INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 83/92

10:00 a.m., June 27, 1983

W. B. Dale, Acting Chairman

Executive Directors	Alternate Executive Directors
	J. K. Orleans-Lindsay, Temporary
	H. G. Schneider
	A. Le Lorier
A. Donoso	
	T. A. Connors, Temporary
	J. C. Williams, Temporary
M. Finaish	T. Alhaimus
A. H. Habib	Jaafar A.
	T. Yamashita
R. K. Joyce	G. W. K. Pickering, Temporary
	D. I. S. Shaw, Temporary
	C. Robalino
G. Laske	P. Kohnert, Temporary
	C. P. Caranicas
	A. S. Jayawardena
	J. E. Suraisry
	S. El-Khouri, Temporary
	J. Schuijer, Temporary
	K. G. Morrell
G. Salehkhou	O. Kabbaj
	E. I. M. Mtei
M. A. Senior	
	A. Linda
	C. Taylor
Zhang Z.	

L. Van Houtven, Secretary
J. C. Corr, Assistant

Also Present

Asian Department: H. Neiss, Deputy Director; K. A. Al-Eyd, C. M. Browne, R. G. Di Calogero, E. Gurgen, F. Le Gall, K. Saito, D. A. Scott. Exchange and Trade Relations Department: D. K. Palmer, Associate Director; M. Guitian, K. M. Meesook, P. Sukachevin. IMF Institute: S. Atthakor, Participant. Legal Department: W. E. Holder, J. K. Oh. Research Department: K.-Y. Chu, L. U. Ecevit, N. M. Kaibni, P. R. Menon, A. Salehizadeh. Advisors to Executive Directors: S. R. Abiad, C. J. Batliwalla, S. M. Hassan, P. D. Péroz. Assistants to Executive Directors: H. Arias, R. Bernardo, J. Bulloch, H. Kobayashi, M. J. Kooymans, P. Leeahtam, J. A. K. Munthali, V. K. S. Nair, Y. Okubo, J. G. Pedersen, J. Reddy, Shao Z., M. Toro, A. Yasseri.

1. WESTERN SAMOA - STAND-BY ARRANGEMENT; EXCHANGE SYSTEM; AND PURCHASE TRANSACTION - COMPENSATORY FINANCING FACILITY

The Executive Directors considered Western Samoa's request for a stand-by arrangement equivalent to SDR 3.375 million (EBS/83/105, 5/25/83; and Cor. 1, 6/22/83) together with a request for a purchase transaction equivalent to SDR 1.15 million under the compensatory financing facility (EBS/83/106, 5/25/83; and Sup. 1, 6/23/83).

The staff representative from the Asian Department made the following statement:

> In line with its standing policy that electricity charges fully reflect increases in the cost of imported fuel, the Government of Western Samoa stated during the stand-by negotiations that these charges would be raised to at least 27 sene per kilowatt hour in order to cover the increased cost of electricity generation due to the devaluation of the tala and the imposition of a duty on diesel imported by the Electric Power Corporation (ECP). On May 24, 1983, the authorities advised the staff that the EPC Board had decided to increase electricity charges from 23 sene to 33 sene per kilowatt hour, effective June 1, 1983. This decision by the EPC Board was noted in the Staff Report (EBS/83/105, p. 10) and in paragraph 14(c) of the letter of intent.
>
> Subsequently, the authorities notified the staff that the Cabinet had limited the increase to 28 sene per kilowatt hour. This level was judged by the staff to be adequate to cover not only the abovementioned increase in costs, but also the nonrecurrent cost due to heavier than expected use of diesel during the first quarter of this year caused by below normal rainfall. A correction reflecting the downward revision in the electricity charges has been circulated.

Mr. Morrell made the following statement:

> The Western Samoan authorities are grateful to the staff for the particularly clear and concise reports on Western Samoa's requests for a stand-by arrangement and purchase under the compensatory financing facility. They are in general agreement with the staff's analysis and conclusions.
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> The objectives of the program for 1983, to be achieved mainly through demand management and exchange rate policies, are to bring domestic spending and available local and foreign resources into better balance, to reduce the rate of inflation, to achieve an overall balance of payments surplus, and to reduce external arrears. This will be an essential first step in achieving, over a number of years, a satisfactory growth rate

with a sustainable external current account position and price stability. The authorities see the program in this medium-term context and are firmly committed to its objectives.

The economic problems being faced by Western Samoa, a small island state with a population of about 160,000, reflect its limited resource base and dependence on a few agricultural products which account for some 50 percent of GDP and 90 percent of export earnings. Production difficulties and adverse movements in export prices in the period 1980-82 led to a worsening of the current account position and the emergence of external payments arrears. The deterioration in the terms of trade since 1979 has been about 45 percent. In addition, there was insufficient adjustment of domestic policies to these very adverse circumstances.

The adjustment called for under the program is considerable, particularly in the fiscal area where the overall deficit is projected to decline by 59 percent from 16 percent of GDP in 1982 to 5.5 percent in 1983. A substantial revenue effort is called for, with total revenues projected to rise by 24 percent, mainly as a result of discretionary tax measures equivalent to 4 percent of GDP adopted in the 1983 budget. The authorities are examining other possible revenue measures for 1984 and are considering various options for broadening the tax base and increasing the elasticity of the tax system. Total government expenditure will decline by about 6 percent, implying a sharp decline in real terms. The main contribution is expected to come from a reduction in outlays due to the improved financial position of public enterprises, as indicated in the table on page 27 of the staff paper. Current expenditures are projected to rise by only 1.8 percent. The Government is maintaining its firm policy of wage restraint announced in the February budget. There will be no increases for public servants in 1983 beyond normal annual increments associated with regular promotions. The private sector is generally following this lead. In addition, policies are in place aimed at gradually reducing the size of the public sector.

