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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 82/33

10:00 a.m., March 19, 1982

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

Executive Directors	Alternate Executive Directors
	O. Kabbaj
	C. Taylor
A. Buira	M. A. Senior
	O. Üçer, Temporary
B. de Maulde	
R. D. Erb	
M. Finaish	T. Alhaimus
	T. Yamashita
	R. J. J. Costa, Temporary
	M. Casey
	J. R. Gabriel-Peña
B. Kharmawan	V. Supinit
	J. A. K. Munthali, Temporary
G. Laske	
	C. P. Caranicas
	A. B. Diao, Temporary
	A. S. Jayawardena
Y. A. Nimatallah	
J. J. Polak	
	B. Legarda
J. Sigurdsson	
Zhang Z.	Tai Q.

L. Van Houtven, Secretary
B. J. Owen, Assistant

Also Present

European Department: L. A. Whittome, Counsellor and Director; B. Rose, Deputy Director; E. Croce, P. B. de Fontenay, G. F. Kopits, T. M. Ter-Minassian. Exchange and Trade Relations Department: S. Mookerjee, Deputy Director. Fiscal Affairs Department: C. Y. Mansfield. Legal Department: Ph. Lachman. Research Department: M. S. Khan. Western Hemisphere Department: J. Ferrán. Personal Assistant to the Managing Director: N. Carter. Advisors to Executive Directors: C. J. Batliwalla, C. Bouchard, S. E. Conrado, S.-W. Kwon, P. D. Peroz. Assistants to Executive Directors: E. M. Ainley, L. Barbone, T. A. Connors, M. K. Diallo, J. L. Feito, J. S. Mair, W. Moerke, V. K. S. Nair, J. R. Novaes de Almeida, Y. Okubo, J. G. Pedersen, D. V. Pritchett, J. Reddy, J. Schuijer.

1. SPAIN - 1981 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1981 Article IV consultation with Spain (SM/82/43, 2/23/82). They also had before them a report on recent economic developments in Spain (SM/82/45, 3/3/82).

Mr. Buira made the following statement:

On behalf of my Spanish authorities I wish to express my appreciation to the staff for the excellent set of papers they have prepared, with which they are in broad agreement.

Spain has had to face the problems brought about by the international recession, the rise in oil prices and interest rates amid a delicate and difficult process of transformation of the political and social institutions of the oil regime to render them fit for a modern democracy. This added to the problems of economic management in Spain, which cannot be fully understood if account is not taken of the unusual influence of political developments on the economy and the priority understandably given to political reforms. Moreover, the country was hit by the world economic crisis at a critical stage in its economic development. Industrial production has tended to be concentrated in sectors in which external and domestic demand was growing slowly and in which competition from other countries was particularly keen. Additionally, a number of reforms necessary to promote the movement of resources and improve the efficiency of the economy were hindered by structural and institutional rigidities.

When seen against this background, the macroeconomic performance of the economy has been commendable, particularly with regard to inflation. The inflation rate has been gradually but steadily reduced from 27 per cent at the end of 1977 to 14.5 per cent last year, and it is expected to be about 12 per cent by the end of 1982. Indeed, Spain is one of the very few countries where inflation declined steadily over the past four years. This price performance has to be seen as a remarkable achievement, especially in view of the domestic pressures for real wages growth--and foreign pressures for exchange depreciation and higher import prices--to which prices have been subjected.

In recent years, the growth of real GDP has ben modest: 0.5 per cent in 1979, 1.2 per cent in 1980, and an estimated 0.5 per cent for 1981. The uncertainies associated with political change and the impact of international recession notwithstanding, Spain has not experienced negative growth rates, though it has certainly grown at rates well below the potential of the economy. One of the main reasons for this limited growth has been the weak performance of private investment over this period. This, in turn, was due not only to the uncertainties derived from political events and the accompanying structural economic reforms, but also to a considerable decrease in profitability resulting from the growth of real labor costs and the deterioration in the terms of trade.

A consequence of the decrease in the rates of investment and growth has been rising unemployment. The unemployment rates, which was of the order of 9.6 per cent in 1979, rose to 12.6 per cent of the labor force in 1980 and further to about 14.5 per cent in 1981. This problem has also been aggravated by the substitution of labor by capital that resulted from the increase in the relative price of labor and by the low labor intensity of energy investments implemented in response to the oil price increase.

