an exchange rate adjustment might have helped the authorities' efforts to slow down the deterioration in the external balance. He found it difficult to judge whether the present rate of exchange was suitable, as domestic prices were largely set by the Administration and as almost all export revenue was earned by oil. A less rigid exchange rate policy might be a means to achieve the authorities' desire to diversify the productive base of the economy.

Mr. Taylor endorsed the proposed decision. Regrettably, perhaps for legitimate reasons, the documents available to Executive Directors had not done full justice to economic developments in the Socialist People's Libyan Arab Jamahiriya, but Mr. Finaish's statement had contributed to filling the gap. The Jamahiriya was a major oil producer and was therefore important in the world economy. Moreover, it had one of the highest per capita incomes in Africa, if not the highest, had been a significant overseas investor, and continued to have a substantial aid program. The Jamahiriya should therefore be included among those countries that had regular, preferably annual, consultations with the Fund. The importance of the case merited fuller and more up-to-date information than he had found in the staff papers. The sharp turnaround in the balance of payments, associated with the economy's heavy dependence on the oil sector, suggested the need for corrective policies, including structural adjustments. He would have welcomed a fuller assessment by the staff of the policies currently being followed and of the prospects for the economy in the next year or two.

According to the paper, Libyan oil output and exports had picked up quite sharply since July 1982, Mr. Taylor continued. Naturally, that development should produce a substantial improvement in the current account and the fiscal position. He would like to know what factors had been behind that improvement, since he had the impression that the world oil market had remained rather soft. Would it be correct to infer that that remarkable transformation had reflected a change in the pricing structure adopted by Libya, and, if so, could the price structure be sustained? How would Libya's export volume be affected?

One problem that had arisen in 1982 had been that of external payment delays, which had risen quite sharply in the second quarter, Mr. Taylor recalled. On the face of it, it would be hard to explain the suddenness of the rise in terms of bureaucratic bottlenecks or noncompliance with import regulations. He had the impression that, in effect, the country's trading partners had been put involuntarily into the position of helping to provide credit for the Jamahiriya. On page 13 of SM/82/228, the staff had noted that, in response to a sudden shortage in foreign exchange, the Libyan authorities had not sought to conceal the problem by borrowing abroad. That statement was true insofar as there were no formal borrowing arrangements, but informally Libya's suppliers might well have found themselves providing some of the financing. Naturally, he hoped that the country would make all practical efforts to remove any external payment arrears remaining as soon as possible.

Regarding the exchange rate, Mr. Taylor said that the Libyan dinar had been pegged to the U.S. dollar since February 1973, or for nearly a decade. Given the importance that the staff had rightly ascribed to a diversification in the Jamahiriya's exports, could the staff say whether there was a case for a more flexible exchange rate policy?

Turning to the domestic economy, Mr. Taylor stated that the growth of the non-oil sector had been described by the staff as relatively satisfactory. Certainly, the growth in the non-oil economy did appear to have been quite strong, a welcome development. Given the sizable resources allocated to those sectors, especially the quantities of imports and the sharply rising number of expatriate workers, he wondered whether quite as much had been achieved in those sectors as the authorities had hoped. Could the staff or Mr. Finaish comment on that point?

On fiscal matters, the staff felt that the authorities should undertake a thorough review of the supplemental expenditures, Mr. Taylor noted. A speedy review might well help, but he would prefer that the authorities decide to eliminate those expenditures or pare them down. A genuinely uncommitted review by the Jamahiriya could be a useful feature in cases in which expenditure was planned in advance. Nonetheless, the allowance for supplemental expenditures appeared to be more of a device for permitting expenditure to rise above official budgeted levels, another point on which the staff might wish to comment.

Mr. Zhang observed that the principal objectives of the Jamahiriya's policy had been to use oil revenue to accelerate the rate of growth and lay the foundation for sustained future development. In pursuing those objectives, the Government had rightly paid special attention to increasing investment in physical and human capital and, at the same time, keeping the rate of investment within the economy's absorptive capacity. Furthermore, the Jamahiriya had adopted a system of comprehensive national planning that had helped to reach the planned targets and transform the economy.