The Government is being most vigilant in its monitoring of budget progress. For example, following a detailed quarterly review by the Treasury of actual budget performance for the first quarter of 1983, the Cabinet recently sat for two full days interviewing individual Department heads on their Departmental expenditure and revenue performance for the first quarter. In addition, a National Economic Council has been established consisting of the Prime Minister, who is also Minister of Finance, the Ministers of Economic Affairs and Agriculture, and relevant Departmental heads. The Council is to involve itself with all matters relating to economic planning and policy implementation and monitoring.

Strong control of expenditures, together with the revenue measures already in place, should ensure the achievement of the particularly large reduction in the budget deficit envisaged under the program. The adjustment effort will be supported by a tight credit policy, with domestic bank financing of the reduced budget deficit equivalent to only 1.3 percent of GDP and growth of credit to the private sector being maintained broadly at the 1982 rate. The growth in total liquidity is estimated at 25 percent in 1983, compared with 35 percent in 1982.

The authorities are pursuing an active interest rate policy aimed at mobilizing domestic resources, encouraging the flow of workers' remittances from abroad, and fostering a more efficient allocation of resources. Interest rates on bank deposits and advances have been raised considerably, and key rates are now positive in real terms. Policy in this area will be monitored closely and will be an important focus of the comprehensive mid-term review.

An active and flexible exchange rate policy is also being pursued, with the tala having been depreciated by some 17.5 percent on a trade-weighted basis in the first half of 1983, virtually eliminating the earlier real appreciation. Exchange rate adjustment, together with demand restraint and some improvement in commodity prices--increases in copra and cocoa prices are already having a favorable impact on export receipts--should lead to a reduction of the current account deficit from 20 percent to 13 percent of GDP over the program period. A small overall balance of payments surplus of SDR 1.2 million is projected for 1983.

The expected balance of payments surplus, along with Western Samoa's net use of Fund resources, will be used to achieve a minimum net reduction in outstanding external payments arrears of SDR 2.9 million in 1983, a performance criterion under the program. It is expected that the remaining arrears will be eliminated by the end of the year through rescheduling. Negotiations with five of the eight major creditors have been completed, and discussions with two others are expected to be completed by the end of June. Successful completion of these negotiations will enable a firm schedule for the orderly elimination of all payments arrears to be drawn up.

As indicated in the section in EBS/83/105 dealing with the medium-term outlook, and in the table on page 32 of the paper, debt service payments should decline substantially over the next few years from their present high levels, although it will obviously be some time before adequate official reserves can be restored.

As noted in the staff paper, the emphasis under the program on external adjustment means that significant improvements in inflation and growth cannot be expected in 1983. Indeed, no growth in real GDP is projected for this year.

The request for a purchase under the compensatory financing facility is straightforward; the shortfall is due mainly to reduced supplies and weak international prices for cocoa and coconut products.

To summarize, the Western Samoan economic performance has deteriorated as a result of a substantial decline in the terms of trade, domestic problems following from the civil service strike, and failure to take adequate adjustment measures. The authorities are firmly committed to the objectives of the program, as evidenced by the strong measures that they have already taken, and I commend both the stand-by and compensatory financing requests to the Board for its support.

Mr. Yamashita observed that Western Samoa had been experiencing severe difficulties on both the external and the domestic fronts. Some of the factors that had contributed to the current difficulties were no doubt beyond the control of the authorities, but the responses and adaptations of domestic economic policies to those adverse conditions had been inadequate, particularly in the areas of fiscal and monetary policies. The growth of current expenditures, including wage and salary bills, had risen sharply in recent years, and domestic credit had expanded at an annual rate of 40 percent, largely as a result of public sector demand.

The Government had appropriately adopted a broad-based program for 1983, Mr. Yamashita continued. In particular, the emphasis on reductions in the public sector deficit was welcome. The overall budget deficit was envisaged to decline from 16 percent of GDP in 1982 to 5.5 percent in 1983. The staff had correctly pointed out that adjustment of that order would entail sacrifices, but that it would be unavoidable if future growth and stability were to be assured.

The measures on the revenue side were particularly notable, Mr. Yamashita considered. The change in the basis of assessment of customs duties, in line with the recommendations of the 1981 Fiscal Affairs Department mission, was especially commendable. Broadening the tax base and increasing the elasticity of the tax system would be essential in the long run, and it was encouraging to note that the authorities were examining measures suggested in the Fiscal Affairs Department report. Expanding the coverage of excise taxes and levying them on an ad valorem basis would need to be considered, and, as the staff suggested, the enactment of a general sales tax would warrant serious consideration at a later stage. On the expenditure side, it was noteworthy that current expenditures were expected to increase by less than 2 percent in 1983 and that restraint in salary increases was to be exercised. The Treasury's quarterly reviews of each department's expenditures and revenues would also prove helpful in ensuring that budgeted expenditures were not exceeded and that revenue targets were met.

Commenting on monetary policy, Mr. Yamashita noted that a significant deceleration in the growth of domestic bank credit was envisaged, particularly to the public sector. The authorities' decision to raise interest rates substantially was clearly in the right direction. The authorities' intention to monitor interest rates in light of domestic price movements and developments in interest rates abroad was also noteworthy. In view of the importance of workers' remittances, that intention should help to improve the balance of payments. He hoped that the proposed transformation of the Monetary Board into an independent Monetary Authority would permit a more consistent monetary policy to support the external adjustment in coming years.

