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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 83/89

10:00 a.m., June 22, 1983

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

Executive Directors	Alternate Executive Directors
	M. K. Diallo, Temporary
	G. Ercel, Temporary
	P. D. Péroz, Temporary
	C. A. Salinas, Temporary
R. D. Erb	J. C. Williams, Temporary
	M. B. Chatah, Temporary
	Jaafar A.
	T. Yamashita
R. K. Joyce	D. I. S. Shaw, Temporary
	J. R. N. Almeida, Temporary
G. Laske	
	C. P. Caranicas
	A. S. Jayawardena
	S. El-Khouri, Temporary
	A. Halevi, Temporary
	K. G. Morrell
G. Salehkhou	O. Kabbaj
	E. I. M. Mtei
	J. L. Feito
	J. G. Pedersen, Temporary
	C. Taylor
	M. Hull, Temporary
	Wang E.

J. W. Lang, Jr., Acting Secretary
S. Fennell, Assistant

Also Present

African Department: N. Abu-zobaa, R. W. Eglin, P. D. Mortimer-Lee. Asian Department: N. Neiss, Deputy Director; J.-P. C. Golle, H. C. Kim, F. Le Gall. Exchange and Trade Relations Department: D. K. Palmer, Associate Director, W. A. Beveridge, Deputy Director; R. Johnson, S. Kanesa-Thasan. External Relations Department: H. P. Puentes. Fiscal Affairs Department: G. Blöndal, J. R. Modi. IMF Institute: C. Holder, Participant. Legal Department: Ph. Lachman, J. M. Ogoola, J. K. Oh. Research Department: L. Alexander, K.-Y. Chu, L. U. Ecevit, N. M. Kaibni, E. C. Meldau-Womack. Secretary's Department: A. P. Bhagwat. Western Hemisphere Department: S. T. Beza, Associate Director; O. Gronlie, D. C. Ross, S. J. Stephens, E. S. Williams, J. E. Zeas. Personal Assistant to the Managing Director: N. Carter. Advisors to Executive Directors: C. J. Batliwalla, S. M. Hassan, H.-S. Lee. Assistants to Executive Directors: R. Bernardo, C. Flamant, H. Kobayashi, M. J. Kooymans, P. Leeahtam, W. Moerke, J. A. K. Munthali, V. K. S. Nair, Y. Okubo, G. W. K. Pickering, E. Portas, Shao Z.

1. BARBADOS - 1983 ARTICLE IV CONSULTATION, AND REVIEW UNDER STAND-BY ARRANGEMENT

The Executive Directors considered the report for the 1983 Article IV consultation with Barbados and a review under the stand-by arrangement (EBS/83/109, 5/26/83; and Sup. 1, 6/21/83). They also had before them a report on recent economic developments in Barbados (SM/83/82, 5/19/83).

Mr. Joyce made the following statement:

My Barbados authorities have asked me to express their appreciation to the staff for the excellent work on the 1983 Article IV consultations and for its help in developing the proposed 1983/84 program under the current stand-by arrangement. They agreed generally with the staff's conclusions.

Despite somewhat more difficult economic circumstances than originally anticipated, Barbados has persisted in its adjustment efforts and, to date, has met the performance criteria under the 20-month stand-by arrangement approved by the Board last October. The Government believes that the criteria contained in these new proposals for 1983/84 are attainable, and indeed most of the policy actions necessary to ensure their achievement have been taken.

Recent developments

Barbados enjoyed a rapid rate of growth in the latter part of the 1970s, but the number of tourists fell as the recession began to take hold in the industrial countries in 1980. In 1981 these problems were compounded by a reduction in sugar production, and real GDP actually declined for the first time in many years. These developments were accompanied by a worsening of the balance of payments induced in part by continued excess demand and growing imports.

The authorities were aware that overly expansionary fiscal and credit policies were partly responsible for the situation, and in the second half of 1981 and again early in 1982 moved to tighten demand management through new revenue measures, reduced capital outlays, and more restrictive credit policies. These efforts were reinforced by measures in the 1982/83 budget.

Economic performance, however, continued to weaken in 1982, and it now seems clear that the fall in real GDP was much more severe than even the Government had anticipated. Real value-added by tourism contracted by 14 percent and sugar production was off by 17 percent. There was some easing in the rate of inflation, but unemployment rose sharply. In the summer of 1982, Barbados negotiated a stabilization program with the Fund, designed to reverse the deterioration in the state of public finances and in the balance of payments. The program aimed at

reducing the overall fiscal deficit of the general government from 6.6 percent of GDP in fiscal year 1981/82 to 3.5 percent in 1982/83 and to 1.8 percent in 1983/84. It was also hoped to bring down the current account deficit of the balance of payments from 10 percent of GDP in 1982 to 7.2 percent in 1983 and to 5.2 percent in 1984.

In the event, the overall fiscal deficit, at 3.8 percent of GDP in 1982/83, was slightly larger than projected, chiefly because of the Government's purchase of a privately owned oil company. Excluding this transaction, the overall deficit would have been only 2.7 percent of GDP. Nonetheless, despite this development, the Government's borrowings from the domestic banking system were substantially lower than permitted under the program. In addition, the reduction in overall credit expansion was more pronounced than projected. Barbados also managed to achieve a greater reduction in the current account balance of payments deficit than originally envisaged, and there was a sharp reduction in the overall payments deficit.

Proposed program

The targets and criteria for 1983/84 were framed in the light of prospects for little or no real growth in the current year and for only a moderate pickup in 1984. These forecasts may be conservative. But it is assumed that manufacturing output will decline in 1983/84 and that growth in tourism and in the sugar sector will be fairly modest. Moreover, construction is unlikely to provide much support for economic activity. This should enable Barbados to hold domestic inflation in the 8-10 percent range, but it will lead, at least temporarily, to higher unemployment.

The authorities in Barbados believe that the island's economy is basically sound, that the present development strategy is well founded, and that policy must continue for now to aim at protecting the balance of payments situation and creating a stable base for the achievement of sustainable economic growth in the medium term. The Government is also committed to taking measures to improve the efficiency of the economy so that Barbados will be better positioned to benefit from the upturn in the world economy.