Naturally, the high level of unemployment is a matter of the gravest concern to the authorities, who are attempting to arrest its increase without abandoning their fight against inflation. To this end, a National Employment Agreement (ANE) was concluded as a mechanism designed to prevent the effect of anti-inflationary policies from falling largely on employment, without significantly affecting the rate of growth of nominal wages. Under this tripartite agreement comprising employers, labor, and government, nominal wage increases will be limited to between 8 per cent and 11 per cent a year, and higher than expected rates of inflation would lead to an upward adjustment of the range so as to achieve annual reductions in real wages of 2 per cent on average. In exchange, the Government is committed to implementing a substantial program of public investment and to reduce gradually the burden of social security contributions. This agreement also encompasses other significant measures aimed at increasing labor mobility and the efficiency of the labor market. For 1982 the objective of the ANE is to stabilize the rate of unemployment at about the present figure and to reduce it gradually in the future.

Over the past two years the current account of the balance of payments recorded a sizable deficit of some $5 billion or 3 per cent of GDP. A continuing deterioration in the terms of trade, decreasing levels of activity in the major Spanish trade partners and the rising cost of the interest service on the external debt are among the major causal factors of this deficit. However, since the external balance has proved to be very responsive to Spain's real competitiveness, my authorities are not unduly concerned by that figure. In fact, responding to a considerable effective depreciation of the peseta in real terms, the figures for the last quarter of 1981 and estimates for the first quarter of 1982 show a notable increase in the growth of exports and approximate balance on current account in the first quarter of 1982.

My authorities in Spain consider that a lasting improvement of competitiveness can best be achieved through a steady deceleration of domestic costs and prices. Therefore in addition to the flexible management of the exchange rate--which is well described in the staff papers--the current anti-inflationary stance of financial policies will contribute to strengthen the balance of payments to the extent permitted by the evolution of the international economy.

Traditionally, Spain's public sector has achieved approximately balanced budgets. Therefore, the current 3-4 per cent ratio of the public sector deficit to GDP, though low by international standards, is a matter of concern for the authorities. Public expenditure has been subjected over the period to forces associated with the political transformation and therefore the deficit should not be seen as the result of a relaxation of fiscal discipline. The peaceful transition from the oil regime into a democracy has certainly been one of the most remarkable in modern history, but it has by no means been a costless process in economic terms. The nature and growth of the public sector deficit reflect, to a considerable extent, the economic aspects of that process. Thus, several of the major sources of growth in public expenditure have been the result of parliamentary action, such as the law on employment, the extension of pensions to the relatives of civil war victims, the law on the modernization of the armed forces, and others. Political factors aside, the pulic sector deficit has acted also as a shock absorber, reflecting and softening the impact of unemplyment resulting from excessive increases in real wages and the deterioration in the terms of trade.

The 1982 budget reflects the authorities' objective of keeping the public deficit from rising beyond present levels, while at the same time shifting the strucutre of public expenditure in favor of greater investment. To this purpose, a three-year investment program is being implemented which centers on the promotion of labor-intensive activities such as construction and transportation infrastructure, as well as in energy sectors. The 1982 budget also includes measures embodied in the ANE to reduce labor costs and stimulate employment.

Over the period, monetary policy has been the main instrument of demand management in Spain. The Bank of Spain was among the first to formulate monetary policy within the framework of quantitative targets for monetary aggregates. Their reliance on quantitative targets is justified by the stability of the relationship between nominal GDP and money, particularly the M-3 definition, and between money and the closer operational variable, i.e., banks' reserves. The Bank of Spain has shown notable success in maintaining money growth within the established targets. This has significantly contributed to the success achieved in the inflation field.

My authorities consider that a sharper reduction in the rate of money growth would result in a fall in output without any significant effect on inflation. They further believe that inflation cannot be arrested by monetary policy alone if monetary restraint is not accompanied by a reduction in the growth of real wages. This is the rationale underlying the National Agreement on Employment. When the different policy options available to the authorities are considered, taking into account the relevant domestic and international conditions, it is difficult to see what other policies could have been followed.

Notwithstanding the difficulties of this period, several structural reforms have been launched, which will increase the flexibility and efficiency of the economy in the coming years. These include:

- In the energy field, a National Energy Plan was introduced in mid-1979 that has already achieved an important reduction in Spain's dependence on imported oil from 70 per cent of its energy needs to some 60 per cent by the end of this year.

- Further reform of the financial system, particularly reduction of the role of selective credit controls. Interest rates have been further liberalized, interest rates on commercial paper and short-term loans up to two years are now free; loans of more than two years were already free. In addition, nonresident accounts have been made fully convertible.

- Continued trade liberalization aimed at reducing the level and variance of the staff and other barriers to trade.

