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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 83/52

10:00 a.m., March 23, 1983

J. de Larosière, Chairman
W. B. Dale, Deputy Managing Director

Executive Directors	Alternate Executive Directors
A. Alfidja	
	C. Taylor
J. de Groote	
	A. Le Lorier
A. Donoso	
R. D. Erb	
	C. Dallara
	T. Alhaimus
	S. R. Abiad, Temporary
A. H. Habib	Jaafar A.
	H. Suzuki, Temporary
	M. Casey
	J. R. N. Almeida, Temporary
	W. Moerke, Temporary
G. Lovato	C. P. Caranicas
	A. S. Jayawardena
	S. El-Khouri, Temporary
	E. M. Ainley, Temporary
J. J. Polak	T. de Vries
	K. G. Morrell
G. Salehkhou	O. Kabbaj
F. Sangare	E. I. M. Mtei
	E. Portas, Temporary
J. Tvedt	
Zhang Z.	

J. W. Lang, Jr., Acting Secretary
K. S. Friedman, Assistant

Also Present

African Department: J. B. Zulu, Director; R. J. Bhatia, Deputy Director; O. B. Makalou, Deputy Director; M. W. Bell, E. A. Calamitsis, M. E. Edo, S. N. Kimaro, T. Oyama, R. Sharer, W. Shields, M. Sidibe. European Department: B. Christensen, W. E. Hermann, R. P. Hicks, H. Ungerer, H. Vittas. Exchange and Trade Relations Department: W. A. Beveridge, Deputy Director; S. Mookerjee, Deputy Director; K. M. Huh, S. Kanesa-Thasan. Fiscal Affairs Department: R. Hurnard, M. Katz. Legal Department: W. E. Holder. Research Department: W. C. Hood, Economic Counsellor and Director; G. I. Brown, K.-Y. Chu, E. A. Milne. Treasurer's Department: A. M. Al-Samarrie. Personal Assistant to the Managing Director: N. Carter. Advisors to Executive Directors: A. A. Agah, E. A. Ajayi, J. Delgadillo, L. Ionescu, H.-S. Lee, I. R. Panday. Assistants to the Executive Directors: H. Alaoui-Abdallaoui, J. Bulloch, T. A. Connors, G. Ercel, C. Flamant, G. Gomel, M. Hull, J. A. K. Munthali, V. K. S. Nair, J. G. Pedersen, J. Reddy, C. A. Salinas, J. Schuijer, D. I. S. Shaw, P. S. Tjokronegoro, J. C. Williams.

1. ZIMBABWE - STAND-BY ARRANGEMENT, AND PURCHASE TRANSACTION - COMPENSATORY FINANCING FACILITY

The Executive Directors considered Zimbabwe's requests for a stand-by arrangement (EBS/83/44, 2/25/83) and a purchase under the compensatory financing facility (EBS/83/45, 2/25/83; and Sup. 1, 3/22/83).

Mr. Sangare made the following statement:

Let me begin by thanking the staff for the set of papers on Zimbabwe's request for use of Fund resources under a stand-by arrangement and the compensatory financing facility. My Zimbabwean authorities are also grateful for the staff's understanding of the problems facing Zimbabwe. The depth of analysis in the two papers before the Board today is a clear indication of this understanding.

Zimbabwe's economic problems stem from many factors, chief among which are the economic recession in the industrial world, which weakened demand for most of the country's export commodities, deteriorating terms of trade, transport problems, drought, declining rate of domestic capital formation, and economic distortions resulting from protracted international economic sanctions and internal conflict. In the recent past these problems have been compounded by an appreciating exchange rate and, to some extent, by expansionary fiscal policies.

Reflecting these factors, the growth rate of real GDP declined from 11.4 per cent in 1980 to 7 per cent in 1981 and to 3.5 per cent in 1982, while inflation, as measured by the consumer price index, is expected to remain high after rising to 17 per cent in 1982 from 9.2 per cent two years earlier. Government finances also continued to be under pressure, and the central government budget deficit (including official transfers) as a percentage of GDP is expected to rise slightly, to 8.2 per cent, in 1983 after declining to 7.8 per cent in 1982 from a high of 12.3 per cent in 1980. The external financial position has also been under strain. The deficit on the current account of the balance of payments climbed from 5.5 per cent of GDP in 1980 to 11.5 per cent in 1982. External debt also kept mounting, with the debt service ratio now projected to stand at 13 per cent in 1983 compared with 3.8 per cent in 1980. Meanwhile, gross official reserves had fallen to a precariously low level, barely enough to cover imports for less than two months in 1982 and 1983.

The authorities were aware of these problems and had put in place measures aimed at correcting domestic and external imbalances in the economy. In 1981, they adopted a stabilization program for which Fund assistance was made available under the first credit tranche stand-by arrangement. Although all the financial targets under that program were observed, the underlying problems persisted, and the external payments position remained difficult. Consequently, a new financial stabilization program, for which the authorities are seeking Fund support in the amount of SDR 300 million under an 18-month stand-by arrangement, is now being implemented within the framework of the country's Transitional National Development Plan (1982/83-1984/85), which aims at mobilizing domestic and foreign resources to maximize growth. The objectives of the stabilization program include a reduction of domestic and external imbalances and the creation of conditions conducive to sustainable economic growth. Under the program, which assumes a 2 per cent growth rate in real GDP during 1983 and a continuing deterioration in the terms of trade, the authorities intend to limit the budget deficit to 7 per cent of GDP in 1983 and to reduce the overall balance of payments deficit to 2.8 per cent of GDP in 1984, after an expected widening to 4 per cent in 1983.

New revenue and expenditure restraint measures have already been incorporated in the 1982/83 budget. With regard to revenue, the authorities increased the rate of sales tax, customs duties on petroleum products, and excise duties on beer, cigarettes, and tobacco products. They also introduced a third installment for the payment of corporate income tax while increasing the surcharge on personal income. In February 1983, the sales tax as well as excise duties on beer and cigarettes were again increased. Moreover, the price of gasoline was raised by more than a third. On the expenditure side, the 1982/83 budget has been modified with a view to reducing total expenditure by 8 per cent or about Z$200 million. Toward this end, directives have been issued to the various ministries on the needed curtailment in outlays. Revenue and expenditure targets have been set for March 1983, deviations from which would trigger consultation with the Fund. Salary increases will not be allowed in either the public or the private sector in 1982/83, and increases in 1983/84 will be limited to half the increase in the cost of living index during the preceding 12 months. The authorities also intend to avoid further supplementary appropriations before the end of the 1982/83 fiscal year. In order to reduce the impact of subsidies on the budget, the subsidies on maize meal were reduced by about 33 per cent last December, and its price to consumers was increased by an average of 50 per cent. Further budgetary subsidies would be reduced under the 1983/84 budget, and controlled prices would be adjusted to reflect the impact of developments in the exchange rate. Railway tariffs are to be raised in March 1983.

As regards monetary and credit policy, the intention is to encourage financial savings and reduce domestic demand to a level consistent with a sustainable noninflationary rate of growth and a viable external payments position. In line with this objective, the rate of growth in domestic credit will be limited to 18 per cent in 1983, compared with 27 per cent in 1981 and 31 per cent in 1982. Following interest rate adjustments in 1981, several rates are now positive in real terms. The authorities are also keeping the interest rate policy under constant review.

In the external sector, the intention was to restore the competitiveness of the export industries and avoid import subsidization. As a consequence, the authorities decided to reverse the appreciation of the effective exchange rate of Zimbabwean dollar and devalued the currency by 20 per cent in December 1982, depreciating it by a further 5 per cent in January 1983. They also intend to prevent any further appreciation of the real trade-weighted exchange rate during the program period, and they have modified the exchange rate currency basket in order to reflect trade weights rather than settlement currencies. Additional incentives including trade promotion and representation abroad, are being provided to stimulate exports, and the proceeds of an export promotion loan of US$70 million now being negotiated with the World Bank would be allocated to exporters to finance imported inputs. In order to improve the external debt profile, the authorities are abstaining from commercial borrowing with maturity of less than one year, while external borrowing with maturities of one to ten years is being limited to SDR 220 million in 1983.

The case for the compensatory financing facility drawing in the amount of SDR 56.1 million to compensate for the export shortfall in 1982 has been well made by the staff. The balance of payments need cannot be overemphasized. The factors responsible for the shortfall, including reduced earnings for most of Zimbabwe's exports resulting from weakened foreign demand, a deterioration in the terms of trade, falling world prices, and adverse weather conditions, are clearly beyond the control of my authorities. The staff agrees that these factors are temporary. The test of cooperation is also satisfied, as is evident in Zimbabwe's frank discussions with the Fund staff in the course of the 1981 and 1982 Article IV consultations as well as in the performance under the 1981 stand-by arrangement and in the request for another stand-by arrangement before the Board today.

Finally, the authorities have undertaken not to impose new restrictions. They believe that the measures that they are taking are adequate to correct the country's payments imbalances and are prepared to take additional corrective measures toward this end if need be. I would therefore urge Executive Directors to approve the draft decisions.

Mr. Taylor stated that he supported the proposed stand-by arrangement and, with several qualifications, the purchase request. He was pleased that the February 1983 issue of International Financial Statistics contained, for the first time, data for Zimbabwe. That development was evidence of the authorities' wish to cooperate fully with the Fund's surveillance effort and augured well for the authorities' ability to monitor the implementation of the proposed program.

Commenting on fiscal policy, Mr. Taylor said that the authorities were to be commended for the renewed efforts to reduce the central government deficit in the present fiscal year, especially as there had been some signs that the deficit might be getting out of hand. The further planned reduction in the deficit in the coming fiscal year was also very welcome and, if achieved, would mark the fourth successive year of decline, with the overall budgetary deficit falling from 12 per cent of GDP in 1979/80 to a projected 5.5 per cent in 1983/84. The reduction in the present year was to be achieved largely through cuts in capital expenditure, presumably mainly in the development program. At first glance, such cuts seemed rather regrettable in a developing economy, but the original plan had been rather ambitious, and the remaining increases were still substantial in real terms. Although the authorities' record on the revenue-raising side was impressive, the scope for further tax increases was somewhat limited, and the burden of adjustment on the fiscal side would have to rest mainly with expenditure restraint. The steady progress that had been made in the recent past, and that was planned for the coming period, in reducing the consumer and producer subsidies was welcome; there seemed to be relatively little scope left for accelerating the phasing out of subsidies, although the process should certainly be continued.