In the face of declining export receipts from oil, the Government had made every effort to adapt its policy measures, Mr. Zhang continued. By doing so, as well as by not resorting to foreign borrowing, the authorities might be able to avoid the strains on the external sector recently experienced by other countries. Finally, in spite of its own difficulties, he found it commendable that the Jamahiriya had maintained the level of its economic assistance to other countries.

Mr. Senior noted that the staff report was somewhat lacking in updated information on the current economic situation, an understandable position in a country still developing its statistical sources and still undergoing basic structural, organizational, and administrative changes. He was in broad agreement with the staff report. The Jamahiriya was still heavily dependent on the oil sector. The need to lessen that dependence had been recognized by the authorities, who had made major efforts to achieve that objective. Nevertheless, such a fundamental transformation could be attained only after a long period, and recent developments in the oil sector had not slowed progress toward the goal.

In the previous two years, the external and fiscal position of the Jamahiriya had deteriorated, Mr. Senior noted, a direct consequence of the impact of sudden and large changes in oil receipts on economic performance. As underscored by the staff, the authorities should be commended for facing those financial difficulties forthrightly. They had taken important measures to tighten the fiscal stance and reduce credit expansion, and plans for the coming year were being based realistically on cautious assumptions. At the same time, the authorities had undertaken a comprehensive review of development policies and priorities in the light of current circumstances, clearly a prudent step at a time when the prospects of the oil markets were uncertain. In conclusion, the authorities were to be commended for continuing their foreign aid program despite current financial difficulties.

Mr. Jaafar expressed general agreement with the staff analysis and appraisal. The economy of the Jamahiriya was in some respects similar to that of Indonesia in its dependency on oil resources. The impact of global economic developments, particularly the weak market for oil, had adversely affected the Jamahiriya's performance: GDP had risen by 8 per cent in 1979 but had fallen by about 10.5 per cent in 1981. Similarly, the current account balance had been adversely affected, changing from a surplus of almost $9 billion to a deficit of about $2.2 billion. In contrast, the GDP figure for the non-oil sector had shown steady growth over the years and in 1981 had increased by nearly 9 per cent. The authorities were to be commended for that achievement, which reflected the efforts taken to diversify into agriculture and manufacturing, as reflected in the development plans. Could they bring about even greater benefits? As the Jamahiriya obviously enjoyed a comparative advantage in oil, he gathered that any effort to restructure would not be at the expense of the progress already made by the authorities in promoting developments in petroleum-based industries.

One of the constraints to the development of the Jamahiriya was a shortage of skilled labor, Mr. Jaafar considered. It therefore appeared that the country would have to continue to rely on expatriate labor to meet some of its manpower needs. Meanwhile, the authorities should consider accelerating the manpower training program. They had been prudent in their use of foreign resources and had accumulated reserves during the previous favorable years. The policy was now paying dividends: the country could meet its financial needs without recourse to borrowing abroad. Its ability to continue to do so would depend on the outcome of the long-expected recovery in the world economy. Meanwhile, the authorities were to be commended for courageously continuing their foreign assistance program despite the economic difficulties that they were undergoing.

Mr. Jones noted that one of the notable developments in the Jamahiriya's economy in recent years had been the expansion of the nonoil sector to the point where it accounted for the greater share of GDP. Nevertheless, the oil sector continued to dominate the economy: oil revenue accounted for over 85 per cent of total budgetary receipts and for almost all export earnings. Therefore, oil production would have a significant effect on the pace of growth in the country. Against that background, he was glad that the authorities were continuing their efforts to diversify the economy, and he commended them for the progress made thus far in agriculture and industry.