The Government's fiscal policy for 1983/84 aims at holding the overall deficit to 2.3 percent of GDP. This will be achieved through continued expenditure restraint and improved revenue performance. The budget of April 27, 1983 contained additional revenue measures, and further improvements are looked for from further upgrading of the tax collecting machinery. On the expenditure side, the Government intends to extend the existing freeze on public sector employment, to reduce government transfers to certain nonfinancial public enterprises, and to allow a minor increase

at most in capital expenditures so that certain large capital projects can be completed. The budget provided for an across-the-board public sector wage increase of 2.5 percent, and this combined with automatic increments will raise the public sector wage bill by 5 percent in 1983/84. These additional wage costs are more than provided for by the additional revenue-raising measures incorporated in the 1983 budget. After allowing for offsetting tax credits and some reductions in consumption duties and marginal rates of income tax, the 1983 tax package will yield net revenues equivalent to 1.2 percent of GDP.

The Government considers that wage restraint is critical to the success of the program. All wage contracts to be negotiated in the public sector in 1983 will be guided by the terms of the Central Government's wage settlement which took effect in 1982. The authorities will continue to stress the need for similar wage restraint in the private sector.

The Central Bank will continue to pursue careful monetary policies which will permit a prudent increase in the net domestic assets of the monetary authorities and a further reduction in the level of central bank lending to the Government. The Central Bank will continue to insist on fairly selective credit policies with restrictions on consumer installment lending and on special rediscounts to the sugar industry. Credit to productive sectors by the banking system will increase by about 14 percent.

The monetary authorities are committed to keeping domestic interest rates competitive in order to discourage short-term capital outflows. While the value of the Barbados dollar has appreciated in real terms in recent years, the authorities believe that its value should continue to be pegged to the U.S. dollar at the existing level. However, they attach importance to maintaining the international competitiveness of the Barbados dollar. They welcome the staff's judgment that there is at present no strong evidence to indicate that a change in Barbados exchange rate policies is required. In the meantime, they have removed fees on purchases of foreign exchange.

The financial program through March 31, 1984, contains performance criteria with respect to the expansion of the net domestic assets of the monetary authorities, the growth on the banking system's credit to the nonfinancial public sector, and limits on authorizations of new publicly guaranteed foreign indebtedness with maturities of one to ten years. The Government believes that the policies being pursued will achieve the objectives of the program and that these criteria will be met. They are prepared to take further measures if this should prove necessary.

The Government's medium-term strategy is directed toward export-led developments and the Government intends to foster a climate favorable to private investors. While there has been some falloff in manufacturing investment applications in recent years, Barbados has been able to attract some high-technology service industries and this has helped diversify the industrial base. The authorities believe that, as economic recovery gains speed, there will be significant increases in tourism and in merchandise exports and that this should lead to a sustainable current account deficit of about 5 percent of GDP. On the capital side, while debt service ratios at present are not excessive, the ratio in 1983, at 8.4 percent, will be slightly higher than originally projected. Moreover, the ratio itself is expected to rise to 12.5 percent by 1986 when repayments to the Fund start to be made. It should probably decline thereafter.

My authorities intend to conduct a comprehensive review of all aspects of their economic program around mid-September 1983.

Extending his remarks, Mr. Joyce said that, in fact, inflation had been reduced to about 5-6 per cent a year in the first three months of 1983, and his authorities anticipated that inflation would be between 6 per cent and 8 per cent for the year as a whole.

Mr. Erb indicated his agreement with the staff appraisal and his support for the proposed decision. The authorities should be commended for having met all the performance criteria in spite of the significantly more difficult economic environment.

At the time of the mid-term review, the original 1983/84 program targets--as a percentage of GDP--had been revised downward because it had been believed that the economic recovery in industrial countries would be less strong than had been expected when the original program targets had been formulated, Mr. Erb went on. If the recovery in the industrial countries was stronger and developed sooner than anticipated by the authorities, the revised targets should be readjusted; those targets should not permit a more relaxed adjustment effort.

Commenting on fiscal policies, Mr. Erb noted that the upward revision of the target for the overall deficit on general government operations had been necessary as a result of the increase in the wage bill. Wage restraint was of crucial importance if the adjustment effort was to succeed; and, given recent improvements in the local inflation rate, such unprogrammed wage increases seemed all the more difficult to justify.

With respect to interest rate policies, Mr. Erb urged the authorities to keep domestic interest rates competitive with rates abroad so as to discourage short-term capital outflows, and more importantly, to encourage domestic savings. He shared the staff's view that existing interest rate ceilings should be removed.

Mr. Taylor stated that he agreed with the staff appraisal and supported the proposed decision. All three quantitative performance criteria had been met by substantial margins, which was evidence of good fiscal and monetary management, given the worse than expected international economic situation. However, the authorities had revised the budget and external current account deficit targets, and they should watch developments closely in case additional adjustment was required. He shared Mr. Erb's view that if the external situation turned out to be better than expected, the authorities should aim for a sharper path of correction. Although the next review was not related to a performance criterion, it should be an occasion for a thorough examination of the authorities' policy stance.

Commenting on domestic policies, Mr. Taylor considered that a continuation of fiscal discipline was essential in order to maintain a better equilibrium between the domestic and external positions. Measures taken in 1983 to reduce the general government deficit to about 2.25 percent of GDP were welcome. Capital expenditure had been reduced by 6 percent, but the capital expenditure program remained high and he welcomed the efforts being made to concentrate on the completion of existing major projects, and on the selective resumption of smaller projects that had been suspended over the previous two years. The authorities should be encouraged to continue with their efforts to maintain stricter control over current expenditure.

In October 1982, his chair had expressed concern at the sharp rise in transfers to the nonfinancial public enterprises, Mr. Taylor recalled, and he was pleased to note that steps had been taken in the previous few months to improve the operations and the pricing structure of those enterprises. In particular, a 25 percent fare increase had been implemented by the transport authorities in May 1983.

With regard to the external sector, Mr. Taylor stated that he was still concerned about the authorities' exchange rate policy. The real effective exchange rate had appreciated by 14 percent since 1980, which had had some discouraging effects on export earnings in the tourism and manufacturing sectors. The authorities had admitted that tourism had fared worse in Barbados than in other Caribbean countries in 1982.