He was pleased, Mr. Taylor continued, that the authorities were managing to reduce the Government's recourse to bank financing, which was expected to fall from 2.5 per cent of GDP in 1981/82 to approximately 1.5 per cent in 1982/83. However, the rate of inflation, at 17 per cent, continued to be uncomfortably high, and the fairly rapid increase in the growth of net credit to the Government and to the private sector--20 per cent and 24 per cent, respectively--was still a cause for concern. A more restrained pace of credit growth over the program period might well be appropriate, particularly as the total growth in domestic credit over the previous two calendar years had exceeded 60 per cent.

Commenting on interest rates, Mr. Taylor noted that both lending and borrowing rates were substantially negative in real terms. Zimbabwe was one of the relatively advanced economies of Africa, and the achievement of positive real deposit rates was an important condition for stimulating and maintaining an adequate rate of private savings. In sum, if progress was to be maintained under the proposed program, monetary restraint would have to be firmly applied.

In the recent past, Mr. Taylor remarked, most of the burden of the counterinflation effort had rested on prices and incomes policies. That approach was understandable and had been applied in a courageous and determined way, but those policies were playing an unrealistically large role. The wage guidelines covered general increases, thereby apparently leaving scope for local wage adjustments and casting some doubt on the effectiveness of the general guideline approach.

It was his understanding, Mr. Taylor went on, that, as a result of recently introduced measures, enterprises were prevented from reducing their labor forces except in exceptional circumstances, a requirement that undoubtedly hampered the effective operation of the business sector. It was also his understanding that there had been sizable accumulations of stocks in the recent past, and he wondered whether they reflected an involuntary response by enterprises to the weakness in demand and to the prohibition against shedding labor.

The authorities had finally published at least the first part of their medium-term development plan, Mr. Taylor noted, and he was pleased that the general emphasis was on export-led growth. While the authorities had made progress in the recent past in tackling the worst of the infrastructural constraints, a number of the targets in the national development plan seemed rather ambitious. Did the staff believe that the plan provided adequate incentives to encourage the required new private sector investment, which, under the plan, was to account for 40 per cent of total investment. On previous occasions, incentives such as tax allowances and tax deductions for mining companies, a special tax allowance for fixed investment, and rebates of customs duties had been mentioned. Were such measures being adopted rapidly enough? He was pleased that the authorities had applied for a World Bank export promotion loan.

The financing of the development plan and of the associated external current account deficit in the coming several years would depend heavily on the disbursement of aid from ZIMCORD (Zimbabwe Conference on Reconstruction and Development), Mr. Taylor observed. Unfortunately, the problem of the slow absorption of foreign aid had not been solved. Although the authorities would be seeking donors' cooperation in converting ZIMCORD funds into quick-disbursing external assistance, the proposed program was not based on the assumption of a substantially accelerated disbursement of such funds, and the staff and the authorities should maintain a cautious approach to development financing.

The authorities were to be commended on their flexible exchange rate policy, which was aimed at preventing a further appreciation of the real effective rate of the Zimbabwe dollar, Mr. Taylor remarked. The shift from a transactions-weighted currency basket to a trade-weighted one seemed to be appropriate. There had been a number of devaluations in southern Africa in 1982 and 1983, and the trend of exchange rates in the region should be further examined. To the extent that the bunched devaluations had reversed the loss of competitiveness between the economies of southern Africa and the rest of the world, they were acceptable. However, it was conceivable that the devaluations had had a mutually offsetting effect, in which event they raised general policy issues that should be considered in a broader context. In general, the staff should consider carefully the consequences of a policy of advising a number of countries in a region to make exchange rate adjustments that, to some extent, were designed to do more than merely restore a previous real exchange rate. For the moment, he would welcome the staff's reassurance that it had given careful thought, in its assessment of the export prospects of Zimbabwe's economy, to the complex developments in the region, including the exchange rate changes made by the dominant economy in the area.

The crux of the program for Zimbabwe, and for that of many other countries, was the balance of payments projections that were implied by the policy commitments, Mr. Taylor commented. In Zimbabwe, and probably in many other countries, the achievement of a sustainable current account deficit depended largely on an improvement in export performance. Zimbabwe was landlocked, and the significant liberalization measures introduced in 1980 and 1981 had affected the services account of the balance of payments. The services account was projected to remain in substantial structural deficit, although he certainly hoped that Zimbabwe would begin to make progress in encouraging tourism. At any rate, the debt service ratio--excluding short-term debt--was predicted to rise steadily through and beyond the program period, from 9 per cent to 22 per cent. That sharp increase implied that there might well be difficulty in servicing external debt unless Zimbabwe developed a sizable trade surplus over the coming several years. The proposed program constituted only a rather modest beginning toward the achievement of the longer-term objectives, and a strong and persistent adjustment effort would have to be made over a long period.

Commenting on the proposed compensatory financing, for a shortfall in merchandise exports in 1982, Mr. Taylor said that he wondered whether the staff had taken into account the accumulation of stocks in a number of export industries in assessing the export shortfall. It was conceivable that the stock accumulations had occurred too recently to have affected exports in the shortfall year. Was the staff concerned about the accumulation of stocks?

There was some doubt, Mr. Taylor said, whether the export shortfall could be attributed entirely to factors beyond the authorities' control. The overvaluation of the Zimbabwe dollar in 1982 and the rapid rise in wages in earlier years had caused a substantial loss of competitiveness, which, in turn, had probably contributed to the slowdown in export growth in 1982. The staff seemed to have taken that factor into account, but a more explicit explanation of the process the staff had used in reaching its conclusions on the development of an export shortfall would be helpful. The judgment in the present case seemed to be a fairly fine one, and he was willing to give the authorities the benefit of the doubt.

Mr. Salehkhou recalled that during the discussion of the staff report for the 1982 Article IV consultation with Zimbabwe, Executive Directors had welcomed the progress that the authorities had made in rehabilitating the economy and in setting the stage for continued economic expansion despite both the enormous difficulties that they had inherited after the long civil war and the continued uncertain security and political problems in the region. Executive Directors had also expressed their concern about a number of developments in Zimbabwe's economy in 1982, noting that some aspects of economic policy had caused an unsustainable expansion of demand and had constrained the promotion of exports and the mobilization of savings for investment. Concern had also been expressed about the projected increase in expenditure under the 1982/83 budget and about the country's weak external balance of payments position. Some Executive Directors had mentioned the main elements of a stabilization program that could be supported by the Fund.

He was pleased, Mr. Salehkhou went on, that most of the Executive Directors' suggestions were reflected in the proposed program. Although the difficulties facing Zimbabwe's economy were largely the result of exogenous factors, particularly the adverse effect of the international economic environment, the authorities had recognized the major role that domestic policies had played, and they were prepared to alter even the most important of their long-term objectives--such as a more equitable distribution of income and the provision of educational facilities to the low-income groups--in order to achieve economic stabilization and to pave the way for sustainable growth.

The proposed program, Mr. Salehkhou noted, retained all the revenue measures that had been included in the original budget, which should yield a 41 per cent increase in budgetary receipts. However, the program was appropriately focused on reducing the projected expansion of expenditures and at achieving a significant contraction of the fiscal deficit from the 10.7 per cent of GDP originally expected in 1982/83 to 5.5 per cent by the end of the program period. The demand management policies were complemented by significant upward adjustments of interest rates and by an important reduction in the rate of domestic credit expansion from 35 per cent in 1982 to 14 per cent in 1983. In that connection, bank financing of the government budget was to be particularly curtailed. The fiscal and monetary policies were to be supported by a set of income and pricing measures that were also designed to achieve a substantial reduction in the expansion of domestic demand and to correct a number of distortions that had harmed Zimbabwe's competitiveness and exports. The authorities had decided to restrain salary increases considerably in the public and private sectors, and to make substantial price and tariff adjustments, which should significantly reduce government subsidies.

The various domestic policies, Mr. Salehkhou went on, were to be supported by flexible external measures, including the two successive large devaluations in December 1982 and January 1983, which should encourage exports. The export promotion loan from the World Bank should also play an important role, although its positive impact would probably not be evident before 1984. The decision to change the currency basket to reflect trade weights seemed appropriate and should help to avoid any further appreciation of the real effective exchange rate.

Given Zimbabwe's broad economic base, diversified exports, and relatively small external debt, Mr. Salehkhou continued, he agreed with the staff that the country's prospects were much better than those of most developing countries. However, the authorities should maintain their careful adjustment policies and closely monitor economic developments under the proposed program, particularly the increase in external borrowing. Although the ratio of foreign debt servicing to export receipts was still relatively small and a large portion of the new loans were to be on concessional terms, foreign financing should be approached with some caution, particularly in the light of the recent experience of a number of developing countries. The proposed decisions were fully acceptable.

Miss Le Lorier said that she welcomed the successful outcome of the long negotiations between the staff and the authorities and warmly supported the proposed decisions. During the discussion of the staff report for the 1982 Article IV consultation with Zimbabwe, there had been broad agreement on the need to restrain excess demand in order to reduce the financial imbalances and to implement medium-term policies aimed at promoting growth. Although the proposed program seemed well designed for tackling the short-term internal and external imbalances, its medium-term framework and supply-side aspects fell far short of what would have been appropriate.

The authorities had clearly made a substantial effort to reduce the domestic and external imbalances, Miss Le Lorier went on. In the fiscal area, in particular, they had already taken steps to limit the budget deficit to 7 per cent of GDP instead of the 10.7 per cent originally projected. A substantial reduction in subsidies had been achieved, and the authorities intended to continue to limit subsidies in the coming fiscal year. However, the target for the fiscal deficit was to be achieved through a 46 per cent increase in revenues and a 39 per cent increase in expenditures and net lending. She was concerned about the possible side effects of such large increases. Zimbabwe's economy was market oriented and had a sizable private sector, and she wondered whether the increases in the fiscal levies might prove to be counterproductive by accelerating the emigration of skilled manpower that had already caused serious bottlenecks in the modern sector.

There had been a clear need for the exchange rate adjustments in December 1982 and January 1983, Miss Le Lorier commented, and the flexible exchange rate policy was warranted by the high rate of domestic inflation that was expected to continue in 1983. She fully agreed with Mr. Taylor on the need to pay due attention to the interrelationship of the Fund's exchange rate policy recommendations in the region. A further comment on the present level of the real effective exchange rate of the Zimbabwe dollar against the South African rand and the risk of a series of countervailing exchange rate adjustments between Zimbabwe and its main trading partner would be helpful. In that context, the adequacy of the level of the exchange rates of the region vis-à-vis the rest of the world was important.

Zimbabwe's debt service ratio appeared to be favorable in comparison with that of many other African countries, Miss Le Lorier remarked, but, at 12 per cent, it was high in relation to the volume of government and government-guaranteed external debt. Considerable nonconcessional and short-term borrowing had been undertaken in the previous two years, and the debt service ratio was expected to increase steadily in the coming period. Hence, the authorities' cautious approach to further borrowing was certainly appropriate. They had wisely committed themselves to avoiding any further commercial borrowing with a maturity of less than one year in 1983, and their limit on new nonconcessional debt was welcome.