The adoption of a flexible exchange rate policy in order to maintain competitiveness and to promote external adjustment would be welcome, Mr. Yamashita added. As the staff suggested, the policy would have to be reassessed at the time of the mid-term review. With regard to exchange restrictions, the authorities would need to effect an early and orderly elimination of existing arrears. In that regard, inclusion of the minimum repayment of external arrears in the quantitative performance criteria was appropriate. On the basis of the staff appraisal, he supported the proposed decisions on the stand-by arrangement and on the exchange restrictions. He also supported the request for a purchase under the compensatory financing facility because it met all the requirements.

Mr. Suraisry said that he supported the requests by Western Samoa for a one-year stand-by arrangement and for a purchase under the compensatory financing facility. It was clear from the staff papers, and from the recent Article IV consultation with Western Samoa (EBM/83/20, 1/26/83) that the country faced serious economic and financial problems. In the previous three years, real growth had been negative, inflation had run at an annual rate of 20 percent, and sizable deficits had been recorded in both the fiscal and the external accounts. Those problems could be traced, in part, to a succession of poor harvests and to a sharp decline in the terms of trade, but also to the delay in adjusting domestic policies to the unfavorable external environment. He welcomed the authorities' decision to adopt a comprehensive stabilization program with support from the Fund. It was also encouraging that the program was part of a medium-term strategy aimed at correcting the more deep-rooted imbalances in the economy.

In the short term, Mr. Suraisry continued, the main priority should be to reduce the budget deficit from the present unsustainable level. The 1983 budget was a major step in the right direction. The tax measures outlined in Table 4 of EBS/83/105 were far-reaching and they should bring in substantial new revenue. He hoped that the authorities would act on the recommendations of the Fiscal Affairs Department to broaden the tax base in the next budget. The introduction of strict controls in current spending was also timely. The effective freeze on public sector salaries was courageous but necessary, as they had risen by over 75 percent since 1978. Some progress had already been made in strengthening the financial position of the public enterprises; he encouraged the authorities to press ahead with plans to allow more flexible pricing policies in the public utilities and to streamline the operations of the marketing boards. The improvement in public finances should contribute to a slowdown in monetary growth by reducing the public sector's demand for bank credit. The establishment of an independent Monetary Authority at the end of 1983 would provide a more effective framework for administering monetary and credit policies.

On the external front, Mr. Suraisry commented, the recent depreciation of the tala, which had reversed the real appreciation that had taken place since the end of 1979, should provide a welcome stimulus to exports, but the current account deficit was likely to remain sizable, and it might be difficult to attract sufficient external financing while payments arrears were outstanding. The proposed reduction of arrears by about SDR 3 million in 1983 was an essential first step; he joined the staff in urging their elimination as soon as possible. In the medium term, the room for maneuver was limited by external financing constraints and the heavy debt service burden. However, the authorities were making commendable efforts on the supply side; he welcomed, in particular, the introduction of more realistic prices in the agricultural sector together with the moves to diversify exports and promote foreign investment. He hoped that the forthcoming paper on the problems of small island economies would throw light on the type of longer-term adjustment policies that would benefit countries like Western Samoa.

There was no doubt that the request by Western Samoa satisfied the criteria for drawings under the compensatory financing facility, Mr. Suraisry added. The balance of payments need was clear-cut; the shortfall, based on actual data, was largely the result of exogenous factors; and the one-year stabilization program, including the commitment to phase out arrears, was convincing evidence of cooperation with the Fund.

Mr. Williams commended the authorities for the actions that they had already taken in support of their adjustment efforts in the exchange rate, interest rates, and fiscal and monetary policies. Those actions had been appropriate responses to the concerns raised by his chair and others at the time of the Article IV consultation in January 1983. It would be critically important for the authorities to monitor developments closely during the coming months and to be prepared to take whatever action should prove necessary to keep the adjustment program on track. The provision of the comprehensive mid-term review of the stand-by arrangement was welcome. With regard to the request under the compensatory financing facility, all the relevant requirements had been met; therefore, he could support the proposed decision.

Mr. Shaw said that he also supported the request for the stand-by arrangement and that he agreed with the staff's appraisal. The critical economic situation in Western Samoa reflected a combination of bad management and bad luck. The economy had been severely affected by reduced prices for its two major export crops, by bad weather, and by increased prices of imports. While those factors could be regarded as bad luck, the question of bad management was less straightforward. However, the authorities had begun to take appropriate action and to implement a strong adjustment program, particularly with regard to the external side.

A reduction in external arrears of SDR 2.9 million in 1983 was a performance criterion under the arrangement, Mr. Shaw noted. Would the rescheduling referred to by Mr. Morrell result in all arrears' being eliminated? The elimination of all arrears would be a positive step in ensuring the confidence of creditors and the creditworthiness of Western Samoa. Finally, the provision of an index in EBS/83/105 was welcome; perhaps a similar type of index could be provided on a consistent basis in staff papers for stand-by arrangements.

The staff representative from the Exchange and Trade Relations Department stated that a rescheduling might make it possible to eliminate all external arrears within the period of the arrangement. However, at the time of the discussions with the authorities, the staff had been unable to establish the timing or the scope of the operation; therefore, the reduction of SDR 2.9 million required as a performance criterion had been set as a minimum. It did not preclude larger reductions or complete elimination. Rescheduling would not affect the other conditions of the program. With regard to the provision of an index in the report, the practice to date had been to include indexes in relatively lengthy papers. For short staff reports, an index appeared less necessary.