As to future developments in those sectors, he was encouraged by the pricing policy of the Government, which favored the payment of remunerative prices to farmers, and by the efforts being made to expand irrigation networks and provide extension services to farmers as well, Mr. Jones remarked. In that connection, the 1981-85 plan had almost doubled the amount allocated to agriculture compared with the previous plan. The Government's industrial policy also appeared to go in the right direction, placing emphasis on the development of export-oriented industries together with those that produced consumer goods by using locally available inputs. A basic constraint to the economy's development effort, however, was a shortage of domestic labor. As the Jamahiriya had to depend on expatriate labor, he welcomed the effort that the authorities were making to develop the quality and efficiency of the Jamahiriya's labor force through various training programs, particularly in technical subjects.

On fiscal matters, the drop in oil output had meant a decrease in government revenue, Mr. Jones continued. The authorities, however, appeared to have begun to take steps to adjust to that reality. Spending in the 1982 budget was lower than in 1981, a figure reflecting reduced allocations for subsidies, improved expenditure control measures, and a deferral of some domestic projects. Meanwhile, efforts were being made to increase non-oil revenue, including improved collection procedures. Regrettably, the staff had indicated that, despite those measures, the overall deficit for 1982 was likely to be higher than for 1981. There might be room, therefore, for a further tightening of expenditure.

With regard to the external sector, the balance of payments was expected to remain under pressure, although there was some hope that the country's position might improve in 1983, Mr. Jones concluded. Yet, if that pressure persisted, the authorities might find it necessary to consider introducing other adjustment measures to prevent any further drawdown in reserves.

Mr. Erb commented that he would agree with Mr. Taylor that, as he had said previously about similar countries, more regular Article IV consultations with the Jamahiriya would be useful. In addition, like Mr. Laske, he felt that more up-to-date statistics would be helpful in assessing more recent developments.

In view of the question that he had asked about Indonesia at EBM/83/6, he was glad to know that Mr. Finaish had spelled out the driving considerations influencing the economic decisions of the Government, Mr. Erb went on. First, a development plan financed out of oil revenue would be sustainable in the long run only if the dissavings inherent in the sale of oil, a depletable asset, were matched as much as possible with human or capital investments. Second, the pacing should be in conformity with an economy's absorptive capacity.

Given that frame of reference, one way for the Jamahiriya to invest was by accumulating foreign financial assets, Mr. Erb noted. Another oil producing country, Kuwait, had explicitly set up a long-term international investment fund. Had there been any similar consideration given in the Jamahiriya to earmarking a certain portion of the foreign financial assets for meeting a very long-term investment strategy with an international dimension as well as a domestic dimension? Second, in light of the current sharp reduction in the price of oil and oil revenue, the authorities were faced with the need to draw down reserves. How was this experience shaping their thinking about the best way in which to manage its external assets and liabilities? One alternative would be to increase external borrowing and then pay off the loans at a later time, or to reduce foreign financial investments to a large degree. Again, he would be interested in learning from Mr. Finaish whether those two points were related.

As for the notion that petroleum was a depletable asset, Mr. Erb said, only a few years previously the expectation had been that petroleum would be a commodity whose nominal price at least, if not the real price, would continue to rise more or less steadily. Nonetheless, there had recently been a sharp decline in the market price of oil, and it was unclear whether the decline was temporary and related to the world recession, and what part was related to a more fundamental transition in the oil markets. To the extent that the cyclical aspect was important in the oil markets, the oil market over time might well show fluctuations rather than steady regular growth. Given that environment, what did Mr. Finaish think about how oil as an asset should be managed in the face of fluctuations over time and how might that style of management relate to the management of foreign financial assets?

The staff representative from the Middle Eastern Department recalled that Mr. Laske and Mr. Taylor had asked about the data base for the Jamahiriya on which the staff reports were based. While the data were not as up-to-date as the staff would hope, they were more available than on earlier occasions. One reason was the cooperative attitude of the authorities, especially with respect to the budgetary accounts: they had put before the mission a set of preliminary accounts covering 1980 and 1981 for the budget, though the authorities were still completing the final accounting.

