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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 83/53

3:00 p.m., March 23, 1983

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

Executive Directors	Alternate Executive Directors
A. Alfidja	J. Bulloch, Temporary
J. de Groote	A. Le Lorier
A. Donoso	T. A. Connors, Temporary
M. Finaish	I. R. Panday, Temporary
	H. Suzuki, Temporary
	G. W. K. Pickering, Temporary
	J. R. N. Almeida, Temporary
	W. Moerke, Temporary
G. Lovato	C. P. Caranicas
	A. S. Jayawardena
	S. El-Khouri, Temporary
	T. de Vries
	K. G. Morrell
G. Salehkhou	O. Kabbaj
	E. I. M. Mtei
	E. Portas, Temporary
T. Tvedt	Wang E.

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

<u>Also Present</u>
European Department: B. Rose, Deputy Director; B. Christensen, W. E. Hermann, R. P. Hicks, H. Ungerer, H. Vittas. Exchange and Trade Relations Department: S. Mookerjee, Deputy Director. Legal Department: J. K. Oh. Advisors to Executive Directors: S. R. Abiad, J. Delgadillo, L. Ionescu. Assistants to Executive Directors: G. Ercel, J. A. K. Munthali, V. K. S. Nair, J. G. Pedersen, C. A. Salinas.

1. GREECE - 1982 ARTICLE IV CONSULTATION

The Executive Directors continued from the previous meeting (EBM/83/52, 3/23/83) their consideration of the staff report for the 1982 Article IV consultation with Greece (SM/83/37, 2/23/82; 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. de Groote said that he agreed with the staff that the adjustment policies were broadly appropriate. The key question was whether the pace of adjustment was excessively gradual. The present policies did not ensure that the public sector and current account deficits would be sufficiently reduced by 1985, when Greece would no longer enjoy the benefits of the transitional arrangements for entry into the EC. In particular, Greece had had to deal with structural weaknesses, such as the size and composition of the agricultural sector and the weak industrial base. The staff conclusion that, at least in the initial stage, Greek imports would increase much more strongly than exports as a result of EC membership, underscored the urgent need to speed up the adjustment effort. He strongly agreed with Mr. Caranicas that the pace of adjustment would be critical, especially as the authorities wished to ensure that the external imbalance should not cause a serious foreign debt burden.

The unexpectedly favorable balance of payments developments in 1982, Mr. de Groote continued, had been due mainly to the larger than projected decrease in imports. At the same time, exports had also declined, to about the level of 1980, as a result of the lack of competitiveness. Did the staff expect the trend to be reversed as a result of the January 1983 devaluation of the drachma?

Fiscal policy had been supportive of the adjustment effort, Mr. de Groote noted, as the Government had increased revenues, curtailed tax evasion, and adequately controlled expenditure. However, more emphasis would have to be placed on increasing the efficiency of public sector enterprises.

The authorities' plan to reform the financial system was welcome, Mr. de Groote went on, but apparently they did not intend either to free interest rates or to make them more flexible; they had given priority to controlling credit allocation and hoped to meet the needs for investment and working capital by small and medium-scale enterprises by giving them access to commercial bank lending at subsidized interest rates. Providing encouragement to small and medium-size firms would certainly have social and political benefits, and domestic and external competitiveness might also be improved. However, since interest rates would essentially be set administratively, additional information on how the authorities expected to monitor exchange rate behavior would be helpful.

The situation in Greece was similar to that in France, Mr. de Groote remarked. Both Governments had come to power expecting to introduce drastic changes in the economy, and both had eventually accepted adjustment policies that were different from those initially envisaged. The Greek authorities were to be highly commended for having acted courageously to make the needed adjustments instead of moving in a direction that would have been impossible to maintain.

The staff representative from the European Department noted that more than two years had passed since the previous consultation with Greece. Apart from staffing problems, the main difficulty had been that a new administration had come to power in late 1981, and changes had been made in virtually all the senior positions. Many persons from outside the Government and the civil service had been brought into the new administration, which had felt that it needed time to work out its significant changes in policy. However, the authorities agreed with the staff that more frequent consultations should be held in the future, and the staff expected to hold the next consultation within 12-15 months.