A more flexible approach to the exchange rate might place less strain on domestic demand and real wage adjustment, Mr. Taylor went on. Perhaps the authorities should consider pursuing a somewhat independent exchange rate policy; after all, they had not subjected themselves to the constraints imposed by the East Caribbean Currency Area. The removal of fees on foreign currency purchases and the abolition of the quota on car imports were welcome. However, several other traded goods had been placed on the list of items requiring import licences.

In the medium term, Mr. Taylor considered, the authorities' primary aim should be to improve the balance of payments position. A current account deficit of slightly less than 5 percent of GDP in 1984 should be

sustainable for normal current account inflows, provided the authorities continued their adjustment efforts and attracted an adequate inflow of private capital. Although interest rates appeared to be broadly competitive, the authorities should consider that private capital inflows would have to replace a significant volume of public sector debt over time.

The performance criterion limiting the acquisition by the public sector of external debt of between one and ten years' maturity was welcome, Mr. Taylor continued. In addition, he was pleased to note that a gradual slowdown in the increase in the stock of external debt was projected through 1986; however, the authorities should perhaps aim at a sharper reduction. In the circumstances, general restrictions on the acquisition of external debt of less than one year's maturity would be inappropriate in the Barbadian case, given the heavy reliance of the private sector on externally financed trade credits following the establishment of a more competitive domestic interest rate structure.

In conclusion, Mr. Taylor said that he had a number of questions. First, why had the staff revised the figure for the debt service ratio in 1982 from 13.4 percent to 7.6 percent? Second, was there scope for supply-side adjustment in the economy if not in the course of the current program, at least in later years? Finally, were the authorities considering a follow-up program with the Fund?

Mr. Morrell indicated his agreement with the staff analysis and his support for the proposed decision. The authorities should be commended for meeting the performance criteria under the stand-by arrangement. Domestic expenditure restraint was the appropriate course of action to reduce the external deficit, and in that respect he noted that under the program the fiscal deficit was to be reduced from 3.8 percent of GDP in 1982/83 to 2.3 percent of GDP in 1983/84.

Commenting on monetary policy, Mr. Morrell said that he endorsed the authorities' intention to keep domestic interest rates competitive with foreign rates. However, the authorities should consider removing the interest rate ceilings, which had already created distortions in the financial system.

Like Mr. Taylor, he was concerned about the exchange rate policy, Mr. Morrell concluded. Tourism was sensitive to exchange rate changes, and perhaps the authorities would gain some benefit from an adjustment in the exchange rate. Finally, the removal of fees on purchases of foreign exchange was welcome.

The staff representative from the Western Hemisphere Department stated that the authorities were conscious of the need to maintain the international competitiveness of the Barbados dollar, but it was their view that the required adjustment could be effected by demand management policies. If the exchange rate was adjusted, the authorities would have difficulties in keeping the wage policy intact. In addition, at the present time a study of exchange rate practices in the entire Caribbean

Community (CARICOM) was being conducted and the authorities believed that it would make sense to review its exchange rate policy in the context of a general realignment of CARICOM currencies. Of course, they intended to keep the exchange rate question under review.

In the 1982 staff report, the debt service ratio had appeared as 13.4 percent, but that figure had included the repayment of a six-month deposit by the Central Bank, the staff representative explained. The debt service ratio had been redefined to cover only loans with a minimum maturity of one year, and therefore the 1982 debt service ratio had been revised from 13.4 percent to 7.6 percent of domestic exports and travel receipts.

Supply-side policies would be aimed at maintaining the competitiveness of the export sector, the staff representative continued, and in that respect, the authorities intended to keep exchange rate policy under review. They were also introducing measures to diversify agricultural exports and to improve the efficiency of the sugar sector through mechanization. The authorities' current policy of maintaining favorable conditions for the development of the private sector and to encourage foreign investment had been fairly successful; and the authorities believed that with the end of the recession in the United States, the inflow of private investment would be resumed.

At the present time the authorities did not believe that a follow-up program with the Fund would be necessary, since the external current account deficit, projected to be 5 percent of GDP in the medium term, could be covered quite easily by long-term capital inflows, the staff representative from the Western Hemisphere Department concluded.

The Deputy Director of the Exchange and Trade Relations Department said that the staff had encouraged the authorities to consider the benefits of an exchange rate change, but the authorities had opted not to adjust it for the reasons outlined by the staff representative from the Western Hemisphere Department. Since the financial targets could be achieved under the existing policies, an exchange rate change was not required.

Mr. Joyce assured the Executive Directors that it was the intention of the authorities to complete the adjustment process as quickly as possible, even if economic recovery proved to be stronger than expected and permitted the overattainment of the new targets. On the other hand, if the world economic recovery did not proceed as rapidly as hoped, or if there were further adverse developments in Barbados, the authorities--with the Fund--would reconsider what other measures might be needed. In that respect, his authorities would take the mid-year review very seriously.

Commenting on the wage increases, Mr. Joyce stated that the additional increase of 2.5 percent granted in 1983 was fully within the overall wage program, which planned for a total increase of no more than 15 percent over 1982-83. Furthermore, the cost of that wage increase had been more than offset by the additional revenue-raising measures undertaken.

On the subject of exchange rate changes, Mr. Joyce remarked that he had little to add to the staff statement. His authorities fully intended to keep the exchange rate policy under review, but it was their view that no exchange rate change was necessary at the present time. There were other ways of proceeding with economic adjustment that would be preferable given domestic economic and political circumstances, in particular with respect to tourism. The authorities recognized that the tourist industry in Barbados had been suffering relative to other countries in the Caribbean, which could be attributed, in part, to the exchange rate situation. However, it was important to note that the currencies of other countries in the Caribbean were also tied to the U.S. dollar and had appreciated in step with the appreciation of the Barbados dollar.

With respect to tourism, what in fact had happened was that Barbados had been pricing itself out of the market, Mr. Joyce explained. The accommodation provided in many of the older hotels had been allowed to deteriorate, but prices for accommodation remained high and that had undoubtedly made Barbados somewhat less competitive; however, action was being taken within the tourist industry to make Barbados once again competitive. The authorities did not believe that the exchange rate was entirely responsible for the noncompetitive position of Barbados, particularly given the fact that manufactured exports had continued to perform well and that wage restraint policies appeared to be succeeding.