On the whole, Miss Le Lorier went on, the demand management stance under the proposed program seemed satisfactory. The medium-term prospects, however, were less comforting. The economy was well diversified and enjoyed a considerable growth potential. It was also dualistic and had a number of structural problems, such as the lack of skilled manpower, shortages of imported inputs for the export industries--which had caused idle capacity--and the need to expand the plants whose capacity was being fully utilized. The existence of those problems, and the recent publication of a three-year transitional plan, would ideally have enabled Zimbabwe to qualify for an extended arrangement. It was true that the authorities' strategy had been finalized at a rather late stage in the negotiation process, but it would have been useful if the staff could have shed additional light on the structural aspects of its recommendations, especially as a number of the staff's expectations for the economy were based on the Government's strategy for dealing with the structural problems.

The World Bank was considering a $70 million loan for promoting manufactured exports, Miss Le Lorier noted. The export promotion scheme had been prepared in close cooperation with the Fund and was obviously a substantial one. The Government had also announced an investment code designed to create a climate conducive to private domestic and foreign investment, and it had undertaken a study of the extent of effective protection in Zimbabwe. The staff seemed to expect a shift in the composition of imports in favor of intermediate and investment goods, which should encourage a recovery in economic growth. The staff had certainly taken all those measures into account in assessing the appropriateness of the exchange rate policy, and future reviews under the program should pay due attention to structural adjustment. She hoped that Zimbabwe could implement its adjustment program in a much less difficult world and regional environment than had prevailed in the past.

Mr. Lovato stated that the proposed decisions were acceptable. There was a discrepancy between the proposed program period and the timing of the stabilization policies. The authorities had adopted important policy measures at an early stage. For instance, in 1982, new taxes had been introduced, public expenditure had been cut, subsidies had been removed, and the exchange rate had been adjusted. Indeed, the authorities had acted as if a Fund program had been in place even before the negotiations on a program had been concluded, and the proposed phasing was somewhat front-loaded in recognition of the authorities' early action. The authorities had displayed a firm determination to introduce the needed adjustment measures.

He was pleased, Mr. Lovato continued, by the downward trend in the budget deficit as a proportion of GDP since 1979/80. The authorities' decision that revenues should exceed, or at least offset, current expenditures, and that only capital spending should be financed by borrowing, was welcome. Such spending guidelines would be appropriate for other countries.

The staff had usefully provided estimates of the likely effect of the devaluation on the fiscal position in 1982/83, Mr. Lovato commented, and such estimates should become a common practice in future staff reporting. There were analytical and statistical difficulties in making such estimates, but the information was useful in evaluating budget targets.

The staff's assessment of the present and prospective external position was helpful, Mr. Lovato stated, and he broadly agreed with it. The authorities had appropriately decided to peg the Zimbabwe dollar to a trade-weighted currency basket and to keep the currency's value roughly constant in real terms. Export promotion was essential to improving the country's balance of payments performance: the staff had sketchily described the export incentive scheme, and further information on it would be helpful. Further clarification would also be useful with respect to the export projections in Table 8. The volume of agricultural exports was expected to increase more rapidly in 1984 than in 1983 as a result of the delayed effects of the exchange rate adjustments. Why did the staff not expect a similar upward trend in manufactures?

The staff projections clearly indicated that the balance of payments position was likely to be rather weak in coming years, Mr. Lovato commented. The expected sizable outflow of private transfers was a reflection of the financial obligations that Zimbabwe had accumulated. There had been a persistent drain on foreign exchange reserves following the political settlement of 1979. It seemed reasonable to conclude that further external assistance by the Fund and donor countries would be desirable in the coming period. Did the staff agree with the authorities that the problems facing Zimbabwe's economy were largely structural? If so, why did the staff not favor an extended arrangement for Zimbabwe?

Mr. Jayawardena stated that the proposed decisions were acceptable. Zimbabwe had acheived normalcy only in 1979, after a long period of internal strife and external difficulties. The transition in Zimbabwe had naturally generated extraordinary expectations, and the Government obviously had to take them into account. The Fund should approach such a situation with care, understanding, and sympathy as, indeed, staff and management had clearly done.

The 1981 program had succeeded in initiating a sensible adjustment, Mr. Jayawardena considered. The budget was the crucial instrument in Zimbabwe for acheiving several national objectives. Nevertheless, in the light of the difficult external conditions, the Government had had to reduce expenditures and mobilize a substantial volume of resources. The resource mobilization effort of the previous two years was impressive, but Zimbabwe was perhaps near the limit of its ability to mobilize additional revenues, and in future the adjustment effort would have to be centered on expenditure restraint. The continuation of the policies first adopted in 1980 to prune gradually consumer and other subsidies was therefore welcome; the effort would have to continue to be a gradual one. The main subsidy had been halved in 1982/83, and the overall fiscal deficit had been substantially reduced, but the delay in making the needed outlays on education were somewhat worrying. In view of the serious manpower constraints following the emigration of skilled manpower, investment in educational facilities should be given a higher priority. The authorities could not hope to make the best use of the existing infrastructure and of investments unless there was a sufficient number of trained persons.

In Zimbabwe, as in many other countries, Mr. Jayawardena noted, the currency had appreciated in the wake of the strengthening of the U.S. dollar. The authorities were to be commended for reversing that trend and for maintaining a sensible exchange rate policy. Zimbabwe's economy was fairly diversified and included a significant industrial sector; the flexible exchange rate policy would undoubtedly be an important aspect of the overall policy stance.

During the discussion on the staff report for the 1982 Article IV consultation with Zimbabwe, Mr. Jayawardena recalled, Executive Directors had expressed their concern about the substantial growth of short-term debt and had raised the question whether the Fund's conditionality had perhaps pushed Zimbabwe to undertake such debt. The authorities' recently stated intention of limiting their recourse to short-term debt was welcome.

He basically agreed with the staff appraisal, Mr. Jayawardena said. Given its broad economic base and diversified exports, Zimbabwe's prospects for achieving a rapid improvement in the external imbalance when world economic conditions improved were better than those of many other developing countries.

Mr. Dallara stated that he broadly agreed with the staff appraisals and accepted the draft decisions. The proposed program represented a significant step in the direction of implementing the adjustment measures needed to achieve a sustainable payments position while laying the basis for stable economic growth in the medium term. Although he harbored a number of doubts whether the overall policy stance was fully appropriate in the light of the existing circumstances and prospects, he was inclined to give the authorities the benefit of the doubt; the proposed program was the first one for Zimbabwe in the upper credit tranches, and the authorities had already introduced a number of measures. They should be encouraged to take further steps, the need for which was becoming increasingly obvious, and he attached particular importance to the assurance that the authorities were committed to making the stabilization program succeed and to introducing new measures promptly if there was any evidence that the program targets might not be achieved.

Commenting on fiscal policy, Mr. Dallara said that he generally welcomed the steps that had been taken to reduce the fiscal deficit from the level originally expected under the 1982/83 budget. The clear and explicit target for the fiscal deficit as a percentage of GDP for 1983/84 was also welcome. However, the 24 per cent increase in current expenditures seemed somewhat excessive, given the demand pressures that appeared to continue to prevail in the economy. A further comment by the staff on the potential for expenditure savings would be useful. The additional cuts made in the previous several months had been concentrated on capital expenditures, something that was in itself a cause for concern, although the original targets and the current ones were somewhat ambitious in the light of Zimbabwe's limited implementation capacity; in the previous two years, the Government had had difficulty in implementing projects because of structural bottlenecks. The authorities should be very careful in expenditure management. Experience had shown that the targets under the development plan had been optimistic, and the present plan seemed somewhat ambitious. Hence, in the light of prevailing and prospective economic and financial conditions, the authorities' intention of implementing the development program on an annual basis was welcome.

He agreed with Miss Le Lorier, Mr. Dallara went on, that revenue mobilization had perhaps borne an excessive burden of the fiscal adjustment effort. Further increases in certain taxes might well prove to be counterproductive for economic activity in general and private sector investment in particular.

The restraint on wages and salaries under the proposed program was appropriate, Mr. Dallara considered. The authorities were obviously under pressure to increase wages, and their policy of restraint was courageous. Given the potential difficulties in fully implementing the objectives under the proposed program, the authorities should be encouraged to be careful to ensure that their policies evolved in a manner consistent with the stated objectives. The authorities were to be commended for their progress in reducing subsidies, and they should be encouraged to make the further reductions planned for 1983/84. In that connection, it was difficult to assess the appropriateness of prices solely on the basis of percentage changes from previous levels. A comment on the comparison of price levels in Zimbabwe with international prices would be helpful.

Commenting on monetary policy, Mr. Dallara said that, despite the reductions in the rate of increase in credit growth under the proposed program, he felt somewhat uncomfortable with the overall monetary policy stance, as he doubted whether it would be able to restrain demand. The staff and the authorities should keep a close watch on developments in the monetary sector, and the credit ceiling for the coming fiscal year should be fashioned in the light of actual developments and prospects, and particularly those concerning the rate of inflation.

The authorities had shown great courage in implementing the devaluations of December 1982 and January 1983, Mr. Dallara considered. They had appropriately decided to alter the currency basket with a view to maintaining a flexible exchange rate policy that would prevent any appreciation of the real trade-weighted exchange rate during the period of the proposed stand-by arrangement.

On previous occasions, Mr. Dallara noted, Executive Directors had expressed concern about the levels and maturity structure of Zimbabwe's commercial external debt, and the prudent and cautious debt management under the proposed program was appropriate. The limitations on contracting debt of less than one year for balance of payments purposes was particularly welcome. However, the proposed program did not provide for an increase in reserves, and he wondered whether the authorities, with the support of the staff, might not wish to begin forthwith to establish appropriate lines of action to create a cushion against unforeseen unfavorable developments in the coming period.

That the current account deficit was not expected to decline in 1983 was not particularly worrying, Mr. Dallara commented, although a downward trend in the external current account and the overall balance of payments beyond 1983 would certainly be welcome. The staff report could have usefully contained a more comprehensive presentation of the medium-term prospects for the economy in general, and the balance of payments in particular. The overall balance of payments deficit in 1985 was projected to be SDR 146 million, and it was not clear to him how such a large deficit was to be financed.