- In the fiscal field, the introduction of the value-added tax, whose implementation has been scheduled for the beginning of next year. The VAT is expected to have a considerable balancing impact on the budget and will facilitate the negotiation with the EC.

The Deputy Director of the European Department explained, in response to a remark by Mr. Buira, that the question that had arisen on the previous day related to a blocking of balances belonging to Equatorial Guinea in a Spanish bank. Inquiries had revealed that the matter had its origin in a dispute between Equatorial Guinea and a Spanish commercial firm, which had gone to court and obtained an order calling for the attachment of deposits with a Spanish commercial bank. The staff had been informed that payment to the Spanish enterprise had been made, the blocking and attachment of deposits withdrawn; the matter was therefore closed. It should be noted that at no point had the Spanish Government or the Bank of Spain been involved in any way at all.

Mr. de Maulde said that he entirely agreed with Mr. Buira's statement that the peaceful transition from the old regime into a democracy had certainly been one of the most remarkable in modern history. As a fellow European country as well as a neighbor, France was proud of Spain's achievements in that respect. It was all the more admirable that Spain had not been diverted from its purpose of carrying out a deep internal transformation because the process was being undertaken in the midst of the worst possible international environment, a worldwide depression following two oil crises. A heavy toll had been exacted; Spain's rate of unemployment, which was approaching 15 per cent, was one of the highest in the industrial world. As far as economic growth was concerned, Mr. Buira had reported that his authorities had succeeded in maintaining a positive rate of growth over the previous three years, of 0.5 per cent in 1979, 1.2 per cent in 1980, and once again of 0.5 per cent in 1981, rates that were of feeble solace, as much stronger ones would have been required to check the steady rise of unemployment.

During recent years, Mr. de Maulde continued, the Spanish authorities had carefully conducted their economic and financial policies by making use of the classic recipes for adjustment. The Bank of Spain was to be commended for maintaining firm control of the money supply; its methods might well be judged archaic by certain outside observers accustomed to more sophisticated instruments, but they worked.

On the fiscal side, Mr. de Maulde added, personally speaking, he would not criticize the current level of the budget deficit, which he understood amounted to 3-4 per cent of GDP. When unemployment was reaching 14.5 per cent of the labor force, it would be economically as well as politically suicidal to try to have a balanced budget. However, he would be interested to know whether or not the staff had made any calculations along the lines of the full employment/fiscal equilibrium concept. It would also be helpful to know whether or not the current budget deficit, and the shortfall in revenue could be attributed entirely to the slackness of demand. In fact, he would be more worried about the nature of budgetary expenditure than about the deficits. As Mr. Buira had observed, several of the major sources of growth in public expenditure had been the result of parliamentary action, such as the law on employment, the extension of pensions to the relatives of civil war victims, and the law on the modernization of the armed forces. At the same time, Mr. Buira had gone on to note that the 1982 budget reflected the authorities' objective of keeping the public deficit from rising beyond present levels, while shifting the structure of public expenditure in favor of greater investment. That was certainly a necessary and commendable objective.

The most encouraging feature of Spain's policies, Mr. de Maulde noted, was in fact the decisive attempt to substitute direct action for the indirect results that were generally brought about by the action of the Central Bank. The National Employment Agreement was a mechanism designed to prevent the effect of anti-inflationary policies from falling largely on employment. According to Mr. Buira, under that tripartite agreement, nominal wage increases would be limited to between 8 per cent and 11 per cent a year, meaning that real wages would be reduced annually by an average of 2 per cent. If his understanding was correct, the Spanish Government had followed a courageous policy of arbitrage between the level of employment and salaries.

The rate of domestic savings might be an element of weakness in the economy, as evidenced by the behavior of the current account of the balance of payments, Mr. de Maulde said. He asked whether the Government was preparing any new action to encourage domestic savings.

Finally, Mr. de Maulde remarked, it was a cause of some concern to him to note the conclusion at the end of the staff appraisal. It suggested that attention be given to a further liberalization of Spain's fairly restrictive import regime, especially for a modern industrial economy that was soon to become a member of the European Community, because the high effective level of protection tended to perpetuate the existence of industries that were no longer able to provide opportunities for expanding employment. He considered that to be the only serious weakness in the appraisal of Spain's current policies by the staff, and echoed by Mr. Buira himself, of Spain's current policies.

Mr. Polak said that, as Mr. Buira had mentioned, Spain's economic and financial problems had to be considered against the background of what he had described as the "delicate and difficult process of transformation of the political and social institutions of the old regime to render them fit for a modern democracy." That thought pervaded the results of the staff's discussions as could be seen, for instance, in the high priority that had to be given to the unemployment problem, a problem which in itself had arisen in part from the urgency in earlier years of raising real wage rates. The National Employment Agreement also had to be seen in that light and warmly welcomed as a cooperative approach to some of Spain's most difficult economic problems.