Finally, Mr. Joyce stated that at the present time the authorities did not believe that a follow-up program would be required; they would be happy to complete the present program and were thankful for the Fund's assistance.

The Chairman made the following summing up:

> Executive Directors generally were in agreement with the thrust of the staff appraisal. They commended the authorities on the economic performance of Barbados so far under the current stand-by arrangement. It was stressed that the upward revision of fiscal targets in the program--expressed as percentages of GDP--based on the forecast that growth would be slower in industrial countries than had been assumed when the program was originally agreed, should be revised downward again if growth abroad proved to be stronger.
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> Directors particularly highlighted the marked improvement in the public finances, which had been achieved mainly through new revenue measures and cutbacks in capital expenditure. Directors stressed the need for further progress in raising public sector savings and believed that more emphasis should be given to curbing the growth of current spending. They urged the authorities to speed up efforts to eliminate the remaining subsidies to public corporations, noting in this connection the welcome recent increase in transport fares.

Directors, while noting the deceleration in wage increases that took place in 1982 and early 1983, urged continued restraint on wages.

In view of the recent appreciation of the Barbadian dollar because of movements in exchange rates among major countries, Directors voiced some concern at the competitive position--especially of the tourist industry--and thus they urged the authorities to keep their exchange rate policy under review. Directors stressed the importance of keeping interest rates at a flexible and competitive level in order to enhance private capital inflows and domestic savings. They recommended the removal of remaining interest rate ceilings, which they felt were creating distortions in the financial system.

Directors praised the authorities for maintaining a liberal trade and payments system. They welcomed the decision to remove the fees on purchases of foreign exchange, thereby eliminating a multiple currency practice.

The authorities were urged to exercise continued prudence in relation to the medium-term balance of payments prospects and in regard to their external debt situation.

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

The Executive Board then took the following decisions:

Decision Concluding 1983 Article XIV Consultation

1. The Fund takes this decision in concluding the 1983 Article XIV consultation with Barbados, in the light of the 1983 Article IV consultation with Barbados conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund notes with satisfaction that Barbados' exchange system is free of restrictions on payments and transfers for current international transactions.

Decision No. 7436-(83/89), adopted
June 22, 1983

Review Under Stand-By-Arrangement

1. Barbados has consulted with the Fund in accordance with paragraph 4(b) of the stand-by arrangement for Barbados (EBS/82/153, Supplement 1, 10/4/82) and paragraph 11 of the letter dated August 23, 1982 attached thereto in order to establish performance criteria subject to which purchases may be made by Barbados during the period after April 29, 1983 through May 31, 1984.

2. The letter from the Minister of Finance and Planning and Governor of the Central Bank of Barbados dated April 29, 1983, together with the annexed memorandum on economic policy for 1983/84, shall be attached to the stand-by arrangement for Barbados and the letter of August 23, 1982 shall be read as supplemented and modified by the letter of April 29, 1982 together with the annexed memorandum.

3. Accordingly, Barbados will not make purchases under this stand-by arrangement that would increase the Fund's holdings of Barbados' currency in the credit tranches beyond 25 percent of quota or increase the Fund's holdings of that currency resulting from purchases of borrowed resources beyond 12.5 percent of quota:

(a) during any period before May 31, 1984 in which the data at the end of the preceding period indicate that:

(i) the limit on net domestic assets of the monetary authorities described in paragraph 10 of the memorandum annexed to the attached letter dated April 29, 1983, or

(ii) the limit on banking system's credit to the nonfinancial public sector described in paragraph 11 of the memorandum annexed to the attached letter dated April 29, 1983, is not observed; or

(b) If Barbados fails to observe the limit on authorizations of new public and publicly guaranteed foreign indebtedness described in paragraph 12 of the memorandum annexed to the attached letter dated April 29, 1983.

4. Purchases under the stand-by arrangement for Barbados shall not, without the consent of the Fund, exceed the equivalent of SDR 12,375,000 until May 31, 1983, the equivalent of SDR 16,275,000 until July 20, 1983, the equivalent of SDR 20,175,000 until October 20, 1983, the equivalent of SDR 24,075,000 until January 20, 1984, and the equivalent of SDR 27,975,000 until April 20, 1984.

Decision No. 7437-(83/89), adopted
June 22, 1983

2. SWAZILAND - PURCHASE TRANSACTION - COMPENSATORY FINANCING FACILITY

The Executive Directors considered a request by Swaziland for a purchase equivalent to SDR 9.0 million under the compensatory financing facility (EBS/83/101, 5/24/83; and Sup. 1, 6/20/83).

Mr. Mtei made the following statement:

I should like to express the appreciation of my Swazi authorities for the staff report which has been prepared in connection with their request for a purchase of SDR 9.0 million under the compensatory financing decision. The proposed purchase is in respect of a shortfall in export earnings for the calendar year 1982.

In recent years, the external payments position of Swaziland has come under increasing pressure, with the balance of payments moving from a surplus of SDR 24.1 million in 1980 to a projected deficit of SDR 24.2 million in 1983. This situation has in turn adversely affected the country's official reserves, which have declined from SDR 120 million at the end of 1980 to about SDR 57 million as of the end of March 1983. One of the major reasons for the balance of payments problem is the drop in prices of most of Swaziland's exports, especially sugar which accounts for the larger share of export earnings. It is to be noted that after increasing by 54 per cent in 1980 and by an additional 10 percent in 1981, export earnings are estimated to have declined by 12 percent in 1982.

The staff calculations show a shortfall of SDR 25.4 million which is due mainly to the decline in earnings from sugar, reflecting the fall in the export unit value to the equivalent of 12.4 U.S. cents per pound from 19.4 cents in 1981, brought about by the shift to other lower-priced markets following the imposition of import quotas by the United States in May 1982. The shortfall, nevertheless, is expected to be temporary as a larger volume of production and higher prices are projected for 1983 and 1984.