He looked forward to hearing the answers to the questions concerning the medium-term strategy and structural problems, Mr. Dallara remarked. Zimbabwe's economy seemed to be unique in the sense that for a number of years it had developed in a fairly isolated position and had been unable to take advantage of the benefits of international trade. It was worth examining the effect of Zimbabwe's access to imports and to export markets both on the development of the economy in the previous several years, and on the outlook for the coming period. Had Zimbabwe had to carve out export markets gradually in the relatively weak world economic environment of the previous several years, or had its broad export base and diversified economy enabled it to move fairly rapidly? The answer to that and other related questions probably had a bearing on the medium-term outlook for the economy and should be addressed in future reports.

While he accepted the proposed compensatory financing, Mr. Dallara commented, he agreed with Mr. Taylor that to some extent the exchange rate and other policies of the Government had contributed to the export shortfall. On the whole, he shared the staff view that the shortfall was beyond the control of the authorities, but further information on the matter would be useful.

While he fully supported the proposed program, Zimbabwe's first upper credit tranche arrangement, Mr. Dallara concluded, the authorities should be encouraged to move quickly to implement the additional measures that seemed to be needed to move the economy toward a sustainable medium-term balance of payments position. He harbored some doubt about the size of, and the phasing under, the proposed program, but he did not wish to place too much emphasis on them.

Mr. Polak said that he was pleased that, after the lengthy negotiations, a stand-by arrangement in the upper credit tranches had been agreed. He shared Mr. Dallara's view that the program seemed rather heavily front-loaded. The major portion of the assistance under the proposed stand-by arrangement covering 18 months would be available before a number of important policy decisions had been made. If the performance criteria for end-March 1983 were met, Zimbabwe would be able to draw SDR 153 million--including a purchase under the compensatory financing facility--or 43 per cent of the total amount that was to be available over the program period. Even without the assistance under the compensatory financing facility, Zimbabwe would be able to draw about one third of the total assistance by end-March 1983.

The recent devaluations were welcome, Mr. Polak continued, and they legitimized the proposed compensatory financing by the Fund. The policy of maintaining the real rate of the Zimbabwe dollar was appropriate, but it was difficult to know whether the level to which the currency had been devalued was the right one, mainly because of the uncertainty about the importance of the trade and payments restrictions and of the export subsidies that were maintained in support of the new rate. Apparently the authorities had not introduced new export subsidies, but it would be useful to know more about the export promotion arrangements mentioned by previous speakers, which were not discussed in detail in the staff reports. In addition, the import surcharge had been substantially increased some time ago, and no mention of a decrease in the surcharge was mentioned in the staff reports. During the discussion on the staff report for the 1982 Article IV consultation with Zimbabwe, the Executive Directors had strongly recommended that Zimbabwe reduce its reliance on restrictions on external payments, but no reference to the matter was contained in the letter of intent. It was difficult to justify an exchange rate in the absence of a clear understanding of the restrictive mechanism involved.

Commenting on the strength of the proposed program and the outlook for the economy, Mr. Polak said that the external position of Zimbabwe had drastically deteriorated in the recent past, and the staff had indicated that it would not be sustainable by the end of the proposed stand-by arrangement. Indeed, the staff hoped that the overall balance would be sustainable by 1987. The need to accept the inevitability of such a long adjustment period was characteristic of some countries, but probably not of Zimbabwe. As previous speakers had stressed, the basic aspects of Zimbabwe's economy were relatively favorable, and he wondered whether a country with an economic potential as great as Zimbabwe's should not be aiming for more rapid adjustment than a period of four to five years. The proposed program seemed to set its sights too low--from the viewpoint of the Government rather than that of the Fund--and aiming for quicker attainment of overall payments balance, probably with the help of substantial capital imports, seemed reasonable for a country of Zimbabwe's inherent strength. Finally, the proposed decisions were fully acceptable.

Mr. Casey noted that the problems facing Zimbabwe's economy were due to a combination of external and domestic factors. For some time, many of the domestic policies had contributed to excess demand. In December 1982, however, the authorities had taken firm corrective action on fiscal, monetary, pricing, and incomes policies and on the official external debt and the exchange rate fronts. The measures seemed to be in the right direction, and, if the proposed 18-month program were successfully implemented, there was no reason why the Fund should not consider approving the extended arrangement that the authorities apparently intended to request. The proposed front-loading under the stand-by arrangement was not a cause for concern, as many of the stabilization measures had already been introduced.

In the recent past, Mr. Casey went on, exports had not recovered quite as fast as had been expected, but the potential for export-led growth in the medium run was thought to be considerable. Zimbabwe enjoyed a rich natural resource base, and there seemed to be considerable scope for increasing domestic value added, for example, by increasing the processing of agricultural and mineral products and by strengthening interindustry linkages, although that kind of supply-side transformation would require an improvement in implementation capacity.

The economy was still essentially a subsistence one, Mr. Casey went on; less than one seventh of the population earned wages. A major portion of the resource base was underused because of the lack of monetary incentives. If more of the resource base could be drawn into the monetized sector and used to produce goods for domestic and foreign markets, the economy could take off. He agreed with Mr. Dallara's comments on the need to develop the tradable goods sector; in that connection, solving the problem of the dual exchange system would make a significant contribution. Despite the recent devaluations, there was no certainty that the exchange rate was at an equilibrium level. It was conceivable that further devaluations would encourage producers to enter the monetized economy and to contribute to export production. Given the diversity of the resource base, the elasticity of supply in Zimbabwe was significant. To the extent that a further devaluation slowed imports, the domestic linkages that he himself had mentioned earlier would probably be strengthened; as imported inputs became far more expensive, producers would have more of an incentive to use domestic products instead. In that connection, it was important to note that, during the period of economic sanctions, import substitution had taken place on a large scale.

A flexible exchange rate policy would help to monetize the economy and strengthen the tradable goods sector, Mr. Casey went on, but it would have to be supported by a whole array of complementary policies and should be examined in the context of the exchange rates in Zimbabwe's neighbors. Outside assistance would also be required, and the World Bank's loan to increase the foreign exchange allocated to exporters to finance import components was welcome.

The proposed stand-by arrangement constituted a strong attempt to restore economic stability, Mr. Casey considered. However, the main medium-term challenge was to provide sufficient incentives to monetize the large subsistence sector--which constituted a kind of sleeping giant--thereby increasing savings, investment, and, most important, exports.

As for the proposed compensatory financing, Mr. Casey commented, the staff's approach was basically a cautious one. Like previous speakers, he had wondered about the treatment of stocks and hoped that an early repurchase obligation would not arise. He was somewhat worried by the footnote on page 4, which mentioned that "the shortfall would be zero, if earnings in the six months' estimated period averaged SDR 113 million per month." Given the possibility of an early repurchase obligation, the authorities should perhaps take a cautious approach to using the compensatory financing facility funds in the immediate future. He warmly supported both draft decisions.

Mr. Alfidja stated that the proposed decisions were acceptable.

The staff representative from the African Department, commenting on the Government's attitude toward layoffs by private sector companies, said that one of the leading asbestos companies, the African Associated Mines, had asked permission to reduce its work force by 2,000 miners and to reduce its output of asbestos. Many companies had made similar requests during the previous year both because of increasing costs--particularly for utilities and labor--and because of the declining trend in commodity prices. A number of companies had asked the Government for interest rate subsidies and loan guarantees, and the authorities had responded to some of them, particularly the iron and steel company. However, one of the largest mines, the Empress Mines, had closed, and it was the staff's understanding that the Government did not intend to respond positively to requests for such assistance from other companies. The staff agreed with Executive Directors who felt that, to the extent possible, the operations of the companies should be influenced by financial considerations. During the previous year, several small gold mines and 14 small base-metal mines had closed. The authorities realized that, in the present circumstances, it would be futile to compel companies to operate at a loss; it seemed best to allow some companies to close temporarily, until conditions in the international markets improved.

The authorities had clearly taken the position that there should be no wage developments that increased pressure on the budget, thereby making it difficult for them to meet the fiscal targets, the staff representative said. In the past, there had been two salary structures for teachers. The Government had gradually unified the salary system by moving lower-paid teachers up to a more intermediate position, so that all teachers earned the same salary for the same work, which had not been the case before 1980. The unification of teachers' salaries was already reflected in the budget and posed no risk to the achievement of the fiscal objectives under the proposed program.

The Development Plan, the staff representative explained, had been developed over a long period and contained appropriate investment priorities. However, the authorities recognized that the Development Plan would have to be reassessed every year, and that expenditures under the plan would have to be determined on the basis of prevailing economic circumstances. The plan assigned a major role to the private sector; 40 per cent of the resources under the plan were to come from that sector. The Government had published a new investment code, and the new World Bank export promotion loan would assist exports. In addition, although the authorities had increased several taxes during the previous year, they had refrained from raising the company income tax specifically to enable companies to continue to operate in the present difficult situation.

The staff's attitude toward the rate of disbursement of ZIMCORD aid was a cautious one, the staff representative said. The staff had assumed that the bulk of the funds would be disbursed by 1987, mainly for rural projects. The authorities had indicated that they intended to approach the various potential donors with a view to accelerating the present and prospective slow rate of disbursement, but an increase in the rate had not been assumed under the proposed program. If some acceleration occurred, the balance of payments position would be somewhat stronger in the near term than currently projected.

The staff shared Executive Directors' concern about the sustainability of the projected rate of growth of revenues, the staff representative commented. The rate of increase in total revenues and grants was 40 per cent in 1980/81, 41 per cent in 1981/82, and 26 per cent in 1982/83. Such rates would be difficult to sustain without running the risk of excessively high tax rates that might encourage the emigration of skilled personnel and dampen private sector activity. It was for that reason that the staff had stressed the need for expenditure control during the preliminary discussions on the 1983/84 budget, and the matter would certainly be taken up again during the scheduled review of Zimbabwe's performance under the stand-by arrangement. The policy emphasis during the coming year should be on expenditure control, and the rate of increase in revenues would probably be lower in the coming 12 months than it had been during the previous three years.

Commenting on monetary policy, the staff representative remarked that many consumer interest rates were positive. However, given the continued increase in the rate of inflation, interest rates on deposits and savings should certainly be a topic of discussion during the review. It was the staff's understanding that some of the free market rates had recently been rising. For instance, the rate on nonrediscountables had increased by three to four percentage points during the previous three months. In the coming period, company taxes were to be paid in three installments, rather than two. The third installment should be paid in May 1983, and the market was anticipating some liquidity shortages at that time. During the coming review, the staff would certainly bear in mind the need to maintain adequate monetary restraint. In recent weeks, the Reserve Bank had reminded all the financial institutions of the importance of maintaining adequate liquidity ratios. The monetary authorities clearly recognized the importance of maintaining a monetary stance that was consistent with the fiscal and exchange rate policies.