It had been implied, the staff representative recalled, that the appendices had been used as a discreet way of dealing with certain issues. Consultation discussions typically centered on the shorter-term aspects of economic policies that were routinely highlighted in staff reports. A report on recent economic developments was meant to give a clear picture of developments in the period covered by a consultation. Any appendices that were also included were meant to give special emphasis to topical questions that could not be sufficiently underscored in the body of the report on recent economic developments. Appendices could also be used to deal with the questions that, for one reason or another, deserved in-depth examination. Staff reports sometimes contained references to medium-term problems, but the Five-Year Plan for Greece had been under preparation at the time of the staff visit, and the staff had felt that it would have been premature to deal with structural problems in detail in the staff report or in the body of the report on recent economic developments. He agreed with Executive Directors that structural matters should be seen in relation, inter alia, to shorter-term demand management policies. The staff hoped to be able to discuss the Five-Year Plan with the authorities in greater detail during the next consultation and thereafter to report on it in more detail.

The new Government had begun its term with a three-stage strategy, the staff representative noted. The first stage was designed to meet election commitments to reducing social and political inequities. However, with the formulation of the 1982 budget, in early 1982, the authorities had recognized the need to give priority to stabilizing the economy. The stabilization effort--the second stage of the strategy--was seen not only as a means of coping with short-term problems, but also as a necessary part of the effort to establish the basis for the third stage, the restructuring of the economy under the Five-Year Plan. The authorities were convinced that it would be futile to undertake a major restructuring effort starting from a position of domestic and external weakness. A number of problems had already been tackled through the initial policy steps taken by the authorities, such as the reorientation of credit allocation to specified sectors, such as housing, whose performance had been weak, and small business and manufacturing. Another example was the reform of the financial system, an element of which was the effort to raise interest rates to more realistic levels by making them less negative in real terms.

The tax increases should not be seen as merely a short-term means of balancing the budget, the staff representative went on. They were in fact part of the medium-term strategy. In the past, taxation had been centered on dependent wage-earners, and many independent self-employed people had managed to evade taxes. It was imperative to tackle that problem both to enhance social equality and to increase the relative efficiency of the various sectors. As a result, tax evasion was one of the targets under the medium-term structural policy. Similarly, the forthcoming introduction of the value-added tax would shift the emphasis in taxation from investment and exports toward consumption, thereby making a contribution to the restructuring of the Greek economy.

The staff reports showed the emphasis being placed on increasing public investment in 1982 and 1983, the staff representative commented. The approach to investment was a broad one. The Government also intended to encourage private investment by providing subsidies and other incentives in certain areas. The success of that effort would be assessed in future consultation reports.

The available information on the savings ratio and the ratio of investment to GNP was fragmentary, and all of it had been reported by the staff, the staff representative said. As for the incomes policy, since the completion of the consultation discussions in Athens, the authorities had made the policy obligatory for all sectors of the economy. There was reason to hope that the policy would be strictly adhered to: the trade unions were keenly aware of the problem of rising unemployment, while the enterprise sector fully appreciated that profits would be adversely affected by excessive wage hikes. There was, of course, a negative medium-term aspect, namely, how the chosen method of indexation would affect work incentives. That issue had not been discussed in the staff reports, because the time elapsed since the implementation of the new incomes policy had been too short to allow conclusions to be drawn, but it had been alluded to in the staff's discussions with the authorities.

Commenting on the public sector finances, the staff representative said that the increase in tax receipts had been only one of the intended results of the newly introduced taxes. The main objective had been to broaden the tax base. The authorities had indicated that, if additional action were needed in the area of public finances in the coming period, emphasis would probably be placed on expenditure constraint rather than on further tax increases, a view that the staff had fully endorsed.

As some Executive Directors had noted, the staff representative continued, pricing policy had adversely affected the performance of the public enterprises. In that connection, however, it was important to differentiate between the operational aspects of public enterprises and the medium-term policies designed to strengthen them. A large portion of the overall deficit of the public enterprise sector had been caused by the increase in investment by the enterprises. The Government was keenly aware of the need to improve the efficiency, and to reform the pricing policy, of the public enterprises. Since the mission had returned, there had been increases in a number of public enterprise prices and tariffs, particularly in the price for oil products and in the tariffs for such services as telephones, transportation, and electricity.