My Swazi authorities intend to maintain the close cooperation with the Fund which has developed over the years. They have recently benefited from the Board's discussion last January which concluded the 1982 Article IV consultation with Swaziland. Since then, steps have been taken to contain the growth in public sector expenditure; interest rates have been raised; and a sales tax legislation is scheduled to be presented to Parliament in October with the hope that it will come into effect as of April 1, 1984. Swaziland continues to maintain an exchange system free of restrictions.

The staff is satisfied that the request of my Swazi authorities meets all the requirements of the compensatory financing decision, namely, that there is a balance of payments need; the country has been cooperating with the Fund; and the shortfall in export earnings, which is temporary and reversible, has been occasioned by factors beyond Swaziland's control. Besides, the proposed purchase is only a small portion of the estimated shortfall, and the authorities have given the normal undertaking to effect an immediate repurchase of that part in excess of their entitlement, should actual data ultimately prove such excess. I therefore recommend the proposed decision in EBS/83/101 for approval by the Board.

Mr. Laske commented that he was satisfied that the Swazi authorities were cooperating with the Fund and that they had a balance of payments need; he therefore supported the proposed decision. However, he had two questions. First, projections for 1983 indicated a marked deterioration in the overall balance of payments primarily due to a large increase in the deficit on services. The staff had stated that the widening of the services deficit was attributable to the costs of three infrastructure development programs, and he was somewhat surprised that those programs could have such a strong impact on the services account. Could the staff provide more information on that matter? Were the projects being financed either by long-term capital inflows or by development aid provided by other countries?

Second, with respect to the projections for sugar exports in the postshortfall years, Mr. Laske noted that the restrictions on sugar imports recently imposed by the United States would have a marked impact on sugar exports from Swaziland. Considering that there was a worldwide oversupply of sugar, projections for the two postshortfall years seemed rather optimistic. In spite of the blockage of export quota increases under the International Sugar Agreement, Swaziland had received a waiver and was allowed to increase sugar exports. Was Swaziland in a position to make use of that higher export quota?

On a related point, Mr. Laske remarked that in the light of health concerns over the use of asbestos, the projections for Swaziland's asbestos exports also seemed overoptimistic. Could the staff comment on its projections?

Mr. Erb indicated his support for the decision, although he was concerned that the export shortfall was part of a larger balance of payments problem. Despite the improvement in the trade balance in 1983, the current account deficit was expected to widen further because of a deterioration in the services balance; in addition, the overall deficit was expected to increase to SDR 24 million in 1983.

The authorities should be commended for their efforts to improve fiscal performance and to introduce a more flexible interest rate policy, Mr. Erb considered. However, stronger measures with respect to both fiscal and monetary policies were necessary in the near term if the balance of payments prospects were to continue to improve. The authorities' continued commitment to an exchange rate system free of restrictions was welcome.

Mr. Morrell stated that he could support the request for a purchase under the compensatory financing facility. Swaziland, a small landlocked country heavily reliant on the export of a single primary commodity, was particularly vulnerable to external developments. It was not clear when, or on what basis, the staff had made its estimates of sugar exports during the last quarter of 1982.

The staff representative from the Research Department commented that Swaziland was a relatively small exporter of sugar on the free market and was covered by a special provision under the terms of the International Sugar Agreement that allowed small exporters to benefit from increased export possibilities if, at the time that the country joined the Agreement, they already had projects under way to expand production. Swaziland was therefore expected to benefit from that provision. Projections indicated an increase of sugar exports of about 12,000 tons for 1983 and of 10,000 tons for 1984, which would be an insignificant addition to the world trade in sugar.

In recent weeks, sugar prices had increased sharply from roughly 6 cents per pound to more than 11 cents per pound, and had currently stabilized at about 10 cents per pound, the staff representative said. That increase was the result of the market reaction to reports of widespread difficulties of production in several major producing countries; droughts had affected sugar production in South Africa and Australia, and excessive rains had reduced the acreage and yield in Europe and the Soviet Union, the largest producer of sugar. Based on those preliminary reports, it appeared that less sugar would be produced in 1983/84, but any such reduction would only prevent an increase in stocks from their already extremely high level. It was too early to tell whether there would be a lasting change, but the short-term outlook for Swaziland's sugar exports seemed somewhat better than the staff had expected at the time the paper was written.

With respect to the projections for asbestos, the staff representative from the Research Department noted that Swaziland was a small producer of asbestos and was therefore able to take advantage of a cutback in output

by Canada--a major producer. Because of the exhaustion of a mine, supplies from Swaziland were expected to diminish in 1984 and that factor had been included in the staff projections.

The staff representative from the African Department stated that the staff was conscious that additional measures were needed to improve Swaziland's balance of payments position. The staff would be holding Article IV consultations with the authorities in October 1983, and at that time it would discuss with them a broad range of policies with a view to reducing the overall and current account balance of payments deficits. There was no indication that the authorities wished to use Fund resources under a stand-by arrangement. The link of the Swaziland lilangeni with the South African rand provided the authorities with adequate access to foreign exchange reserves.

There were three projects contributing to the increase in expenditure on services, the staff representative from the African Department continued--an airport improvement project, a railway link with South Africa, and a hydro-electric power project--which were financed largely by the World Bank, the African Development Bank, and the European Investment Bank. Only the hydroelectric project was under way, and the two others were projected to start in 1983. The increase in the cost of services in 1983 was due mainly to expenditures relating to feasibility studies, consultancy fees, and technical assistance.

Mr. Mtei commented that the Swazi economy depended considerably on sugar exports. The request under the compensatory financing facility was a very small proportion of the calculated shortfall and, given the increase in sugar prices in the recent past, it was unlikely that the authorities would be required to make a repurchase as a result of overcompensation.

The Executive Board then took the following decision:

1. The Fund has received a request by the Government of Swaziland for a purchase equivalent to SDR 9.0 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 representations of Swaziland and approves the purchase in accordance with the request.

Decision No. 7438-(83/89), adopted
June 22, 1983

3. SOLOMON ISLANDS - STAND-BY ARRANGEMENT

The Executive Directors considered a request from Solomon Islands for a stand-by arrangement equivalent to SDR 2.4 million (EBS/83/81, 4/22/83; and Cor. 1, 6/20/83).