The authorities' exchange rate policy was designed to offset the appreciation of the real effective exchange rate in the previous two years, which had been a factor in the erosion of Zimbabwe's competitive position, the staff representative commented. As a result of the recent devaluations, the staff felt that the real effective rate was below the rate at the end of 1980. The authorities had introduced an import surcharge in August 1981 mainly for revenue reasons, although they had clearly also hoped to influence the demand for imports.

The $70 million World Bank export promotion loan, which had been approved in February 1983, the staff representative remarked, was encouraging and was fully consistent with the proposed program. The major effect of the loan was expected to be an increase in the availability of foreign exchange for general allocation. Some of the foreign exchange would be allocated to imports intended for export production. The main objective of the export promotion loan was to encourage the traded goods sector, thereby enabling Zimbabwe to increase its export receipts and to improve the overall balance of payments position.

The staff hoped, the staff representative remarked, that the adjustments of producer prices would help to increase production in the rural areas. The producer price of maize had been substantially increased in 1980/81, causing a large rise in output in that year. The present policy was to increase substantially the producer prices for other crops in order to stimulate production in rural areas. Agricultural production was managed to a large extent by marketing boards, and the increased production should enhance deliveries from rural areas to the marketing boards, thereby helping to bring a larger portion of rural activity into the monetized economy.

The proposed program was the first upper credit tranche program for Zimbabwe, the staff representative remarked. A program in the first credit tranche had expired in April 1982. The staff felt that the proposed upper credit tranche program was a suitable compromise between the need for a longer-term perspective on the economy and the need to assess short-term developments carefully. In addition, although the authorities had prepared a three-year transitional plan, the staff believed that the objectives under the plan were not fully suitable as a basis for a medium-term Fund-supported program. The expectation was that, at the end of the present 18-month stand-by arrangement, the staff and the authorities would negotiate another medium-term program that would take more fully into account the longer-run prospects for the economy in general and the balance of payments in particular. The Fund and World Bank staffs were looking closely at the present three-year plan to determine whether it could be made more consistent with the balance of payments and fiscal prospects.

The discussions between the staff and the authorities on the proposed program were held over a long period, the staff representative explained. Indeed, the original intention had been to complete the discussions soon after the expiration of the first credit tranche stand-by arrangement in April 1982. The discussions had taken longer, and the authorities had taken steps to reduce the subsidies on beef and to eliminate subsidies on edible oils and flour in the first half of 1982. In addition, the fiscal deficit for the previous fiscal year had been within the broad framework that the staff and the authorities had been dicussing. Moreover, action in the exchange rate field had been taken, and in December 1982 the Government had taken the difficult step of increasing by 50 per cent the consumer price for maize meal, a basic food item. Another factor in the length of the negotiations was the authorities' wish to involve the Cabinet. The authorities had indicated that they would be willing to complete the negotiations on the proposed stand-by arrangement only after the Cabinet had given its approval, and there had been two rounds of discussion within the Cabinet to assure that all the various ministerial allocations would be within the program targets. Hence, the Government had demonstrated a strong commitment to the program. The authorities were fully aware of the problems facing the economy and were eager to make certain that the program was successfully implemented.

Commenting on exchange rate policy actions by other countries in southern Africa, the staff representative said that the staff hoped that, with the use of the trade-weighted exchange rate basket, the movements in exchange rates in Zimbabwe's trading partners would be automatically taken into account in the daily adjustments in the exchange rate of the Zimbabwe dollar. That was not to say that discrete adjustments in the peg against the basket itself would be unnecessary. The exchange rate and the possibility for further promotion of exports would have to be kept under review.

The authorities recognized the potential problems in the external debt scenario, the staff representative from the African Department said, and the program contained fairly strict limits on new borrowing for one to five years. Only SDR 10 million could be borrowed in 1983. Moreover, there was to be no borrowing for less than one year, a requirement that was particularly important given the present external debt situation.

The staff representative from the Exchange and Trade Relations Department, commenting on the exchange rate developments in the region, said that one of the main factors to keep in mind was the importance of the competitive position of the devaluing countries--namely, Malawi, Botswana, and Zimbabwe--vis-à-vis the major economy in the area. Accordingly, the currency basket of Zimbabwe had been adjusted by increasing the weight for the South African rand and reducing the weight for the U.S. dollar.

Because the negotiations on new programs had been lengthy, the staff representative went on, the first two purchases were quite close to each other. More important, the authorities had already introduced several measures, particularly in the exchange rate area. One of the understandings with the authorities had been that the Fund's financial assistance could probably be provided promptly once the appropriate exchange rate action had been taken. In any event, of the total amount of financial assistance under the proposed 18-month stand-by arrangement, only one third would be available in the first six months.

On page 17 of the staff report, the staff representative noted, it was mentioned that the authorities intended to increase the incentives available to exporters. The staff did not know whether or not the authorities had in fact taken steps to provide subsidies. The main element of the export promotion effort that had been agreed with the World Bank would make additional foreign exchange available to export enterprises. The staff would carefully examine any export subsidy proposals during the scheduled review.

The balance of payments position had been so difficult, particularly in the second half of 1982, the staff representative from the Exchange and Trade Relations Department explained, that the authorities had felt compelled to tighten the system of import restrictions. The staff had concluded that, at least in the early stages of the program, no action to liberalize the import restriction or to reduce the surcharge would be feasible. That policy area would certainly be closely reviewed during the stand-by arrangement. Moreover, the authorities had expressed an interest in an extended arrangement, and the negotiations on it would undoubtedly cover import liberalization.

Mr. Taylor said that he was worried that the practice of devising policy on a country-by-country basis could result in biased projections, depending on the extent to which the staff was able to take into account possible consequential exchange rate changes in the countries in a region. How did the staff cope with that problem in making export projections? Did it assume that nominal exchange rates in the rest of the region remained unchanged, or did it try to anticipate adjustments by countries in the region to restore their competitive position? The matter should be further examined on another occasion.

The staff representative from the Exchange and Trade Relations Department said that his preliminary response was that in many cases the staff drew conclusions after examining the movement in the real effective exchange rate of the countries concerned and in the profitability of the export sector. In a number of cases, the staff had found that the existing exchange rate was not in line with the cost structure of the export sector.

Mr. Dallara commented that he had some difficulty in accepting the idea that the time involved in negotiating a program should be a significant factor in the phasing of the Fund's financial assistance. It was of course true that some of the policies that the staff believed were needed had in fact already been implemented, and their adoption should be one of the factors taken into account in determining phasing. However, it would hardly be feasible to include the time taken to negotiate a program among the factors determining phasing, particularly in programs that were negotiated relatively quickly.

The staff representative from the Exchange and Trade Relations Department said that the closeness of the first two purchases under the stand-by arrangement was a secondary factor. The most important factor to note was that Zimbabwe would be able to purchase only one third of the total amount of resources to be available under the stand-by arrangement in the first six months of the stand-by period. Hence, there was little, if any, front-loading under the proposal.

Mr. Polak noted that the justification for the degree of the depreciation of the exchange rate had been expressed entirely in terms of the real effective rate. The concept of the real effective exchange rate was of course a useful one, but it assumed that an equilibrium position prevailed in the base period. In the case of Zimbabwe, the sizable distortions in international trade in the past naturally led to some doubt about the existence of an equilibrium in the base period. The staff should explore the matter further with the authorities during the coming review. Serious consideration should be given to distinguishing the equilibrium exchange rate from movement in the rate since a specified base date.

Responding to further questions, the staff representative from the African Department said that, under the proposed stand-by arrangement, the Fund's holdings of Zimbabwe dollars, excluding special facilities, would rise to 225 per cent of quota. Hence, the Fund could conceivably continue to provide financial assistance to Zimbabwe at the end of the proposed stand-by arrangement. The World Bank was also examining the possibility of providing financial assistance over the longer run. In projecting Zimbabwe's financing in the coming period, the staff had not been able to make specific assumptions about possible recourse to the Fund in the absence of a definite Fund-supported program, although additional assistance from the Fund and, perhaps, from other international organizations was a distinct possibility.

The Chairman noted that the Fund would play a large role in financing Zimbabwe's overall deficit. Zimbabwe's debt service was increasing rapidly, and the time was ripe for the Fund to draw the authorities' attention to the rapid tightening of the debt situation. The debt servicing situation was of course still under control, but the rapid increase in the ratio should certainly be a matter of concern henceforth; it would undoubtedly constitute the major financial burden on the country in coming years. Although a trade account surplus was forecast for the medium run, the equivalent of 200 per cent of quota was to be made available to Zimbabwe in just 18 months, and it seemed wise to stress the need for further adjustments and further concessional aid.

The staff representative from the Exchange and Trade Relations Department noted that on page 24 of the staff report it was mentioned that the authorities hoped that quick-disbursing assistance would become available in 1983. In that event, the budget and balance of payments outcome could be better than currently expected, and the resources purchased under the proposed stand-by arrangement could be used to build up reserves rather than to finance the external deficit without relaxing the adjustment effort under the new program. The Fund could perhaps take the initiative, together with the World Bank, in encouraging external assistance from donor countries.

Mr. Alfidja said that, while his countries were willing to make needed adjustments, they hoped that, at the same time, friendly countries that were urging them to make the adjustments would be able to provide crucial financial assistance. He disagreed with Mr. Dallara's position on the relevance of the length of negotiations on a stand-by arrangement in the phasing of the assistance under the arrangement. Experience suggested that arrangements concluded quickly often placed the authorities concerned under great pressure and often failed.

The staff had usefully noted the involvement of the Zimbabwe Cabinet in the negotiations in explaining the reasons for the relatively lengthy negotiations, Mr. Alfidja remarked. Such participation should be encouraged to ensure that countries would be in a position to implement Fund-supported programs successfully. In any event, the Fund itself usually took some time to assess the policy stance of a government that wished to use the Fund's resources. Nor did he agree with Mr. Dallara's position on front-loading assistance under arrangements. Some countries negotiated bridging financing in the expectation that Fund assistance would be forthcoming soon afterward. Countries tended to feel that the Fund faced liquidity problems and was therefore tightening its conditionality. The Fund should be cautious in the phasing of assistance under arrangements with member countries.

Miss Le Lorier said that she fully agreed that in the coming period the authorities would have to rely on concessional financing and should avoid extensive short-term borrowing. It had to be noted, however, that the figures on the financing requirement up to 1987 were based on the assumption of constant terms of trade, which had an important bearing on the projected debt service ratio.