The staff representative from the Asian Department commented that, even if external arrears were to be completely rescheduled before the end of 1983, the authorities would still repay the amounts required under the performance criteria of the arrangement, i.e., a reduction of SDR 1.6 million by the end of September 1983, and SDR 2.9 million by the end of December 1983. In the negotiations with creditors, it was being assumed that the reduction in arrears would be made as part of the rescheduling effort. Given the general weakness in the external situation, the complete elimination of arrears should not lead the authorities to relax their adjustment effort in either the short or the medium term.

Mr. Morrell noted that most of the arrears related to current payments to oil companies, not to banks. It was likely, therefore, that repayment would be made over a relatively short period. To his knowledge, the arrears had arisen with regard to short-term credit, not through failure to pay interest or principal on longer-term debt. He welcomed the comments by Directors and the acknowledgment that the Western Samoan authorities had embarked on a strong adjustment program. They were determined to make the program work.

The Executive Board then took the following decisions:

Stand-by Arrangement

1. The Government of Western Samoa has requested a stand-by arrangement for a period of one year from June 27, 1983 to June 26, 1984 in an amount equivalent to SDR 3.375 million.

2. The Fund approves the stand-by arrangement attached to EBS/83/105, Supplement 1.

3. The Fund waives the limitation of Article V, Section 3(b)(iii). (EBS/83/105, 5/25/83)

Decision No. 7449-(83/92), adopted
June 27, 1983

Exchange System

1. The Fund notes that Western Samoa maintains external payments arrears as described in EBS/83/105 and the intention of the authorities regarding their early elimination.

2. The Fund approves the retention by Western Samoa of the exchange restriction involved in the maintenance of external payments arrears until January 31, 1984, or the completion of the mid-term review under the stand-by arrangement, whichever is the earlier. (EBS/83/105, 5/25/83)

Decision No. 7450-(83/92), adopted
June 27, 1983

Purchase Transaction - Compensatory Financing Facility

1. The Fund has received a request from the Government of Western Samoa for a purchase of SDR 1.15 million under the Decision on Compensatory Financing of Export Fluctuations (Executive Board Decision No. 6224-(79/135), adopted August 2, 1979).

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

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

Decision No. 7451-(83/92), adopted
June 27, 1983

2. THAILAND - STAND-BY ARRANGEMENT - MODIFICATION OF PERFORMANCE CRITERIA; AND PURCHASE TRANSACTION - BUFFER STOCK FINANCING FACILITY - SIXTH INTERNATIONAL TIN AGREEMENT

The Executive Directors considered a request by Thailand for a modification of performance criteria under the stand-by arrangement (EBS/83/114, 6/6/83) together with a request for a purchase transaction equivalent to approximately SDR 22 million under the decision on the buffer stock financing facility (EBS/83/129, 6/21/83: and Sup. 1, 6/27/83).

Mr. Habib made the following statement:

I would like to express the appreciation of my authorities in Thailand on the excellent staff reports relating to its requests for a modification of performance criteria under the stand-by arrangement and the use of Fund resources under the Tin Buffer Stock Financing Facility. They are broadly in agreement with the staff appraisals. I commend these requests to the Board.

I wish to highlight briefly Thailand's economic performance, its policy, and its relationship with the Fund.

Since the Board's approval of the stand-by arrangement in November 1982, the economic performance has been quite different from that envisaged in the program. Economic growth in 1982 was only 4 percent, compared with the 5 percent expected earlier. This was largely due to weaker investment demand and lower demand from the public sector. The projection for 1983 is also expected to be lower than the previous estimate. The weaker domestic demand induced a lower import level and sluggish economic activity in 1982. As a consequence, government revenues from import duties, corporate income tax, and business tax were much lower than expected.

However, the key objectives of the Fund program to contain the current account deficit and slow down inflation have been achieved. In 1982, the current account deficit was only $1.1 billion compared to $1.5 billion envisaged in the program. Moreover, inflation was less than 3 percent, compared with the original target of 5 percent.

As a consequence of lower inflation, real interest rates have become highly positive. These are unprecedented in the Thai economy and have thereby accelerated the intermediation of the financial markets. As stated in the staff paper on page 10, there is evidence of shifts of financial savings and borrowings from the informal sectors and, especially in rural areas, into the banking system.

The authorities view this financial intermediation as desirable because it will result in greater efficiency of resource allocation, as envisaged in the Development Plan. The staff agrees that the present financial intermediation has not exerted any pressures on domestic demand or the balance of payments because the process involves a structural shift and does not affect total demand to any significant extent.

Since September 1982, the authorities have adopted a more flexible approach to interest rate policy. The Bank of Thailand, which had directly fixed lending and borrowing interest rates in the past, changed the policy and insisted that commercial banks adjust the rates by themslves. Thus far, the new approach has worked quite satisfactorily. The banking system has already adjusted interest rates several times in line with prevailing market conditions.

In addition, my authorities would like to indicate that they agree with the staff analysis of interest rate policy on pages 9 and 12, which states that there is scope for further reduction of nominal interest rates. However, they would like to add that savings mobilization is still a key objective of their monetary policy. The authorities will closely monitor the movement of interest rates to assure that they are at appropriate levels so as to strike a balance between the objectives of stabilization and resource allocation.