Monetary policy in Greece, the staff representative explained, was characterized by two important aspects. The first had to do with the overall control of liquidity through various instruments, such as the reserve requirement. The second had to do with the sectoral distribution of credit. For a number of good reasons, there was a strong tradition in Greece of encouraging financial flows to the sectors of the economy that, in the eyes of the authorities, deserved support, and particularly to export-oriented and growth-oriented industries. The problem with the approach was that it was relatively inflexible. In the past, the Currency Committee--which had recently been abolished--had been the main institution responsible for credit and monetary policy, and the revision of policy had often been a slow process. The staff hoped that the new reforms in the financial system would make implementation of the policy more efficient than it had been in the past.

Commenting further on the macroeconomic aspect of monetary policy in Greece, the staff representative said that there was little room for a genuinely independent monetary policy, because the shape of the policy depended largely on the financing needs of the public sector. There were virtually no capital markets in Greece, and the financing need of the public sector had to be met either by the Bank of Greece, as had been the case in the past, or by the commercial banks on the basis of certain regulatory arrangements. There were simply no regular means of allocating credit on the basis of market forces. However, the authorities were attempting to reform the system by introducing ceilings on certain types of central bank credit to the public sector. There were limits on Treasury bills that could be purchased directly by the Central Bank. Those limits were not prescribed by law; they had been decreed by the General Counsel of the Bank of Greece and could conceivably be increased in the future. There were no ceilings on long-term credit by the Central Bank to the Government. However, there was a limit on short-term advances, and, in making recourse to the Central Bank, the Government would have to pay relatively high interest rates; the Greek authorities hoped that the high rates would inhibit attempts by the Government to use the credit facilities of the Bank of Greece. In any event, the Government itself recognized the need to give the Central Bank more independence, something that would enable the institution to move beyond the reforms implemented in 1982.

The 10 per cent ceiling on short-term advances of the Central Bank to the Government was a cumulative ceiling, the staff representative explained. At present, the room for advances had been largely used up by the Government. The ceiling had proved, and should continue, to be an effective one.

Under the secondary reserve requirement in Greece, the staff representative said, banks were obliged to deposit 37 per cent of their deposits with the Bank of Greece to meet the Government's need for Treasury bills. However, those deposits were not automatically placed at the disposal of the Government. Rather, any request by the Government for Treasury bills was met out of the deposits. At present, the amount of Treasury bills issued by the Government, and taken up by the Bank of Greece against the deposits, was below the ceiling. Hence, the secondary reserve requirement served two purposes, namely, as an instrument for securing financing for the Government, and as an instrument for controlling liquidity creation in the economy. In sum, there was little room for an independent monetary policy in Greece. The Government determined the basic line of fiscal policy, and monetary policy was essentially fitted to it.

The answer to whether or not monetary policy had been accommodating, the staff representative remarked, was to some extent a definitional one. The rate of increase in M-1 had been broadly in line with the growth of GNP and thus had not been accommodating. However, the rate of growth of M-3 had increased much more rapidly than the growth of M-1 in 1982, probably because of the sharp increase in private savings; in that context, monetary policy had been accommodating. Account should also be taken of the external sector, which had recorded a small deficit in 1982. The question naturally arose whether it was the creation of money in the economy that had created the external deficit, or vice versa. The staff preferred to examine the pattern of credit expansion in the domestic economy. The rate of increase in domestic credit had exceeded the target, which itself exceeded the rate of growth in nominal GNP. Credit expansion to the private sector had remained within the target, but that fact merely implied that there had been a relatively rapid increase in credit to the public sector, something that underscored the point that monetary policy in Greece was largely dependent on developments in the public finances. Given the recession in the private sector in the recent past, there had been no crowding out of that sector. However, the staff doubted somewhat whether private sector credit had been allocated to the appropriate productive groups; for instance, there had been little extension of credit to manufacturing enterprises, which had fared badly in 1982. It was conceivable that, in the coming period, if the public sector were unable to meet its objectives and increase its share of available financing, the private sector could be crowded out, and the achievement of the overall monetary targets could be endangered.