The staff made the following statement:

Executive Board consideration of the request by Solomon Islands for a stand-by arrangement (EBS/83/81) was originally scheduled for May 23, 1983. Shortly before the scheduled Executive Board discussion, the staff, however, received information indicating that net credit to the Government at the end of April 1983 exceeded the ceiling set for April-June 1983. In order for the staff to determine whether the data were final and to ascertain whether it could be regarded as being a temporary aberration, the Executive Board consideration of the Solomon Islands' request was postponed.

Additional communications from the authorities have confirmed that net credit to the Government at the end of April 1983 exceeded the limit set for that date (by SI$0.78 million) but that such credit was below the ceiling (by SI$0.14 million) at the end of May. The excess of net credit to the Government over the ceiling at end-April 1983 was due largely to temporary factors, i.e., a delay in the disbursement of external loans from the OPEC Fund for International Development and in concluding a loan agreement with the Commonwealth Develpment Corporation (CDC). The OPEC Fund loan (SI$0.5 million) was disbursed in May and the loan agreement with the CDC for SI$1.8 million is expected to be concluded in June.

The authorities stress that the development in April was temporary and that net credit to the Government will be kept under the ceilings during the remaining period of the stand-by arrangement. The recent developments have heightened the authorities' awareness of the need to keep the budgetary situation under close review and to improve procedures in respect of obtaining reimbursement under foreign assistance loans and grants. The staff believes that credit ceilings under the proposed stand-by arrangement will serve a constructive purpose in this regard.

Apart from net credit to the Government, recent developments in Solomon Islands have been broadly in line with the expectations underlying the program. The rate of inflation had decelerated from 10 percent in December 1982 to about 6 percent in April 1983, due in part to a decline in import prices. During January-May 1983, total domestic credit expanded at an annual rate of about 30 percent to reach SI$33.3 million at the end of May, compared with the ceiling set for April-June of SI$35.5 million. The authorities have managed the exchange rate flexibly and the trend

of depreciation of the Solomon Islands dollar against the basket has continued. Gross international reserves, following a decline during January-April, rose in May 1983 to SDR 35.1 million, equivalent to about six months of imports. The May increase reflected a drawdown by the authorities of $5.0 million, the last tranche of the Eurodollar loan of $20.0 million contracted in 1981.

Mr. Morrell made the following statement:

On behalf of the Solomon Islands authorities, I would like to thank the staff for their excellent and thorough work in developing this proposal. The authorities are in general agreement with the staff's analysis and conclusions.

The authorities are requesting a one-year stand-by arrangement equivalent to SDR 2.4 million in support of a comprehensive set of policy measures designed to assist the private sector regain profitability and recommence a strong flow of investment; make fuller use of the capacity of private and statutory corporations; reduce the bottlenecks on government absorptive capacity; and strengthen the balance of payments over the medium term.

Solomon Islands is a small, open island economy with a population of about 250,000. Some 40 percent of total output is derived from subsistence agriculture and the export structure is highly dependent on a relatively small number of commodities, principally fish, timber, copra, and palm oil. Employment in the export sector accounted for one third of the total formal employment in 1982 and government revenues are very sensitive to export performance.

In 1981 and 1982 Solomon Islands experienced a sharp deterioration in the terms of trade and a decline in international demand for its products, seriously checking the very favorable economic performance of the 1970s. Average export prices were some 13 percent lower in 1981-82 than in 1979-80. This has seriously affected the profitability of enterprises, reducing new investment and increasing their recourse to the banks for short-term loan funds. In addition, with the world recession and other factors constraining the growth of the cash sector, the noncash sector has had to assume a greater part of the burden of supporting a rapidly growing population.

As the staff paper notes, the authorities' strategy for 1983 aims at stimulating investment in export industries in order to strengthen the balance of payments over the medium term. It is to be noted that the balance of payments position is expected to worsen in 1983, with the current account deficit

(excluding grants) widening to SDR 25.2 million (16.8 percent of GDP) from SDR 19.7 million (13.7 percent of GDP) in 1982. The 1982 figures, however, reflect a sharp fall in imports of machinery and equipment due to lower levels of private and government investment. As investment recovers in 1983--as it must do in order to protect the productive base of the economy and lay the basis for export-led growth--imports can be expected to rise. The 1983 current account position is also predicated on an assumption of some continued weakness in external demand and, in particular, a further deterioration of export prices. As the staff notes, given the focus of investment on the export sector, the projected increase in the current account deficit "is in line with a medium-term strategy of development and growth in the context of a sustainable external position" and consistent with Solomon Islands' capacity to service the present and projected levels of external debt. The availability of foreign grants and concessional assistance is an important factor in this regard.

The substantial adjustment measures that have been adopted in the period since 1980 have been aimed at expanding exports, restraining nonessential imports, promoting productive investment, and increasing domestic resource mobilization. In particular, the authorities are committed to a flexible exchange rate policy aimed at maintaining export competitiveness. Significant devaluations of the Solomon Islands dollar were effected in March 1981 (6 percent) and August 1982 (10 percent), when a trade-weighted basket was reintroduced to reduce the risk of loss of competitiveness through creeping appreciation. Other financial incentives have also been introduced to promote private sector profitability and investment. Import duties were increased in 1982 in order to increase revenue and contribute to external adjustment. Banks have been given guidance by the authorities on lending to priority areas, including the export sector. Interest rates on bank deposits were increased by an average of 2 to 3 percentage points in March 1983 and rates on treasury bills and development bonds have also been adjusted to assist the mobilization of domestic savings.

The authorities recognize the contribution that a sound wages policy can make to external competitiveness and investment. Informal wage guidelines, aimed at keeping increases within a 6 to 8 percent range, have been followed in most major enterprises. The introduction of retail price control on a limited range of commodities is viewed by the Government as part of the price of employee acceptance of wage restraint; the effectiveness of these controls is being kept under close review.