On fiscal policy, the new Cabinet formed after the general election in April 1983 has indicated its firm adherence to continuing the cautious policy stance. The budget ceiling for FY 1984, involving an increase of only 8.4 percent, the lowest recorded in past decades, has been adopted by the new Cabinet on June 21, 1983. In addition, the recent liquor distillery concession bidding, which is a part of the revenue measures under the present stand-by program, has yielded an extra revenue of B 5.1 billion, compared to the original estimate of B 2.9 billion. Moreover, the new Cabinet has demonstrated its determination to continue with the policy to improve the financial position of public enterprises by raising train fares by 7.1 percent, effective June 21, 1983.

With regard to the recent reduction of energy prices in the international market, my authorities intend to maintain domestic energy price levels with a view to conserving energy and containing the burden on the balance of payments. However, because of strong political pressure for a reduction, the authorities have decided to reduce marginally the domestic energy price. The windfall revenue will, therefore, further improve the public sector's financial position.

On external debt policy, the new Cabinet intends to maintain a conservative external borrowing stance by discouraging short-term borrowing by both the private sector and the public sector. On June 21, the new Cabinet approved the extension of interest tax exemption on private borrowing from abroad for another year, effective July 1983. The loans eligible for this exemption should be for a maturity of longer than 24 months, compared with only 12 months at present. During the first half of FY 1983, which ended in March 1983, public sector borrowing from abroad was only $104 million, below the program performance limit of $1,500 million. The successful issuance of a $60 million floating rate note by the Electricity Generating Authority of Thailand, priced at only 0.25 percentage points above LIBOR, in June 1983, was clearly a demonstration of Thailand's creditworthiness in the international financial market.

Finally, the Thai authorities would like to stress their adherence to the policy as agreed with the Fund under the stand-by arrangement. Although the expansion of credits has already exceeded the program limit by a substantial amount, they have requested a modification of the ceilings to a lower margin. This request reflects their intention to undertake further measures to bring the credit trend back to the target by accelerating the sales of government bonds to the nonbank public, and by absorbing some excess liquidity of commercial banks through the repurchase market. In addition, they are now in the process of announcing a change in the regulations on the repurchase market which will effectively reduce access by the commercial banks.

The Thai authorities maintain a good relationship with the Fund in several aspects. I take this occasion to convey to the Fund staff their appreciation for technical assistance in various areas. The Ministry of Finance has greatly benefited from the assistance of the Fiscal Affairs Department in its tax administration reform. The Bank of Thailand has also benefited from the assistance of the Bureau of Statistics and the Bureau of Computing Services.

In addition, the IMF Institute has greatly upgraded the work standards of its staff. I also wish to thank the Institute on behalf of the SEACEN Center for its helpful cooperation. Last but not least, the Thai authorities have also benefited from the frank and useful discussions with the Fund staff on policy matters during the Article IV consultation.

Finally, I would like to add that the Thai authorities intend to conduct the Article IV consultation with the Fund on the standard 12-month cycle.

Extending his remarks, Mr. Habib added that he had been informed by his Thai authorities that Thailand had already made its contribution to the International Tin Council (ITC) in the amount of £15,145,976.70, approximately equivalent to SDR 22 million, by crediting the ITC's bank account in London.

Mr. Yamashita commented that the Government of Thailand had made economic adjustment efforts in accordance with the 14-month stand-by arrangement approved in November 1982 (EBM/82/148, 11/17/82). There had been a marked improvement in inflation and the balance of payments, but the performance criteria on total domestic credit and on net credit to the Government had not been met at the end of March 1983. In considering Thailand's request for a modification of the credit ceilings, Directors should examine the cause of the larger than expected credit expansion and the impact of the proposed increases in the credit ceilings on the achievement of the inflation and balance of payments objectives of the original program.

The expansion of net credit to the Government was closely related to recent fiscal developments in Thailand, Mr. Yamashita continued. In the first half of the current fiscal year, revenues had fallen short of the original target because of slower real growth, lower imports, and the lower rate of inflation. To cover the higher budget deficit, increased recourse to bank financing would be needed. However, given that the revenue shortfall was partly due to cyclically reversible factors, and that the outcome on the inflation front was better than expected, the increase in net credit to the Government would not jeopardize the achievement of the inflation and balance of payments objectives.

Commenting on credit to the private sector, Mr. Yamashita remarked that the unprecedently high levels of real interest rates on deposits had caused the rapid growth of broad money, especially time and savings deposits, resulting in a swelling of bank liquidity. In addition, the absorption of informal financial markets into the banking system had been speeded up by the high real interest rates, resulting in a shift of credit demand from those markets to the banking sector. Because the rapid expansion in bank credit had been due to a structural change in financial markets, and because it did not represent a departure from the original stance of monetary policy, it would not be a cause for rekindling inflation or for aggravating the balance of payments position. He welcomed the Thai authorities' intention to continue to monitor bank liquidity closely in order to contain the increase in credit within the proposed ceiling; he supported the request for a modification of the credit ceiling.

The request for the use of the buffer stock financing facility met all the requirements under the relevant decisions, Mr. Yamashita added. He supported the proposed decision.

Mr. Zhang noted that the staff stated that the key objectives of the original stand-by arrangement--to contain the current account deficit and to slow down inflation--had been achieved, and that the nonobservance of the credit ceilings had resulted from changed economic circumstances not fully foreseen in the original program. The staff also believed that the proposed increase in credit ceilings for the second and third quarters of 1983 would not jeopardize the achievement of the inflation and balance of payments objectives of the program. He agreed with the staff's evaluation and supported the request for the modification of the performance criteria. He also supported the request for a purchase under the buffer stock financing facility.