The staff had found it relatively difficult to determine precisely the desirable size of a devaluation in Greece, the staff representative remarked, because of statistical deficiencies in certain areas. For instance, unit labor costs were available only for the manufacturing sector, which was relatively small, and manufacturing production was intended mainly for export. No information was available on the effects of the exchange rate on tourism or other relevant sectors of the economy. Unit labor costs gave an indication, but should not be taken as a precise measure, of the appreciation of the currency and the need for a devaluation. Similarly, as a rule there were problems with using wholesale prices as an indicator of the precise need for a devaluation. In Greece, in particular, the close monitoring of price developments probably had the effect of preventing wholesale prices from fully reflecting the underlying inflationary trend. The authorities had relied on their intuition in choosing the percentage rate for the devaluation.

The question had been raised, the staff representative recalled, whether the devaluation had been sufficient to deal with the problem of Greece's competitiveness. In that connection, the quality of exported goods and the structure of the manufacturing sector were particularly important, and there were difficulties in both areas. In addition, the Greek economy was relatively small and could produce only a limited range of goods, some of which--such as textiles and shoes--were especially vulnerable to external developments. Many Greek exporting enterprises were relatively small and found it difficult to compete with larger enterprises in other countries. Those qualitative problems of competitiveness could be dealt with only in the medium term in the context of the authorities' structural adjustment efforts.

The official import projections for 1983 contained in the staff report had been made in December 1982, the staff representative explained. No new projections had been made. However, the staff had been informed by the Greek authorities that the preliminary indications were that the projected deficit for the trade account and the current account in 1983 were to be revised downward, partly because of the lower import prices, particularly the price for oil.

Greece was not a member of the European Monetary System, the staff representative commented. At the present stage, the authorities were not contemplating joining the EMS, as they felt that the country's price performance and its ability to export and substitute for imports should be improved first. However, the exchange rate policy was oriented toward the EC--which affected all members of the EC as well as the participants in the EMS--in recognition of the fact that exchange rate policy in Greece had to take into account developments within the EC. It was difficult to know precisely how the recent realignment of rates within the EMS had affected Greece. The drachma was not pegged or institutionally related to the EMS; it was pegged to the U.S. dollar, and the impact of the EMS realignment would depend entirely on the movement of EMS currencies against the dollar. For instance, a weakening of the Italian lira against the U.S. dollar could conceivably create problems for Greece in the field of tourism. On the other hand, there was some question whether Greece directly competed with Italy in tourism. After all, in absolute terms, tourism in Greece was much smaller than tourism in Italy, although tourism was relatively important in the context of Greece's economy, and Greece apparently appealed to different tourists from those who tended to visit Italy. It could be argued that Greece competed more directly with Yugoslavia and Cyprus than with Italy in the tourist field.

Membership in the EC had structural implications for the Greek economy, the staff representative from the European Department concluded. Greece's small enterprises had found it difficult to compete with the larger enterprises in other EC countries, and there had been considerable import penetration. At the same time, Greek industry could make only a relatively small range of goods available to other EC countries. However, membership in the EC brought to light more clearly the inherent structural problems facing the Greek economy and underscored the need to deal with them if Greece was to compete successfully within the EC and in the larger international environment. On the other hand, membership in the EC was beneficial for Greece in financial terms, as it involved both transfers under the Common Agricultural Policy and access to various credit facilities like the European Investment Bank. The EC also had facilities to provide balance of payments assistance to members if needed. Membership in the EC forced the Greek authorities to monitor exchange rate developments more carefully than they had in the past.