The Government's fiscal policy for 1983 aims at holding the overall budget deficit at 10 percent of GDP. Current expenditures are budgeted to increase by only 3 percent in nominal terms

(against a forecast inflation rate of 10 percent), while capital expenditures should increase by 24 percent, with emphasis on infrastructure to support private investment. Expenditure control is seen as effective. Domestic revenue is projected to increase by 7 percent in 1983. The authorities recognize the need to broaden the tax base to reduce reliance on trade-based revenues. However, they consider that increased taxation of the monetized sector in present circumstances could prejudice economic recovery in 1983. Further improvements in tax administration and collection are being pursued.

It needs to be kept in mind, of course, that a very large part of the projected budget deficit will be funded from offshore grants and concessional loans for development purposes. Recourse to domestic borrowing would be only SI$2.1 million (with bank financing limited to SI$0.6 million). The authorities have indicated that, if necessary, they will take prompt measures, including the imposition of additional expenditure controls, to ensure achievement of their budgetary objectives.

The stand-by arrangement provides for a tight ceiling on net credit to the Government, which the authorities agree is appropriate. However, as noted in the statement by the staff, the net credit ceiling for April was exceeded due to a temporary and unforeseen delay in drawing external assistance. The end-May figure was within the ceiling and the authorities are confident that they will meet this performance criterion in subsequent months. They note in this regard the creation of a National Planning Department and other measures to improve project planning and implementation in the public sector. Shortages of senior technical and administrative staff have in the past contributed to slow utilization of external aid for capital projects, which have sometimes been maintained on a temporary basis from the budget.

I note finally that the Government is very conscious of the need for persistent application of its policy measures over several years if they are to be effective. I commend the request to Executive Directors.

Mr. Shaw indicated his support for the stand-by request from Solomon Islands and his agreement with the staff appraisal. He would support a waiver if it was required because of the ex ante breach of the net credit ceiling; that breach had been necessary because the volatility of capital transfers made management of the fiscal accounts very difficult.

The proposed program was in line with the Government's objective of strengthening the balance of payments position over the medium term, Mr. Shaw noted. The authorities' strategy of shifting the emphasis of

its fiscal policy to export-oriented capital expenditures while maintaining the size of the fiscal deficit was welcome, particularly when accompanied by a commitment to reduce inflation and increase interest rates. Nevertheless, the authorities should proceed with caution as there were possible weak points that could present problems for the successful implementation of the program. In view of the planned reduction of bank financing and the large increase in foreign assistance, there should be no credit shortages. The shift from current to capital expenditures was welcome, but a key factor in the success of that strategy would be the authorities' ability to ensure economic viability of the investment expenditure.

Turning to the external sector, Mr. Shaw commended the authorities for their commitment to the implementation of a flexible exchange rate policy in order to prevent any erosion in the competitiveness of exports. Some improvement in commodity prices could also help improve export profitability.

Solomon Islands was expected to have access to foreign grants and concessional loans in excess of its capacity to identify and implement projects, Mr. Shaw noted, and it was therefore important that the authorities should ensure that concessional financing was not directed toward unsound ventures. In that respect, there were three questions that he would like to put to the staff. First, to what extent did the projected investment program reflect projects that were on line and already had a financing commitment? Second, what mechanisms had been introduced to ensure that concessional resources were only directed to those projects that had an acceptable internal rate of return? Third, how would the problem of the shortage of skilled manpower be overcome when implementing the 1983 investment program?

The creation of the National Planning Department (NPD) was welcome, Mr. Shaw concluded, it reflected the authorities intention to improve project implementation. Finally, he commended the authorities for their commitment to reducing inflation and to continuing the increase of interest rates; but, interest rates might still remain negative in 1983 and he urged the authorities to continue their efforts to bring real interest rates to positive levels.

Mr. Hull commented that the excess in net credit to the Government could be regarded as a temporary aberration. In fact, it might have heightened the authorities' awareness of the need to improve procedures for monitoring foreign assistance.

Solomon Islands had a fairly diversified export base, Mr. Hull considered, and the basic strategy of seeking to broaden that base still further was correct. The economy had been hit hard by external factors beyond the authorities' control: there had been a 40 percent decline in the terms of trade between 1979 and 1981, and a further fall was projected for 1983. Solomon Islands was fortunate in enjoying a substantial level of concessional external finance, but balance of payments support was necessary in the short term to stimulate the depressed domestic economy.

With respect to fiscal policies, the authorities should persist with efforts to reduce the budget deficit further, Mr. Hull remarked. The budget deficit had been reduced to about 10 percent of GDP, but that was still on the high side and the Government would need to watch expenditures very closely. The intention of the authorities to eliminate that deficit in 1983 was welcome. Capital expenditure should be allowed to increase in order to promote recovery through investment, since private commercial investment would need to be supported by public sector infrastructure. In that respect, current expenditure would need to be monitored closely, and wage increases should be maintained at, or preferably below, the rate of inflation.

On the revenue side, service charges and user fees should be maintained at realistic levels, Mr. Hull went on. In that connection, the authorities should be commended for the timeliness of their action to raise tax rates on imported petroleum products in 1982.

Commenting on monetary policy, Mr. Hull welcomed the establishment of a Central Bank in January 1983 and the increase in interest rates. The 29 percent increase in domestic credit expansion was nevertheless large and would need close monitoring. The majority of that credit should be directed to the private sector and would probably be more than sufficient to finance increased economic activity.

The authorities did not seem to have settled on a very specific energy policy and were still uncertain about the optimal mix of fuels to be developed in the medium term, Mr. Hull remarked. Given that oil still accounted for about 25 percent of Solomon Islands' imports, it would perhaps be wise to draw up more specific, although still flexible, medium-term plans. In that context, he noted that World Bank involvement in Solomon Islands had been limited. Would the next Bank mission later in 1983 be looking at feasible energy projects?

On the external side, Mr. Hull commented that although the rise in the current account deficit in 1983 was unwelcome, it was consistent with Solomon Islands' capacity to service the present and projected levels of external debt. The debt service ratio was only 3.5 percent due to the concessional nature of most loans, and the authorities' decision to restrict the amount of nonconcessional debt and to avoid short-term debt seemed appropriate. The authorities would be prudent to maintain reserve levels at about 4-6 months of imports in view of the variability of export earnings and the irregularity of import payments. Providing those reserves were earning a reasonable rate of interest, that policy also appeared appropriate.