Mr. Jayawardena recalled that at the time of approval of the stand-by arrangement in November 1982, he had strongly supported the program, regarding it as sound and involving substantial structural adjustment. Indeed, he had wondered whether the adjustment proposed was too strong in the short period envisaged, and whether a smaller, but more extended, adjustment would have been appropriate. It was clear that, as a result of the strong adjustment measures, domestic demand had been weaker than anticipated, imports had been lower than expected, and government revenues had also fallen below expectation. On the other hand, the fundamental liberalization of the money markets had expanded the scope of the formal financial market resulting in absorption of the informal market. As a result, the ceilings for domestic credit, including the public sector credit ceiling, had been exceeded.

However, the basic framework of the program remained intact, Mr. Jayawardena considered. Indeed, economic growth was expected to recover moderately to about 5.6 percent in 1983, a satisfactory rate by current world standards. The external current account deficit in 1983 would be well within the program targets, and the fight against inflation had been a considerable success. For those reasons, he endorsed the staff's appraisal and supported the modification of the criteria under the arrangement. The buffer stock financing facility request was straightforward. He supported the proposed decisions.

Mr. Connors remarked that Thailand's adjustment effort remained broadly on track, although economic and financial developments had turned out to be somewhat different than projected at the beginning of the program. Therefore, he supported the request for the modification of the performance criteria. He also supported the buffer stock financing facility request.

Mr. Kohnert commented that Thailand's nonobservance of the ceilings on total domestic credit and on net credit to the Government clearly revealed the weakness of the tax system in Thailand. As in many developing countries, public sector revenues depended heavily on external trade. The issue had been frequently addressed on the occasion of previous Executive Board discussions of Thailand's request for the use of Fund resources. For example, the previous stand-by program had become inoperative in 1982 because ceilings on net credit to the Government had been breached. In November 1982, when the present program had been approved, a number of Directors had stated that it appropriately placed emphasis on fiscal adjustment. However, concern had been raised about the narrowness of the tax base and the heavy reliance on specific taxes, a problem that did not appear to have been addressed by the Thai authorities.

The staff had informed Directors about the additional revenue measures taken to contain the budget deficit, Mr. Kohnert continued. However, the measures had turned out to be insufficient to offset the revenue shortfall that had resulted primarily from the fall in trade-related revenues, a direct consequence of the structural weakness of the tax system. The staff's comment that "approximately half of the shortfall can be ascribed to temporary and reversible causes" had not been helpful. He urged the authorities to think of ways to broaden the tax base as soon as possible. Thailand had received substantial technical assistance from the Fiscal Affairs Department. He invited the staff to comment further on the state of the comprehensive review of the tax system announced for the end of 1982.

Commenting on interest rate policy, Mr. Kohnert noted that commercial banks in Thailand had apparently not adjusted their interest rates in line with lower domestic inflation and declining foreign interest rates. Was that attitude the result of a lack of competition in Thailand's banking system? Or was it more the result of expectations that recent expansionary monetary developments would lead to a substantial surge in the exceptionally low inflation rate? Thailand's success in slowing down inflation was commendable. Indeed, the present inflation rate was almost unprecedented. He invited the staff to comment on the extent to which the peg to the U.S. dollar had supported the authorities' endeavors to fight inflation. What had been the approximate costs in terms of export competitiveness? He supported both the proposed decisions.

Mr. Pickering said that he also supported the proposed decisions. With regard to the stand-by arrangement, the lower real growth of the domestic economy and the lower than expected inflation rate had appropriately warranted a somewhat easier fiscal stance than originally planned. However, some of the data presented in Table 3 of EBS/83/114 with regard to the impact of slower growth and lower inflation on government revenues had been unclear. For example, B 2.7 billion of the revenue shortfall in FY 1982/83 was due to factors other than stock adjustment effects, lower growth, and lower inflation. Significant unexplained shortfalls had occured in mineral taxes, excise taxes, and corporate income taxes. Perhaps the shortfall was related to other types of cyclical factors, or to administrative tax problems as suggested by Mr. Kohnert. He invited the staff to comment on the issue.

Government expenditure as a percentage of GNP for FY 1982/83 remained unchanged from the ratio in FY 1981/82, Mr. Pickering continued, despite the originally planned decrease of 0.9 percentage points. In view of the lower than expected inflation rate and the shortfall in revenues, was it not surprising that nominal expenditure levels had not been lower than expected?

Commenting on monetary policy, Mr. Pickering considered that it was regrettable that the larger fiscal deficit had resulted in greater recourse to financing from the banking system. In light of that development and the somewhat stronger growth expected later in 1983, he welcomed the authorities' intentions to reduce considerably the size of the deficit and its financing from the banking system in FY 1983/84. He invited the staff to say whether recourse to bank financing had contributed to the continuation of high real interest rates. Finally, he agreed with the staff's argument that a more rapid than expected rate of growth of broad money and bank credit to the private sector largely reflected growth in financial intermediation. He looked forward to a more quantified assessment of those effects at the time of the next Article IV consultation.

Mr. El-Khouri stated that he supported both the proposed decisions. With regard to the request for modification of performance criteria under the stand-by arrangement, monetary and fiscal developments during the first half of FY 1982/83 had turned out to be significantly different from those assumed under the arrangement. Revenues for the fiscal year were substantially below the program estimates, and broad money had grown at a much faster rate than expected. He agreed with the staff that the modifications in the credit ceiling that the authorities were requesting did not jeopardize achievement of the inflation and balance of payments targets of the original program.