Similarly, some Directors had asked to see a more forward-looking appraisal of the prospects for the Jamahiriya's economy, the staff representative went on. Again, the difficulty had been that, to a large extent, the prospects resulted from the outlook for the oil industry and the international recession, as well as the formulation of fiscal policy for 1983 by the Jamahiriya's authorities. In all those areas, the outlook was uncertain, and, at the time of the discussions, the authorities had not yet begun to draw up the major outlines of their policies for 1983. In those circumstances, a more detailed assessment of the prospects for 1983, beyond the general indications mentioned in the staff report, was not considered feasible.

There had been a question on pricing policy and the rate of domestic inflation, the staff representative noted. Of course, in a centrally planned economy, the rate of inflation reflected decisions and actions taken by the authorities in adjusting administrative prices, except in the sectors that were allowed some price flexibility. The point made by the authorities was that they had developed a more flexible attitude toward pricing policy. Costs were being reflected more fully. Prices of petroleum products had been raised almost to the international pricing level. Public enterprises were obliged to compete on a commercial basis. Some Directors had made the point that the large increase in credit to the public enterprises might have reflected difficulty in financing the deficits because of inability to charge higher prices. The authorities' actions in instructing the banks to make sure their lending was on a commercial basis suggested that they wished to prevent financing of deficits of public enterprises by the banking system.

With regard to public finance, two Directors had raised questions regarding supplemental expenditures, the staff representative went on. The available information was included in SM/82/237: the mission had been informed that the composition included some defense expenditures, certain other expenditures abroad, and a subsidy of cost of living items. A breakdown of that expenditure was not available. The distinction between supplemental expenditures and other types of expenditure was that supplemental expenditures were subject only to approval by the General People's Committee, i.e., the Council of Ministers, whereas, according to the budgetary process, the appropriations were processed by the General People's Congress, a participatory popular body. Thus, the authorities had felt that on certain expenditures they might have to move with flexibility and a certain sensitivity, and that, for the time being, they would prefer to keep the decision-making process regarding those expenditures within the Cabinet.

Since July 1982, according to press reports, there had been a pickup in the Jamahiriya's sales of oil abroad, which that had accelerated in November and December, the staff representative stated. Because of the time lag between sales and the actual receipt of export proceeds, the acceleration in sales had little effect on revenue estimates for 1982. But if the increase in oil output were sustained over a number of months in 1983, it would, to that extent, result in improving the outlook for 1983. At present, however, the trend had only begun. As for the price of the Jamahiriya's oil, the authorities had stated that their pricing policies were within the framework agreed at the Organization of Petroleum Exporting Countries. Of course, there were certain premiums and quality differentials, and some flexibility or variation in that context was possible. The trade journals suggested that there might be some sort of indirect discounts of oil prices, perhaps through the terms of the sales or the period of credits. Nonetheless, the authorities stated officially that they were adhering to the price structure agreed with the other oil exporting countries.

Questions had been raised by Mr. Laske and Mr. Taylor about the delays in the making of external payments, the staff representative recalled. The authorities stated that the delays were of a technical nature arising from the change in the enterprises charged with importing and exporting, and that they were in touch with other countries' authorities to determine whether there had been any delays attributable to other than technical reasons, in which case, they asserted, accounts would be settled expeditiously. Technically, those delays might be said to constitute some kind of financing by a lender abroad, involuntarily, but the delays were quite small relative to the decrease in external assets that the Jamahiriya's authorities had been permitting in order to finance their external deficit. In general, therefore, it was correct to state that the authorities had refrained from large-scale foreign borrowing to finance the deficits.

Two Directors had asked what role the exchange rate of the dinar played in the Jamahiriya's economy, the staff representative from the Middle Eastern Department said. When a country's export receipts suddenly dropped sharply, any weakness in the structure of the balance of payments was revealed, and the suitability of the country's exchange rate was questioned. However, the role of the exchange rate in a dual economy, and for that matter in a heavily centrally planned economy, was not easy to disentangle. The subject of the profitability and feasibility of domestic import substitution by local industry ought to be dealt with on its own merits, even if in the next year or two the Jamahiriya's oil exports were to rise sharply and if overall balance of payments equilibrium were restored. Aware of the importance of the exchange rate in a planned economy, the authorities had made an assessment about the profitability and feasibility of import substitution and about building up non-oil exports and other activities.