The staff representative from the Research Department commented that the movement of stocks in recent years had probably reduced the size of the export shortfall. In 1981 Zimbabwe had had serious transportation problems, and the stocks of a number of commodities had increased in 1981 but were estimated to have declined in 1982. Of the ten commodities mentioned in the staff report, stocks of three of them--tobacco, maize, and asbestos--had increased in the shortfall year; the stocks of the other commodities had been estimated to have declined. Tobacco stocks had increased from 53,000 tons at end-1981 to an estimated 56,000 tons at end-1982, still well below the normal level of 64,000 tons. Asbestos stocks has risen from 60,000 tons at end-1981 to an estimated 89,000 tons at end-1982, compared with the normal level of approximately 96,000 tons. In 1982, stocks of maize had increased above the 1981 level, but Zimbabwe had experienced difficulties in marketing its maize because of the surplus of maize in world markets. The international price of maize had fallen by 17 per cent in 1982 in terms of U.S. dollars, and although its export price had been reduced by 26 per cent, Zimbabwe had been unable to sell all the maize that it had wished to. Therefore, the increase in maize stocks was seen by the staff to have been caused by factors beyond the control of the member.

It was true, the staff representative continued, that the appreciation of the real effective exchange rate in recent years had eroded Zimbabwe's external competitiveness. However, the effect of the appreciation on the shortfall was smaller than suggested by the rate of appreciation in the shortfall year mentioned in the staff report. The appreciation of the real effective exchange rate had become evident at the end of 1980 and could well have been a factor in the erosion of export competitiveness in both the preshortfall and the shortfall years, thus affecting both the value of exports in the shortfall year and the export trend. Moreover, the exchange rate was a relatively unimportant cause of the sizable export shortfalls in 1982 in tobacco, asbestos, cotton, and the category of miscellaneous exports. The shortfalls in tobacco and cotton lint were attributable largely to production shortfalls caused by the drought. The decline in asbestos exports in the shortfall year was due to weak foreign demand and marketing difficulties, despite the sharp--9 per cent--decline in the price charged by Zimbabwe. The group of miscellaneous exports consisted of agricultural products, minerals, and manufactures, which had been adversely affected by weak demand abroad and bad weather in the country. Hence, the staff had concluded that the main factors in the shortfall in aggregate exports were the drought and weak external demand, both of which were beyond the control of the member.

Mr. Sangare noted that more than 90 per cent of total economic activity in Zimbabwe occurred in the private sector. The Government had provided some encouragement for private sector activity, and the sector's 41 per cent contribution to development financing should be seen in that context and in the light of its large role in the economy.

The long-standing and deep-rooted problems facing the economy made it difficult for the authorities to make all the needed adjustments in the economy sooner than 1987, Mr. Sangare remarked. They had taken difficult steps to encourage foreign investment, and the adjustment targets for 1984 would be hard to achieve without foreign financial assistance. It was of course appropriate for the Fund and friendly countries to encourage other countries to make needed adjustments, but the Fund and the donor countries should help to provide the financial assistance that was crucial to the adjustment effort. Finally, he agreed with Mr. Alfidja's comments on front-loading and the length of time required to complete negotiations on extended and stand-by arrangements.

The Executive Board then turned to the proposed decisions, which it approved.

The decisions were:

Stand-By Arrangement

1. The Government of Zimbabwe has requested a stand-by arrangement for the period from March 23, 1983 to September 22, 1984 for an amount equivalent to SDR 300 million.

2. The Fund approves the stand-by arrangement attached to EBS/83/44, Supplement 1.

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

Decision No. 7369-(83/52), adopted
March 23, 1983

Purchase Transaction - Compensatory Financing Facility

1. The Fund has received a request from the Government of Zimbabwe for a purchase of SDR 56.1 million under the Decision on Compensatory Financing of Export Fluctuations (Executive Board Decision No. 6224-(79/135), adopted August 2, 1979).

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

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

Decision No. 7370-(83/52), adopted
March 23, 1983

2. GREECE - 1982 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1982 Article IV consultation with Greece (SM/83/37, 2/23/83; Cor. 1, 3/21/83; and Sup. 1, 3/21/83). They also had before them a report on recent economic developments in Greece (SM/83/44, 3/7/83; and Cor. 1, 3/21/83).

Mr. Caranicas made the following statement:

On behalf of the Greek authorities and myself, I want to express our deep appreciation to the staff for its enormous amount of work and professionalism. The staff papers contain a clear presentation and objective analysis of economic developments in Greece and of the policies pursued.

Since the previous Article IV consultation discussion on Greece, a new Government assumed office in October 1981. It faced a rapidly deteriorating economic situation, which made its task difficult in many respects, to say the least. Growth in GDP in real terms had been following a declining trend from the peak in 1978 and was actually negative in 1981. Industrial production, already stagnant in 1980, was falling in 1981, reflecting considerable weakness in manufacturing output, and the country was in a "slumpflation."

On the demand side, the most striking feature was the accelerating decline in private fixed investment, due partly to severe weaknesses in the housing sector. This downturn in activity had an impact on the labor market, where the unemployment rate had risen to an estimated 4 per cent by 1981, or 5.5 per cent in the urban and semiurban areas. And yet, despite this slack in activity, inflationary forces were gathering strength throughout 1980 and 1981 to reach 25 per cent a year, and the price and cost performance in Greece was distinctly less favorable than in its main European trading partners. Problems were also intensifying in the balance of payments, with a marked weakening in both the trade and invisibles accounts. The current account deficit had deteriorated steadily, to 6.5 per cent of GNP in 1981, compared with 3 per cent in 1978.

Two important considerations stood out in this situation confronting the new Government. First, the world recession was affecting the external position at the same time as Greece was endeavoring to make the difficult adjustments needed following its accession to the European Communities on January 1, 1981. The problem was highlighted by the substantial import penetration occurring after accession, with the abolition of duties on many categories of imports, particularly with respect to agricultural products; reflecting this, the balance of trade in agriculture, traditionally positive for Greece, turned sharply negative in 1981.

Second, the imbalances in the economy, which did not go unnoticed in the 1980 consultation report, worsened, partly owing to the previous stance of domestic policies. In particular, the financial position of the public sector had been allowed to weaken markedly, with a major escalation in the gross public sector borrowing requirement to the equivalent of 19 per cent of GNP in 1981, compared with 6.5 per cent in 1978. This situation reflected a deterioration in the Central Government's budgetary position, as well as in the finances of the public enterprises. In this environment, the monetary aggregates had risen apace, with total domestic credit and broad money both increasing by 35 per cent in 1981. The competitiveness of the Greek economy was suffering in this situation, with the lax financial position adding to the inflationary problem.

Under these conditions, the principal priority of the new Government was to stabilize the economy as a necessary prerequisite for sound economic growth. Economic policy was to be shaped within the context of the Government's basic social philosophy, with special emphasis on improving the social and economic conditions of the lower-income groups, and on supporting small business and agriculture. For the longer term, the authorities are aiming at modernizing and restructuring the economy with the help of a major public investment program. These objectives are being incorporated into the Government's Five-Year

Plan with the accent on, inter alia, the role of structural change in improving cost competitiveness, strengthening production in the export and import-competing sectors and providing a more even pattern of regional development. Realization of these various aims is to be facilitated by a more effective use of policy instruments--including greater efficiency in fiscal management and a more flexible administration of monetary policy.

The Government is fully aware of the somewhat limited room for maneuver in implementing its policies, at least in the short run. On the one hand, the Government had made certain social and political commitments to the electorate, particularly as regards raising the incomes of lower-paid people to achieve greater equity in income distribution. On the other hand, the realities of the economic situation were such that immediate attention needed to be given to stabilizing the economy and improving competitiveness, both by holding down costs and by strengthening the range and quality of production. Indeed, in certain respects, these considerations tended to involve competing claims, especially in improving the incomes of lower-bracket Greeks, while constraining production costs and overall growth of incomes. In this situation, therefore, the authorities have been proceeding in a pragmatic fashion, but have been placing special emphasis on stabilizing the economy.

During 1982, while trying to stay within this broader context of economic stabilization, economic policy succeeded in meeting certain aims of the Government. In particular, wages and salaries in the lower-income brackets were selectively increased, and annual leave was extended. Furthermore, emphasis was given to expansion in social housing programs, which had been somewhat neglected in the past. Incomes policy also provided for the introduction of a formal price indexation mechanism compensating for only part of the cost of living increase, the figure averaging about 70 per cent in 1982. At the same time, provision for significant tapering, with full indexation only at the lower-income brackets, ensured that the social objectives were being furthered in the context of the broader stabilization aims.

Undeniably, all these measures resulted on average in a sizable increase in real incomes. The Central Government's budget for 1982, however, was clearly designed and implemented in a restrictive manner, and the deficit remained virtually unchanged in absolute terms and declined relative to GNP. Although the financial position of the public enterprises deteriorated further in 1982, the gross public sector borrowing requirement declined to about 15 per cent of GNP, as against 19 per cent in 1981. Monetary policies played a supportive role in this restrictive stance. It is heartening that, in some areas, developments are moving in the desired direction, especially as regards some slowing of the pace of inflation and a reduced current account deficit relative to GNP; unemployment, however, edged up further to about 6 per cent in 1982.

The Government fully recognizes that a significant distance has yet to be traveled before adjustment can be achieved, and that the icipient measures of 1982 must be built on and consolidated. The speed of adjustment will be critical, especially as the authorities wish to ensure that the external imbalance is held at levels that impose no serious foreign borrowing burden. In line with this approach, the incomes policy for 1983 has been tightened with a stretching of indexation adjustments, no change in the tapering brackets to allow for inflation, and no wage and salary increases beyhond indexation.

The average compensation for cost of living increases is expected to be somewhat less than in 1982, and a significant decline in average real incomes is projected for 1983. The stance of fiscal policy will be broadly the same in 1983 as in 1982, aiming at a further reduction of the gross public sector borrowing requirement relative to GNP, while monetary policy will support these tighter policies. More attention is to be given to reining in the finances of the public enterprises, especially with emphasis on improved efficiencies and provisions for more flexibility in pricing policies. A further critical step in the adjustment program was taken in early January with the significant devaluation of the drachma and a request to the European Communities for restrictions on certain categories of imports.

These important measures were taken as an essential step toward improving competitiveness and shifting the structure of production toward the external sector. The Government believes that the flanking measures, already in place prior to the depreciation, allow the economy to benefit from the exchange rate action. The authorities are of course aware that flexible policies that exercise firm control over price and cost developments are necessary for this step to be effective. They are committed to such a course so as to ensure that the benefits derived from the recent devaluation are not dissipated. It is therefore expected that there will be some resumption of growth in 1983, albeit at rates still considerably below Greece's potential. Such an upturn would help strengthen the employment position, which is of concern to the authorities not only in the short run but also in the medium term. Thje restraint foreseen for wages in the current year should also materially improve the outlook in the labor market.