Mr. J. C. Williams indicated his agreement with the staff appraisal and his support for the proposed decision. The developments in April had been of a temporary nature, but they emphasized the necessity of exercising heightened vigilance in financial management. The proposed adjustment program under the stand-by arrangement incorporated the policy

recommendations discussed by the Executive Board at the time of the 1982 Article IV consultation with Solomon Islands, and built upon the policies adopted under the 1981 stand-by arrangement.

Finally, with respect to the long-term structural adjustment effort, he welcomed the creation of a national planning department, Mr. Williams concluded. Solomon Islands could benefit from more involvement by the World Bank in the evaluation of the strategic planning decisions taken by the authorities.

The staff representative from the Asian Department commented that the formal wage guideline provided for an increase in wages for government employees of about 8.5 percent in 1983. Under that guideline the wage increase in the private sector had also been limited to about 6-8 percent.

With respect to proposed capital expenditure by the Government, the staff representative noted that roughly 82 percent represented expenditure for ongoing projects and 18 percent expenditure for projects initiated in 1983. It was the major task of the National Planning Department in the Prime Minister's Office to ensure that investment expenditure was allocated to those projects with the greatest potential for productive returns. In addition, most of the concessional grants and loans from donor countries would only be disbursed after the donor authorities had made some assessment of the projects considered.

Commenting on the shortage of skilled manpower, the staff representative remarked that in the short term the Government was hiring more expatriates in order to enhance the capital absorptive capacity of the country. In the long run, the authorities recognized that they would need to train local government employees.

In March 1983 the interest rate paid on passbook savings deposits had been raised by about 3 percentage points to 7 percent or, in some cases, to 8 percent, the staff representative went on. The rates on current deposits were between 8 percent and 9.5 percent; as the expected rate of inflation for 1983 was less than 10 percent, those interest rates were positive in real terms.

The authorities aimed to hold the overall budget deficit at 10 percent of GDP for 1983, the staff representative continued. The maintenance of the deficit at 10 percent had been accompanied by a shift of government expenditure from current to capital investment projects; the authorities would continue to exercise fiscal restraint in 1984 in order to reduce further the size of that deficit.

Commenting on the envisaged expansion of total domestic credit, the staff representative stated that a rate of increase in domestic credit of 29 percent for 1983, when compared with previous years, was not too high; in 1980 and 1981 the rate of increase in total domestic credit had been 55 percent and 47 percent, respectively. Furthermore, the expansion of 29 percent reflected a very low rate of increase in 1982, when private

credit had expanded by only 4 percent. Furthermore, the expansion envisaged for 1983 was not unduly large considering that it reflected a small domestic credit base; the need to revive private sector investment; and, in particular, the need for bank financing of planned timber operations and fishing fleet expansion.

Turning to the medium-term energy policy, the staff representative from the Asian Department commented that the World Bank had concluded that the estimated cost of the Lungga hydroelectric project, which the Government had contemplated in 1981, was too large. After preliminary investigations the World Bank had advised that the project should be shelved, and that the authorities should concentrate on a wood-burning power plant which could supply 7-8 megawatts. The Bank would also be making a recommendation that Solomon Islands, Fiji, and Papua New Guinea should agree on a consumption pool arrangement so that together they could import the required oil products, but reduce the transportation and distribution costs. In addition, the Asian Development Bank was considering carrying out a power development study and a review of the tariff structure in 1983. Finally, there was little likelihood of discovering petroleum reserves.

Mr. Morrell commented that Solomon Islands provided a clear example of a developing country that had come to the Fund for support when there was a need, but before there was a crisis. The adjustment program was designed to support the balance of payments need during a period of strain, which had followed a sharp decline in the terms of trade.

Turning to the question of viability of investments, Mr. Morrell remarked that it was particularly important that the expenditure of concessional funds should be scrutinized rigorously by donors. The authorities had found it necessary to finance some of the expenditure themselves, pending receipt of those funds. Although the amount was relatively small, it could lead to some difficulties with respect to the quarterly performance criteria.

With respect to interest rates, Mr. Morrell noted that inflation was below 6 percent a year--although the program projection remained at 10 percent--and therefore the interest rates were close to being positive in real terms. Treasury bill rates were about 11 percent, which was a fair rate in the circumstances.

As to medium-term energy policies, the World Bank would be issuing an energy assessment report that covered Solomon Islands and included a proposal for technical assistance for energy planning later in 1983, Mr. Morrell said. The staff representative from the Asian Department had outlined the various projects; it was clear that there had been considerable involvement by the World Bank.

The Executive Board then took the following decision:

1. The Government of Solomon Islands has requested a stand-by arrangement for the period from June 22, 1983 to June 21, 1984 for an amount equivalent to SDR 2.4 million.

2. The Fund approves the stand-by arrangement set forth in EBS/83/81, Supplement 1.

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

Decision No. 7439-(83/89), adopted
June 22, 1983

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/83/88 (6/20/83) and EBM/83/89 (6/22/83).

4. BELIZE - ACCEPTANCE OF OBLIGATIONS OF ARTICLE VIII, SECTIONS 2, 3, AND 4

The Fund notes with satisfaction that with effect from June 14, 1983, Belize has accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement. (EBD/83/171, 6/16/83)

Decision No. 7440-(83/89), adopted
June 20, 1983

5. TUNISIA - 1983 ARTICLE IV CONSULTATION - POSTPONEMENT

The Executive Board notes the request contained in EBD/83/173 (6/17/83). Notwithstanding the period of three months specified in Procedure II of the document entitled "Surveillance Over Exchange Rate Policies" attached to Decision No. 5392-(77/63), adopted April 29, 1977, the Executive Board agrees to postpone its consideration of the 1983 Article IV consultation with Tunisia until not later than August 1, 1983.

Decision No. 7441-(83/89), adopted
June 21, 1983

6. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 83/7 through 83/9 are approved. (EBD/83/169, 6/14/83)

Adopted June 20, 1983

7. EXECUTIVE BOARD TRAVEL

Travel by an Executive Director as set forth in EBAP/83/160 (6/20/83) is approved.

APPROVED: November 18, 1983

JOSEPH W. LANG, JR.
Acting Secretary