Mr. Finaish noted that a major change in the oil position of the Jamahiriya had led to important changes in the country's fiscal and external payments situation. As stated, production had declined from an average of about 2 million barrels a day in 1976-80 to fewer than 600,000 barrels a day in late 1981 and early 1982. Income from oil had declined by almost one third in 1981 and by nearly 50 per cent in the past 18 months: reserves had fallen, and the current account balance had fallen from a surplus of over $7 billion in 1980 to a deficit of $5 billion in 1981.

As soon as the picture had become clear late in 1981, the authorities had reacted by introducing important adjustment measures, most of which were outlined in the staff papers and in his earlier statement, Mr. Finaish continued. Since the authorities had based the five-year plan on assumptions quite different from those that had prevailed, they had adjusted their policies and had spent some of their reserves. They had not gone to the market, although there had been no shortage of offers to lend. As for the immediate future, the authorities expected the current situation to continue in 1983: there would be a budget deficit and a deficit on the overall balance of payments. The authorities intended to continue adjusting. They had not completely excluded the possibility of borrowing from outside sources. All in all, they intended to act on cautious assumptions, and much would depend on the oil situation.

In the long run, Mr. Finaish commented, it should be clear to the Jamahiriya and other oil exporting countries that national authorities had to use the returns from transforming a depletable asset in a prudent way, keeping in mind the implications of wide price fluctuations. The authorities would have to be careful in planning future policies and future use of oil revenue.

He would of course agree that there was room for improvement in the provision of data, Mr. Finaish said. As to the reported delays in payments, the staff representative had correctly stated that they were caused basically by technical shortcomings. The authorities had taken steps to ascertain the precise amounts owed and the underlying causes of the delay. They felt it necessary to consult with representatives of some of the countries involved because some of the imports did not correspond to the agreed specifications and there could always be duplication of documents for obtaining exchange in a less than legal way.

On a general question raised by Mr. Erb, growth financed from oil revenues would be sustainable in the long run only if the "dissaving" inherent in the sale of oil--a depletable asset--were matched as closely as possible by investment in physical or human capital, or investment in financial assets, Mr. Finaish went on. He had spoken on the subject at some length at the Executive Board's recent seminar discussion on the paper "The 'Energy Crisis' and Payments Imbalances--A Twin Challenge: The Role of Oil Exporting Developing Countries." Briefly, in the long run, when determining the optimal rate of oil extraction of petroleum in oil exporting countries, the authorities were basically comparing the rate of return on oil left in the ground with the rate of return on other possible investments in real capital, human capital, and financial assets. However, differences existed among countries on the possibilities of investment. For example, in Kuwait there was relatively limited scope for investment in factories and farms, so that the authorities in that country laid much greater emphasis on investing oil revenues in financial assets. By contrast, the Jamahiriya was a vast country with greater potential for real capital formation. Agricultural production could be expanded enormously, and there was a need for better roads and communications. Investment in human capital was another high-priority area, but there was a question of how to undertake such investment. Having won independence only after World War II, the Jamahiriya had to rely largely on expatriate labor, currently making up some 40 per cent of the labor force. In 1981, the expatriate labor force had increased by 100,000, in a country with a little over 3 million people. It was important to keep in mind that, when dealing with oil extraction, the authorities were engaged in a transformation of assets, not in an activity that enriched the economy in terms of value added, hence the importance of a judicious use of oil proceeds for future income growth.

In conclusion, he doubted the effectiveness of any exchange rate adjustment in a country like the Jamahiriya, which had almost 100 per cent of its exports in oil, Mr. Finaish said. He wondered how the exchange rate could be effective, particularly in the short run, in dealing with that situation.