The Chairman remarked that, as a general rule, the Fund should try to maintain a regular yearly cycle of consultations with member countries. The average consultation cycle had slipped from 18.5 months in 1981 to 21.5 months in 1982, an unfortunate development, given the variety of important developments that the Fund should have been surveying in 1982. Moreover, the consultation cycle with some countries had been even longer than 21.5 months. Management had recently adopted the following three broad categories of member countries for which a one-year consultation cycle should be maintained: countries that had a substantial impact on other countries on either a global or a regional basis; countries that were implementing a Fund-supported program; and countries whose economic situation required careful scrutiny by the Fund, including countries characterized by a significant balance of payments disequilibrium, significant external borrowing, or a significant reduction in reserves for the financing of the balance of payments; and countries that maintained or introduced restrictions for balance of payments purposes or had an inadequate exchange rate. Those categories would entail some increase in staffing, as was reflected in the proposal in the new budget for increasing the number of staff in the various area departments.

Mr. Caranicas explained that for various reasons there had been several delays in the latest consultation with Greece. He hoped that a regular pattern of consultations on a cycle of 12 to 18 months at most could be established in the future.

It had been said that the pace of adjustment of the current account deficit and the public sector borrowing requirement had been fairly slow, Mr. Caranicas remarked. That might be true; but the pace was a function of both political considerations and economic necessity. The authorities had taken the unpopular decision of implementing a courageous incomes policy, the politically acceptable limits to which had probably been reached. The emphasis of economic policy was on increasing productivity as an essential condition to reducing costs, thus making Greece's products more competitive in the export markets, which were contracting at present, and avoiding a rapid rate of increase in unemployment.

Monetary policy had been fully explained by the staff, Mr. Caranicas noted, and he would only add that the abolition of the Currency Committee had strengthened the position of the Central Bank. As a result, the Central Bank of Greece was somewhat more independent than, say, the Bank of France, and somewhat less independent than, say, the Bundesbank. The Prime Minister of Greece favored a strong Central Bank and had called for the abolition of the Currency Committee in his pre-election statements. Before the Committee's abolition, the state had been able to finance subsidies and losses of public enterprises through nearly unlimited access to the Central Bank. That access was limited under the new arrangements; for instance, no more than 10 per cent of total government budgetary expenditures could be financed by the Bank of Greece.

In Greece, as elsewhere, the role of public enterprises was a controversial issue, Mr. Caranicas commented. The prices and tariffs of those enterprises, particularly of the public utilities, had recently been increased, despite the obvious political cost, and the authorities attached great importance to bringing in new managerial talent. It was difficult to reduce the work force of the enterprises, particularly in a period of high unemployment, but attrition was occurring, and improvements in management were being made.

The decision concerning import restrictions, like the decision concerning the devaluation, Mr. Caranicas continued, was a necessary part of the overall effort to increase the competitiveness of Greek goods on both the domestic and international markets. It was a response to the decline in exports and the surge in imports, particularly from Greece's EC trade partners. The rapid rise in imports had clearly contributed to the decrease in local production and the increase in unemployment. The timetable for eliminating the import restrictions depended greatly on developments in a number of areas, including domestic production, employment, and trade.

Many of the difficulties facing the economy, Mr. Caranicas said, were related to Greece's accession to the EC. Much of the country was still underdeveloped, and Greece could hardly have joined the EC at a more difficult time for all of its members. The structure and developmental stage of the Greek economy differed markedly from those of the EC countries, and the special features of the Greek economy as a Mediterranean country hampered its smooth functioning within the framework of the EC. The substantial import penetration in Greece was the most obvious negative effect on its status as the economically least developed member of the Community. Greece had responded by attempting to improve productivity, but the continuing problems had led the authorities to submit a memorandum in March 1982 to the Commission of the European Communities, noting the problems facing all the members of the EC and the handicaps facing the Greek economy as a new member of the group. The memorandum requested modifications in the transitional arrangements under the Treaty of Accession, and the final recommendations of the EC Commission were to be submitted by end-May 1983. The authorities expected that by the end of the year the Greek economy would be in a more favorable position, as a result of the incomes policy and the resumption of economic growth in the United States and, subsequently, in Europe.

Commenting on the effect of the EMS exchange rate realignment on Greece, Mr. Caranicas said that there had been no effect except perhaps a psychological one. Some of the devaluations resulting from the EMS realignment had involved countries much stronger economically than Greece, thereby placing Greece's devaluation of the drachma in a more favorable light.