In sum, my authorities are in broad agreement with the staff's well-balanced appraisal. However, I have some reservations on certain views as they are presented and which are not mere points of emphasis. The staff states that monetary policy in 1982 has been accommodating. My authorities take a somewhat different view, in particular since growth in M-1 was broadly in line with the rise in nominal income. As for 1983, the monetary program envisages money supply growth that is less than nominal GNP, and a lower credit expansion in the private sector. The stance of the fiscal policy is intended to be strict enough to support a tightened incomes policy.

On the need for greater efforts to reduce the public sector and current account deficits, we fully agree with the staff. Nevertheless, in following responsible policies, the authorities believe that the approach in reducing the deficit should be gradual and over the medium term.

Finally, the additional information contained in SM/83/37, Supplement 1 demonstrates that the Government's policies brought about considerable improvement in the envisaged current account deficit. In particular, I would like to point out that the current account deficit for the year 1983 is expected to be slightly below the revised estimate of $1,897 million for the year 1982.

Mr. Moerke noted that the gap between the latest and previous consultations with Greece was nearly two-and-a-half years. There had been important developments in the economy since the previous consultation, and an earlier discussion would have been desirable.

The Government's economic policies in 1982 had been in the right direction, Mr. Moerke considered, and encouraging progress had been made in important areas. The substantial reductions in the external current account deficit and the public sector borrowing requirement and the deceleration in the rate of inflation were particularly noteworthy. However, the economic situation in Greece was still difficult, and the authorities had a long way to go to solve the problems, particularly the structural ones.

Commenting on the proposed pace of adjustment in Greece, Mr. Moerke said that the improvement expected in 1983 in the budgetary position, in inflation, and in the external current account was marginal. A gradual adjustment was certainly preferable to a shock approach, but the pace of adjustment that the authorities had in mind for 1983 seemed excessively gradual. A further comment on the medium-term targets for inflation, the budget deficit, and the balance of payments would be welcome.

The steep decline in investment activity in the previous several years was a cause for serious concern, Mr. Moerke remarked. The problem was due to a large extent to the reduction in profit margins, and the authorities' intention of relying heavily in 1983 on incomes policy to restore enterprise profitability was fully welcome. In that connection, the indexation system would not be supportive, unless it was accompanied by additional labor legislation, as had been the case in 1982.

The authorities had had remarkable success in reducing both the overall fiscal deficit relative to GDP and the public sector gross borrowing requirement in 1982, Mr. Moerke remarked. They had also had considerable success in curtailing tax evasion. However, special nonrecurrent events, such as the decline in oil inventories after the substantial accumulations in 1980 and 1981, had helped to improve the public sector finances. The authorities hoped that the substantial increase in investment expenditure in 1983 would not increase the overall government deficit relative to GDP. The restructuring of public expenditure was welcome, but it was worrying that tax revenues had risen by about 100 per cent from 1981 to 1983, and he wondered how much scope was left to squeeze more such revenues out of the economy. In the coming period, it was probably more appropriate to curtail current expenditures than to resort to further tax increases.

Monetary policy had not made a sufficient contribution to the needed adjustment, Mr. Moerke commented. In the past, monetary policy had accommodated fiscal policy; it was therefore unsurprising that the failure to bring expenditure down to the fiscal policy targets had also been accompanied by monetary growth and overshooting of the official monetary targets. Some progress had been made in 1982 in improving the institutional framework for monetary policy by transferring responsibility for monetary and exchange rate policies to the Bank of Greece. Whether the move would in fact lead to an increase in monetary control in the coming period would depend to a considerable extent on how the Government interpreted the right of the Central Bank to pursue its policy within the framework of the overall policies of the Government. The introduction in 1982 of new limits on the Government's short-term access to borrowing from the Bank of Greece was an improvement, but the limit of 10 per cent of total budgetary expenditures still gave the Government an undesirably large access to easy money; the Government would still be able to finance about 40 per cent of its deficit in 1983 through short-term borrowing from the Central Bank. The Government continued to enjoy access to the Central Bank's medium and long-term facilities.

There were about 100 different interest rates in the Greek economy, Mr. Moerke remarked. They were subject to a wide network of regulations, both on the lending and deposit sides, and were substantially below the rate of inflation. He fully agreed with the staff that there was a clear need to establish appropriate interest rate levels to help develop the financial markets and to attract both domestic savings and capital inflows. There was also a clear need to streamline the interest rate structure.

The staff and the authorities seemed to hold different views on the extent to which monetary policy was too accommodating, Mr. Moerke observed. In his view, monetary policy was accommodating fiscal policy but without being inflationary. In the second half of 1982, the authorities had successfully slowed the rate of increase in credit to the private sector while expanding public sector credit more rapidly than had been planned. He wondered whether those developments meant that finance for the private sector had been crowded out.

Commenting on external policy, Mr. Moerke said that maintaining competitiveness was crucial, particularly in the light of the substantial import penetration by the EC countries and the risk of a resurgence in imports once the Greek economy began to recover. He was uncertain whether a further depreciation of the exchange rate would be appropriate for two reasons. First, there was the problem of how to measure competitiveness on the basis of either relative unit labor costs or wholesale prices. Second, in some cases the quality and design of export products could be an obstacle to the success of an exchange rate adjustment.

The authorities took into account movements in the EC in setting the exchange rate of the drachma, Mr. Moerke continued, and he wondered whether they intended to join the European Monetary System. Finally, he agreed with the staff that the import measures should be seen as being strictly temporary.

Mr. Abiad stated that he broadly agreed with the thrust of the staff appraisal. The authorities had maintained commendable policies during the previous difficult 18-month period. While striving to reduce the various imbalances in the economy, they had initiated a number of structural adjustments that were required because of, inter alia, Greece's entry into the EC in a period of global recession and weak import demand in EC member countries. The noteworthy improvements in 1982 had included a decline in the public sector borrowing requirement relative to GNP, a deceleration in the rate of price increases, and containment of the external deficit.

He agreed with the view of Mr. Caranicas and the authorities on the appropriateness of the monetary policy that had been maintained in 1982, Mr. Abiad went on. He had noted that the 1982 ratios of domestic savings and gross investment to GNP were not reported, and it would be useful to have a comment on that problem.

Before the recent depreciation of the drachma, Mr. Abiad commented, the loss of competitiveness reflected in rising domestic unit costs had been an important factor in the persistent relatively large trade deficit. The gap between the rate of increase in unit labor costs in manufacturing and the increase in wholesale prices had been widening, and a further comment on the trend would be helpful.

The authorities were to be commended on their flexible and pragmatic exchange rate policy, Mr. Abiad considered. The latter was based on a mix of domestic demand management and direct exchange rate action. The recent exchange rate adjustment should help to restore competitiveness and alleviate the pressure on the external current account. Finally, the value of net oil imports was projected to be slightly greater in 1983 than in 1982, and he wondered whether the staff had taken full account of recent oil price developments. The proposed decision was acceptable.

Mr. Erb said that he generally agreed with the staff appraisal. Given the uncertainties in the international capital markets and the magnitude of Greece's foreign debt and borrowing requirements, the authorities should strengthen their adjustment effort, thereby shortening the expected period of adjustment. A medium-term orientation was appropriate, but it should not become an excuse for delaying adjustment, particularly in price and monetary policy. The price controls in the public sector had adversely affected the financial position of the public sector enterprises and had increased the public sector borrowing requirement. The performance of the monetary aggregates had remained excessively accommodating, and, despite selective increases in interest rates, the rates in general were still negative in real terms. The staff's description of the reform of the financial system suggested that the credit allocation system was seriously inefficient.

Two-and-a-half years had elapsed since the previous Article IV discussion with Greece, Mr. Erb noted, and he hoped that future consultations would take place on a more regular basis. It would probably be appropriate to hold consultation discussions with Greece on a 12-month cycle. Finally, he reluctantly approved the import deposit scheme requirement, but only on the assumption that the Government was committed to removing it by January 1984.

Miss Le Lorier stated that she agreed with the thrust of the staff's recommendations concerning corrective action in the various areas of weakness. However, she felt uneasy about the lack of discussion in the staff appraisal on the supply-side aspects of the economy and on the structural adjustments that were required.

Supply-side matters had admittedly not been a regular feature of Article IV consultation discussions in the past, Miss Le Lorier remarked. However, both the authorities and the staff--the latter in the appendices to its report on recent economic developments in Greece--had attached considerable importance to the supply side of the economy. Greece had undertaken to make certain changes required by its membership in the EC, and it had received substantial support in the form of net budgetary transfers from the EC budget and loans from the European Investment Bank. The detailed information reported by the staff in the appendices to its report on recent economic developments in Greece could have been usefully reflected to a greater extent in the body of the report itself. It appeared that the staff used the appendices as a discreet way of dealing with the issues concerned.

The structural adjustments would obviously have a bearing on fiscal, monetary, and exchange rate policies, Miss Le Lorier commented. On a previous occasion, Mr. Guitian had demonstrated that there was a shadowy area between demand management and structural adjustment, and that a single policy action might well affect both areas; a single policy could conceivably support one area but adversely affect the other. A government should not always give priority to speeding up adjustment through demand restraint over the adoption of appropriate supply-side measures; in some cases, the two kinds of measures could be mutually reinforcing. In Greece, for instance, she fully agreed with the staff that improved support services for marketing and organization in the export sector would be even more beneficial than demand restraint in increasing the economy's competitiveness. Some assessment of the interrelation between overall restraint and structural adjustment in the short and medium term would be helpful.

The first steps that the authorities had taken to reform the financial system were certainly welcome, Miss Le Lorier said, and additional steps were clearly needed, although the authorities had to move in stages to avoid disrupting the economy. The authorities had a somewhat different view from the staff on monetary policy in 1982. The increase in total domestic credit to the Government had exceeded the target, but by a relatively small amount in comparison with previous years, and the rate of credit expansion to the private sector was expected to remain below the target. Moreover, there had been a shift from M-1 to M-3. On the whole, the monetary results reflected some degree of success. The shift in the monetary aggregates was significant in a country where almost all savings were collected by banks and credit institutions. However, she agreed that an expansion of the nonmonetary savings instruments--led perhaps by Treasury borrowing--and a curtailment of the excessive growth of public sector credit would be helpful.

She fully agreed with the staff, Miss Le Lorier continued, that interest rates should be increased, and that the interest rate structure should be streamlined. However, selective credit policy could play a role in the structural adjustment process.

The public sector deficit should be reduced, and the financial position of the public sector enterprises should be improved, Miss Le Lorier considered. To that end, both appropriate domestic demand policies and continued structural adjustment were needed.