The Acting Chairman made the following summing up:

Directors were generally supportive of the views expressed in the staff appraisal. They commented favorably on the results of the development effort, particularly with respect to training, education, and social services as well as income redistribution.

Non-oil GDP growth continued at a satisfactory pace, and domestic pricing policy had become more flexible than in the past. Financial developments reflected mainly the impact of the sharp decrease in oil revenue starting in the second half of 1981 and continuing throughout most of 1982. The results were large fiscal and external deficits during the past two years.

Directors commended the authorities on their determined efforts starting in late 1981 aimed at containing the deficits within manageable limits. The steps taken in the fiscal area were substantial, and the cautious attitude of the authorities was commended by Directors. They added that restraint on budgetary expenditure should be reinforced with restraint on demand of the other sectors for bank credit.

Directors noted that the enforcement of exchange regulations had become more strict and that import allocations had been reduced. They expressed the hope that the authorities of the Jamahiriya would be able to resume the liberalization stance followed in the past decade, and they encouraged the authorities to eliminate the reported delays in the making of external payments.

Directors observed that the external deficit was financed through a substantial reserve drawdown rather than through external borrowing. The recent increase in oil exports, if sustained, should be helpful in restoring balance in the fiscal and external accounts.

Directors noted that the authorities are reviewing development policies and practices in the light of current circumstances, and they encouraged the authorities of the Jamahiriya to pursue economic diversification in order to reduce reliance on the oil sector.

Finally, the authorities were commended on the maintenance of their foreign aid program. They were also encouraged to improve further the timeliness and comprehensiveness of economic and financial statistics as an aid to policy formulation and appraisal.

The Executive Board then took the following decision:

Decision Concluding 1982 Article XIV Consultation

1. The Fund takes this decision relating to exchange measures of the Socialist People's Libyan Arab Jamahiriya subject to Article VIII, Section 2, and in concluding the 1982 Article XIV consultation with the Socialist People's Libyan Arab Jamahiriya, in the light of the 1982 Article IV consultation with the Socialist People's Libyan Arab Jamahiriya conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. As described in SM/82/237, the authorities reduced foreign exchange allowances for certain travel abroad with effect from April 7, 1982. The intensified restriction is subject to approval under Article VIII, Section 2(a). The Fund notes the intention of the authorities to remove this restriction as soon as possible and, in the circumstances of the member, grants approval for the retention of this restriction until March 31, 1984, or the next Article IV consultation with the Socialist People's Libyan Arab Jamahiriya, whichever is earlier.

Decision No. 7295-(83/7), adopted
January 7, 1983

3. OFFICE IN EUROPE - SECURITY

The Acting Chairman informed Executive Directors of developments relating to the bombing the previous June of the World Bank's building in Paris, in which the Fund had its offices. The magistrate handling the case had recently determined that a suspect should be remanded for trial. The World Bank had informed him that it had joined in the criminal action; it did not intend to proceed on the civil side, but rather to pursue discussions with its insurance carrier. The Fund itself had suffered no damage in the incident, and there had been no personal injury involved.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/83/6 (1/7/83) and EBM/83/7 (1/7/83).

4. MEXICO - REPRESENTATIVE RATE FOR MEXICAN PESO

The Fund finds, after consultation with the authorities of Mexico, that the representative exchange rate for the Mexican peso under Rule O-2(b)(i), against the U.S. dollar is the mid-point between the buying and selling rates in the controlled market for spot delivery of U.S. dollars. The Banco de Mexico will immediately inform the Fund of any change in the representative rate. (EBD/83/5, 1/4/83)

Decision No. 7296-(83/7) G/S, adopted
January 7, 1983

5. COSTA RICA - MEETING ON DEBT RESCHEDULING - FUND REPRESENTATION

The Executive Board approves the proposal set forth in EBD/83/4 (1/4/83).

Adopted January 7, 1983

APPROVED: June 20, 1983

LEO VAN HOUTVEN
Secretary