A number of technical points could usefully be clarified, Mr. El-Khouri considered. First, if the Board approved the proposed modifications at the present meeting, would the authorities be able to resume purchases under the stand-by arrangement immediately? Net credit to the Government at the end of March 1983 had exceeded the proposed limit for the quarter April-June 1983. Perhaps a waiver for the end-March performance criteria would be needed if immediate purchases were to be resumed. Second, the authorities were not requesting a modification of the ceiling on net credit to the Government for the third quarter of the fiscal year, although the limit for the second quarter had been exceeded and the modification was being requested for the fourth quarter. He invited the staff to comment further on the reasons for that situation. Third, the staff mentioned that, although the commercial banks had used substantial liquidity to purchase Government securities and to reduce their net foreign liabilities, they had also extended more credit to the private sector. Together with higher credit to the Government, that development had led to a breach of the ceiling on total domestic credit. However, it could have been expected that the continuation of high real interest rates on the lending side would have acted as a check to the demand for credit by the private sector. Did the developments in the case of Thailand indicate that the interest rate mechanism did not constitute an effective instrument for controlling credit to the private sector?

Commenting on the request for the use of Fund resources under the buffer stock financing facility, Mr. El-Khouri observed that it met all the requirements under the relevant decisions; he fully supported it.

Mr. Taylor remarked that he endorsed the staff appraisal in EBS/83/114 and that he supported the proposed decision on the modification of the performance criteria under the stand-by arrangement. He also supported the request for a drawing under the buffer stock financing facilty. With regard to the latter request, he understood that the drawing was intended to support Thailand's cash contribution under the Sixth International Tin Agreement. If the purchase was approved, repurchases would be required when, and to the extent that, Thailand received a refund from the International Tin Council. Was it correct to assume that the requirement applied to the eventual repayment of Thailand's contribution to the buffer stock of the Fifth International Tin Agreement? If so, Thailand would have to make an early repurchase within the next 12 months.

Mr. Morrell commented that the Thai authorities and the staff had made a clear case for the modification of the performance criteria on total domestic credit and on net credit to the Government. The staff described how the record monetary growth that had led to the breach in the credit ceiling had arisen as a result of high interest rates' attracting funds from the informal markets and as a result of credit demand's shifting to the banking sector. Those events ought to be welcomed, as the development of the financial sector strengthened the ability of the Thai economy to adjust and to grow over the long term. The relaxation of credit ceilings would allow some stimulus to sluggish demand without adverse consequences on prices or on the external balance; the latter was more favorable than projected and more favorable than for most non-oil developing countries. It was a common problem with monetary statistics that a change in the nature of the financial system resulted in the growth of credit appearing higher than the increase that had actually taken place. He could also accept the relaxation of the ceiling on net credit to the Government to cover revenue shortfalls arising from lower demand and lower imports. Table 3 of EBS/83/114, "Sources of Tax Shortfall and Components of Change," had been a useful example of how to indicate where slippages had occured in revenue collection or other areas. He also supported the request under the buffer stock financing facility.

Mr. Salehkhou said that he agreed with the staff appraisal and that he supported both the proposed decisions.

The staff representative from the Asian Department commented that financial developments in Thailand in 1982 and 1983 had been unprecedented in Thai history. The financial market had to be considered in two categories--the banking sector, around which the performance criteria had been shaped, and the financial system as a whole, including the informal markets. All the available indicators, which were not comprehensive and which could not all be systematically quantified, suggested that a slackening in the demand for credit had taken place in the informal money market in 1982 and that, as a result, interest rates in that market had fallen. With the decline in interest rates, deposits had been shifted to banks. In addition, there was evidence that bank managers had agressively sought deposits because they were rewarded on the basis of deposit growth, a factor that reflected a competitive banking system, not a lack of competitiveness.

With regard to the demand for credit in the private sector, the staff representative continued, it appeared that, although interest rates in the informal market had declined to about 25 percent a year by the middle of 1982, compared with 30 percent earlier in the year, borrowers had found the rates of 18-19 percent in the banking sector relatively attractive. Thus, the demand for credit had been present at the time when the banks were becoming more liquid and when they were seeking new customers for their liquid funds. As a result, demand for credit had shifted from the informal market to the banking market, leading to more credit's being offered by the commercial banks. However, neither the staff nor the authorities had found significant evidence that the increase in credit from the banks was financing a much higher level of aggregate demand than had been expected. For example, there was no evidence of such a development from the demand for imports or from the rate of inflation. Therefore, a structural transformation of the financial system seemed to be taking place. Both the staff and the Thai authorities were keenly interested in quantifying that transformation as far as possible; the authorities would welcome it, provided that it did not lead to a level of aggregate demand inconsistent with their basic objectives of strengthening the balance of payments and restraining inflation.

He agreed with the Director who had commented that there were basic weaknesses in Thailand's tax system, the staff representative remarked. The staff had pointed to the weaknesses in the elasticity of the tax system, a factor partly related to the inadequacies in tax administration, and partly related to the importance of import duties on certain products, particularly petroleum. The staff believed that the authorities were making serious and effective efforts to strengthen administration in the Revenue Department, but the process was long term and would not immediately bring about significant increases in revenues. The situation simply implied that expenditures could not grow rapidly in the hope that revenues would materialize as a result of improved tax administration. The authorities recognized those limitations on the revenue side, and the staff did not believe that expenditure growth had been inappropriately large.