The staff had provided a useful analysis of the evolution of the structure of expenditure and revenues, Miss Le Lorier remarked. It was fully consistent with her belief that due attention must be paid to both the size and the composition of a fiscal deficit.

She agreed with Mr. Moerke that incomes policy had a key role to play in the Greek economy, Miss Le Lorier said. It should certainly be one of the main flanking measures of the recent devaluation. A small country like Greece had comparatively little scope for differentiated price movements. The indexation provisions for 1983 should result in a significant decline in real wages, but they should be supported by restrictive financial policies. She wondered whether the increase in labor costs could be contained by wage moderation alone; supply-side action was also needed to increase productivity in the public enterprise and agricultural sectors.

She fully agreed with the staff comments on Greece's external policies, Miss Le Lorier concluded. She hoped that the recently introduced import restrictions could be eliminated soon. Finally, the proposed decision was acceptable.

Mr. Ainley said that he too had been struck by the long interval since the previous Article IV consultation with Greece. He hoped that the interval between the present consultation and the next would be much shorter, in keeping with the newly agreed guidelines.

He generally agreed with the staff appraisal and accepted the proposed decision, Mr. Ainley continued. As Mr. Caranicas had stressed, the Greek economy was going through a difficult period. The internal and external imbalances could be traced, in part, to the problems associated with the transition to full membership in the EC. As the staff had noted, the transition was not easy, and the short-term costs were considerable. However, the benefits of membership should become evident in the medium term if the authorities made appropriate preparations, particularly on the supply side. The inclusion in the five-year plan under preparation of measures to improve investment incentives and to revitalize the export sector was encouraging.

The authorities recognized that, in the immediate future, stabilization would have to be given first priority, Mr. Ainley went on. In that connection, some progress had been made in the previous year, and the fact that the current account decifit was expected to be considerably lower in 1982 than in 1981 was particularly encouraging. Moreover, he agreed with the staff that the policies might have to be strengthened if the adjustment process was not to be unduly protracted. As Mr. Caranicas had mentioned, there was a significant distance yet to travel. The recent tightening of incomes policy was a useful first step toward limiting the increases in costs and prices, but to be effective it would have to be supported by firm financial policies designed to reduce the rate of inflation.

Restraint was particularly required on the fiscal side, Mr. Ainley said. Despite the improved budgetary performance in 1982, the public sector borrowing requirement was still large and was expected to decline only slightly in 1983. The recent moves to strengthen expenditure control and to reduce tax evasion were welcome and were clearly in the right direction. The introduction of the VAT should provide an opportunity to rationalize the present system of indirect taxation and to broaden the tax base. There was also scope to improve the performance of the public enterprises, which had been adversely affected by poor productivity, high labor costs, and inadequate pricing policies. The authorities should carry out their intention of making the enterprises more efficient and of allowing them to set more realistic prices.

On the monetary side, Mr. Ainley went on, the simplification of the complex system of credit regulation and the limitation on central bank financing of the budget deficit were welcome. They should allow the instruments of monetary policy to operate more efficiently in support of the policy of fiscal restraint.

Externally, Mr. Ainley remarked, the recent devaluation of the drachma should help to improve Greece's competitiveness, provided that it was supported by the firm domestic policies that he had described. Continued flexibility in exchange rate policy might be appropriate in view of the uncertain prospects for the external current account. It would be useful to know whether the recent EMS realignment had effected the authorities' thinking about the present stance of exchange rate policy.

He agreed with the staff that the authorities should not rely heavily on foreign borrowing, Mr. Ainley stated. If they did, their freedom of maneuver would be restricted, particularly as the debt service ratio could rise to close to 20 per cent by 1986.

The reduction in the existing import deposit requirements was welcome, Mr. Ainley said. Like the staff, he hoped that the import restrictions that had been introduced at the time of the devaluation were temporary and would be removed as soon as possible. Firm adjustment measures would be needed in 1983 and beyond to prepare the economy for full membership in the EC and to provide the basis for achieving the authorities' medium-term goals.

Mr. Portas said that, in the face of the weakening of economic growth and the deterioration in the external position, the new Government had correctly given a high priority to stabilizing the economy in order to create a solid basis for achieving structural adjustment in the medium term. Preliminary estimates indicated that in 1982 positive steps had been taken to reverse the weakening trend observed in the previous two years; the authorities had clearly made progress despite the difficult external economic environment: GDP in real terms had increased slightly, the rate of inflation had decelerated to 21 per cent, and the external current account had declined to 5 per cent of GDP. Nevertheless, unemployment had continued to rise, and industrial production had further declined as a result of, inter alia, the increase in unit labor costs. Real private investment in 1982 had decreased by 5.4 per cent; however, the decline had been smaller than in the previous two years. Investment in equipment and machinery had increased, while investment in housing had continued to decline, although at a slower pace than in recent years. Apparently the fiscal and credit measures maintained by the authorities since the beginning of 1982 had helped to encourage private investment activity. Private investment also seemed to have benefited from the increase in public investment.

On the supply side, Mr. Portas went on, industrial output, and especially the rate of growth in the manufacturing sector, had continuously declined during the previous four years, and a negative rate had been recorded in 1982. Import penetration resulting from Greece's full membership in the EC partly explained the decline in manufacturing production in the recent past, but the country's competitive position had weakened following the appreciation of the real effective exchange rate in 1981 and 1982. To reverse the loss of competitiveness, and as part of their determined effort to make further progress in adjusting the economy, the authorities had devalued the drachma in January 1982.

A flexible attitude toward exchange rate policy, Mr. Portas went on, together with a continued effort to improve the public finances and to strengthen monetary policy would be needed if the progress that had been made in adjusting the economy in 1982 was to be sustained in the coming several years. The substantial reduction in the public sector borrowing requirement in 1982 constituted an important fiscal adjustment. Although no major fiscal measures were included in the 1983 budget, the authorities had indicated their intention of introducing additional measures if the public finances did not improve as planned. More attention was to be given to maintaining flexible pricing policies to improve the financial position of the public enterprises, and an important investment program was to be implemented in 1983. In the monetary policy area, the elimination of the Currency Committee and the introduction of limits on the Government's access to the Bank of Greece in 1982 were welcome, but further steps were needed, especially increases in interest rates to improve the efficiency of the credit system and strengthen the balance of payments.

The emphasis to be given to further tightening incomes policy in 1983 was appropriate, Mr. Portas considered. The emphasis on low-income groups was consistent with the objective of making the distribution of income more equitable. At the same time, the indexation mechanism, which provided only partial compensation for increases in the cost of living, should help to contain the rise in real wages, thereby making an important contribution to cutting the labor costs that had contributed to the deterioration in Greece's competitive position in previous years.

He agreed with the authorities that the present gradual pace of adjustment was adequate, Mr. Portas said. Although the authorities fully recognized that greater effort was needed to eliminate the structural imbalances that had considerably strained the economy, a more rapid pace of adjustment could be achieved only at a high cost in terms of slower economic activity and rising unemployment. Finally, the proposed decision was acceptable.

Mr. Taylor remarked that there had been a long gap between the present and previous Article IV consultations with Greece. At the present stage, it was more necessary than ever for the Fund to maintain surveillance over small and large industrial countries. There were of course constraints on the human resources of the Fund, and they should be kept in mind during the coming discussion of the Administrative Budget.

He strongly agreed with the thrust of the staff appraisal, Mr. Taylor continued. Although progress had been made in reducing both the rate of inflation and the current account deficit in 1982, there was clearly scope for further improvement. The Government's strong effort to solve the problems facing the economy would have to be continued in the coming period. The staff and Mr. Caranicas apparently held somewhat different views on monetary policy in Greece. In his view, the fact that the growth of M-1 in 1982 had been broadly in line with the rise in nominal income was not fully convincing evidence that the policy had been right. It probably would have been preferable for the growth of M-1 to have been slightly slower than the rate of increase in nominal income. In any case, a strong case could be made for raising interest rates.

He fully agreed with the staff on the need to improve control over the size of the public sector borrowing requirement, Mr. Taylor continued. He was glad that the authorities intended to adopt additional measures if the developments in public finances turned out to be less favorable than the authorities hoped.

The incomes policy obviously played a leading role in the effort to reduce inflation in Greece, Mr. Taylor remarked, but he agreed with the staff that it would have to be supported by stronger financial policies. The proposed indexation arrangements would cover the civil service but not the rest of the economy, and he wondered whether there was not some danger of considerable slippage occuring at a time when real wages were under pressure.

The authorities' intention to maintain a flexible attitude toward the exchange rate was welcome, Mr. Taylor stated, and the staff's recommendation for temporary approval of the import deposit requirement was acceptable. The Government had made progress toward abolishing the practice, as was required by the Treaty of Access to the European Communities. The authorities had another nine months to eliminate the practice, but they should act earlier, if possible. The Government, with the approval of the EC, had recently imposed restrictions on imports from other EC members. Those restrictions were intended to be temporary, and the authorities should be urged to remove them as soon as possible.

Membership in the EC would probably continue to have a considerable impact on Greece's current account as a result of the increased import penetration and the substantial transfer flows to the economy from the rest of the EC; a somewhat more detailed discussion of the policy implications of that aspect of the economy would have been welcome, Mr. Taylor concluded. The authorities should take every opportunity to adjust to the accession to the EC by strengthening their adjustment effort rather than by relying on financial support from other EC member countries. He agreed with the staff that, if the adjustment was excessively slow, there was a significant risk that Greece would incur an uncomfortably large debt burden. An adequate inflow of financial support for the balance of payments might well be possible at the present stage, but it might not always be so relatively easy in the coming period. At some point in the future, the authorities might find it difficult to be able to cushion the economy from unexpected developments abroad, particularly in view of the current financial environment and the rather modest level of reserves. He hoped that the authorities would be able to strengthen their policies in response to unexpected external factors and domestic inflationary pressures.

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

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/83/52 (3/23/83) and EBM/83/53 (3/23/83).

3. GRENADA - EXCHANGE SYSTEM

The approval of Grenada's multiple currency practice under Decision No. 7219-(82/131), adopted September 30, 1982, is extended until September 30, 1983, or the completion of the next Article IV consultation with Grenada, whichever is the earlier. (EBD/83/72, 3/17/83)

Decision No. 7371-(83/52), adopted
March 22, 1983

4. ASSISTANTS TO EXECUTIVE DIRECTOR

The Executive Board approves the appointments set forth in EBAP/83/83 (3/18/83).

Adopted March 22, 1983

5. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 82/129, 82/130, and 82/132 are approved. (EBD/83/68, 3/15/83)

Adopted March 21, 1983

6. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/83/84 (3/22/83) is approved.

APPROVED: August 25, 1983

LEO VAN HOUTVEN
Secretary