As Mr. de Groote had noted, Mr. Caranicas concluded, the leaders of Greece, like those of France, had had to apply their economic and social program more gradually than they had originally intended. For the time being, the authorities' approach to policy implementation was a pragmatic one which, once the shorter-term demand management policies had had their effect, would permit the full application of the social and economic reforms that had originally been conceived.

The Chairman made the following summing up:

> Directors welcomed the intention of the new Government to give high priority to domestic stabilization. They agreed with the authorities that strengthening the public finances was essential if the Government's objectives were to be achieved. While noting that in 1982 the objective of bringing down the budgetary deficit relative to GNP was broadly realized, some Directors were concerned that progress in this area may not have been sufficient, particularly in view of the fact that the 1982 outcome was influenced by special factors. This concern was reinforced by the continuing expansion of the deficits of the public enterprises and the deteriorating situation of the public entities. It is thus critical that public enterprises make every effort to improve cost performance and not be constrained, as was the case in 1982, in their ability to pass on cost increases to prices for their products.
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> Directors therefore welcomed the objective to reduce the public sector borrowing requirement relative to GNP in 1983. However, several Directors noted with concern that the public sector deficit--which, at about 15 per cent of GNP, was at an unsustainably high level--was expected to rise significantly in 1983 in absolute terms. This casts some doubt on the firmness of the fiscal stance.
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> A firm fiscal policy would be essential to ensure the success of the tightened incomes policy for 1983. Directors strongly endorsed the restraint inherent in this policy and considered it imperative that the objective of a significant cut in wages and salaries in real terms be realized. Such an outcome would help to improve the competitive position of the

economy on the domestic side and would facilitate the task of adjustment stemming from Greece's accession to the European Communities.

More generally, most Directors considered it important that, given the size of the imbalances, the pace of adjustment in the economy should be stepped up.

Directors noted that the sharp expansion of the monetary aggregates over recent periods was due chiefly to the strong demand for credit from the public sector and felt that this reinforced the case for fiscal restraint. They noted the authorities' aim to keep the rate of expansion of M-1 in 1983 below the growth rate of nominal GNP. There was a discussion on whether or not monetary policy had been accommodating in 1982. The majority of speakers felt that it was accommodating.

Directors noted the recent progress made in reforming the institutional framework for monetary policy, but some Directors felt that further reforms were necessary, especially in order to make interest rates more realistic and to streamline interest rate regulations.

The authorities' desire to strengthen the infrastructure of the economy was appreciated by Directors, especially in view of the present weaknesses in that area and the new competitive environment due to Greece's accession to the EC. An important challenge for the authorities was to make progress in infrastructural development without complicating the task of domestic and external stabilization.

The requirement to strengthen the supply side of the economy was stressed, and it was mentioned that short-term aspects of demand management should not blur the need to restructure the economy over the medium term.

Directors considered that the devaluation of the drachma against the U.S. dollar by 15.5 per cent in January 1983 was an appropriate step, given the significant effective appreciation of the drachma in real terms over recent periods. Directors welcomed the authorities' flexible attitude toward exchange rate policy and emphasized the need for appropriate flanking measures to ensure its effectiveness. They urged the authorities to keep foreign borrowing at a sustainable level. To do so, it was essential to achieve a reduction in the current account deficit. In this respect, Directors considered that the significant decline in the balance of payments deficit in 1982 was an encouraging development but pointed out that temporary factors were involved and that serious underlying imbalances remained.

Directors urged the authorities to terminate the recently imposed import restrictions at an early date.

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

The decision was:

1. The Fund takes this decision relating to Greece's exchange measures subject to Article VIII, Sections 2 and 3, and in concluding the 1982 Article XIV consultation with Greece, in the light of the 1982 Article IV consultation conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund notes the reduction in the existing import deposit requirements (as described in SM/83/44) since the last Article IV consultation and the intention of the Greek authorities to abolish the system on January 1, 1984. In the circumstances of Greece, the Fund grants approval of the resulting exchange restrictions until January 1, 1984, or the completion of the next Article IV consultation, whichever is earlier.

Decision No. 7372-(83/53), adopted
March 23, 1983

APPROVED: August 26, 1983

LEO VAN HOUTVEN
Secretary