The lack of downward flexibility in nominal levels of expenditure in a particular fiscal year was a reflection of the fact that many budget items, for example, wages and salaries, were predetermined on the basis of salary scales decided earlier, the staff representative continued. Without reductions-in-force, nominal salary payments would increase as a result of promotions through the system. Similarly, many investment projects were effectively predetermined within a fiscal year. If inflation turned out to be lower than had been expected at the beginning of the fiscal year, there was no compensating downward adjustment of expenditures in nominal terms, unless there was a deliberate mid-year decision to cut back on certain activites. However, the analysis undertaken by the authorities and the staff suggested that no such retrenchment was required in the present circumstances and that the economy was moving in an appropriate direction.

It was difficult to quantify the extent to which the containment of inflation in Thailand had been helped by the strength of the U.S. dollar, the staff representative commented, although it had undoubtedly been an important factor in the low increase in import prices. There had been a depreciation of the baht in July 1981 following a period of depreciation of the U.S. dollar. Since then, there had been a further strengthening of the dollar and a relatively fixed relationship between the dollar and the baht, giving rise to some concern on the part of both the authorities and staff. The staff expected to discuss the question more intensely with the authorities at the time of the forthcoming Article IV consultation.

The staff did not expect that the authorities would be able to make a purchase under the stand-by arrangement immediately following approval of the modification of the performance criteria, the staff representative from the Asian Department noted. Nor did the authorities intend to seek a waiver of the performance criteria for the outcome on March 31, 1983. It was unlikely that the April level of net credit to the Government would be met, and it was questionable whether the level would be met in May, because of uncertainties with regard to the collection of revenues. The ceilings for the third quarter were not being modified because the authorities believed that they would be met, largely as a result of higher than expected revenues from the new tax measures.

The staff representative from the Research Department stated that, in accordance with the liquidation arrangements of the Fifth International Tin Agreement, Thailand would receive its share of the assets of the Fifth Agreement by June 1984. In those circumstances, Thailand would be obligated to complete the repurchase of the purchase made in September 1982 with respect to the Fifth Agreement.

Mr. Habib noted that his Thai authorities intended to continue to cooperate closely with the Fund.

The Executive Board then took the following decisions:

Stand-By Arrangement - Modification of Performance Criteria

1. Thailand has consulted with the Fund in accordance with paragraph 11 of the stand-by arrangement for Thailand (EBS/82/192, Sup. 2, 11/18/82) and paragraph 19 of the letter from the Minister of Finance and the Governor of the Bank of Thailand dated October 15, 1982, attached thereto.

2. The letter from the Minister of Finance and the Governor of the Bank of Thailand dated May 27, 1983, shall be annexed to the stand-by arrangement for Thailand, and the letter from the Minister of Finance and the Governor of the Bank of Thailand dated October 15, 1982, shall be read as supplemented and modified by the letter of May 27, 1983.

3. Accordingly, the limits on total domestic credit of the banking system for the periods April 1-June 30, 1983 and July 1-September 30, 1983 and on net credit to the Government for the period July 1-September 30, 1983 shall be those referred to in paragraph 8 of the letter of May 27, 1983 and specified in the

table attached thereto in place of those referred to in paragraph 14 of the letter of October 15, 1982 and specified in the table appended to it. (EBS/83/114, 6/6/83)

Decision No. 7452-(83/92), adopted
June 27, 1983

Purchase Transaction - Buffer Stock Financing Facility - Sixth International Tin Agreement

1. The Fund has received a request by the Government of Thailand for a purchase of approximately SDR 22 million (the equivalent of £15.1 million) under the decision on Buffer Stock Financing Facility: The Problem of Stabilization of Prices of Primary Products, Decision No. 2772-(69/47), June 25, 1969, as amended by Decision No. 4913-(75/207), December 24, 1975, and the decision on Buffer Stock Financing Facility: Sixth International Tin Agreement, Decision No. 7247-(82/147), November 12, 1982.

2. The Fund determines that this purchase would be consistent with the decisions referred to in (1) above, notes the representations of Thailand, and approves the purchase in accordance with the request.

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

Decision No. 7453-(83/92), adopted
June 27, 1983

3. EXECUTIVE DIRECTOR

The Acting Chairman bade farewell to Mr. Habib at the conclusion of his term of office as Executive Director.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/83/91 (6/24/83) and EBM/83/92 (6/27/83).

4. ROMANIA - STAND-BY ARRANGEMENT - PHASING OF FURTHER PURCHASES

1. The Fund decides, pursuant to paragraph 4 of Executive Board Decision No. 7375-(83/56), adopted March 30, 1983 that satisfactory arrangements have been made for the rescheduling of debt service payments falling due in 1983.

2. Purchases under the stand-by arrangement shall not, without the consent of the Fund, exceed SDR 817.5 million through December 31, 1983, provided that purchases shall not exceed the equivalent of SDR 633.9 million through July 31, 1983, nor the equivalent of SDR 725.7 million through November 30, 1983.

Decision No. 7454-(83/92), adopted
June 24, 1983

5. ANNUAL MEETINGS - GOVERNORS' PER DIEM ALLOWANCES

The Executive Board approves the recommendation contained in EBAP/83/158 (6/15/83) regarding per diem allowances for Governors and Alternate Governors during attendance at meetings of the Board of Governors.

Adopted June 24, 1983

6. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 83/13, 83/15, and 83/16 are approved. (EBD/83/174, 6/20/83)

Adopted June 24, 1983

7. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/83/163 (6/23/83) is approved.

APPROVED: November 25, 1983

ALAN WRIGHT
Acting Secretary