In the difficult external and internal setting with which Spain had had to contend, Mr. Polak continued, the policy results in recent years had to be judged as having been broadly successful. The authorities had shown a willingness to go to the roots of problems; both on price inflation and on wage increases, it was a matter of satisfaction to note the success that had been achieved, and the reasonably favorable prospects for 1982 for various aspects of the economy. Major problems still faced the authorities: high unemployment, the large current account deficit, which however apparently responded well to movements in the exchange rate, and the government deficit, which was itself in part a reflection of the difficulties attending the process of political transformation. Certainly, he shared the staff's view that the problems of unemployment and government finances should be attacked by structural means. He agreed with the policy mix, with its focus on the generation of increased exports, both because of the possible employment effects and because of the benefits that could be derived for the current account, thereby also alleviating the foreign debt burden. He also concurred in the exchange rate policy that Spain had followed of managing at the same time to achieve an improvement in the real effective exchange rate and a reduction in the rate of inflation.

One of the important reasons for pursuing a reduction in the government deficit, Mr. Polak observed, was to free resources for investment, which had been disappointingly low in Spain. Another reason was the monetary impact of the deficit, in the absence of a well-developed capital market; three quarters of the government deficit in recent years had been absorbed by monetary expansion, with the result that on some occasions in the past, monetary targets had had to be adjusted because of the disappointing results of fiscal policy, with the risk of unfavorably affecting the battle against inflation. It would also be interesting to know what link there was between the external position and the monetary targets. It was somewhat surprising that a country having to contend with serious balance of payments problems, actual or contingent, and with a managed exchange rate, would rely entirely on setting targets for M-3, and not on domestic credit expansion.

Savings had declined as a percentage of GDP over the previous ten years, Mr. Polak observed, an unfavorable development, considering the need for domestic investment and reduced reliance on foreign capital. There were no indications in the staff report that the ratio of savings to GDP would increase, even though some measures were being taken to raise interest rates and liberalize the financial system. The issuance of short-term government paper was however meeting with opposition from the banking sector, because it was seen as competing for bank deposits that carried a low fixed interest rate. He wondered therefore whether savings were still being discouraged by institutional constraints and whether it was important for the Fund to urge upon Spain a rapid further liberalization of financial instruments. After all, Spain might not have to have a fully developed capital market before savers, including small savers, could enjoy the benefits of the high interest rates that obviously prevailed for the main components of capital in Spain.

As a further general comment on economic policy in Spain, Mr. Polak noted with some concern a certain inclination to make use immediately of any room for maneuver that was opened up. One example was the easing of monetary policy in 1979, which had soon had to be reversed, and another was the intention at present to increase domestic demand if there was an improvement in the terms of trade. As a general matter, there should be reason for taking a contrary position, one based on great caution, because the authorities seemed rather close to the boundaries of their present policy. Even though the fiscal deficit was not high from an international perspective, it was high in light of the poor savings rate in Spain and the potential conflict with monetary policy. High unemployment could easily hamper a shift in public expenditure from consumption to investment, whereas the promotion of investment was one of the essential requirements for an upswing in exports, which was itself the basis for an upswing in the Spanish economy. Again, the current account of the balance of payments might become a constraint; it seemed particularly important to limit Spain's dependence on imported energy and to watch closely the burden of external debt, lest it become a severe constraint on policy.

Having noted all those constraints, Mr. Polak concluded, the conduct of economic policy in Spain in recent years nevertheless gave every reason to expect that the authorities would meet the challenges before them.

Mr. Laske said that in broad terms he could agree with the staff appraisal. It was clear from the staff reports that the Spanish authorities were confronted at present with conflicting priorities. They faced unemployment that was extraordinarily high, but the rate of inflation, although it had decreased considerably over the past two years, also continued to be rather high, especially compared to rates of inflation in other European countries that Spain hoped to join soon in the European Community. For domestic reasons, therefore, employment should be fostered or, at the very least, a further increase in unemployment forestalled; for both domestic and external reasons, continued emphasis had to be placed on containing inflationary pressures. The choice of instruments to be employed in that precarious balancing act required careful consideration so as to prevent one priority from being undermined by the pursuit of another. A general stimulation of economic activity would certainly be counterproductive. It would not stimulate employment in the longer run, partly because of the many rigidities still prevalent in the economy. On the contrary, inflationary pressures would likely be rekindled, with detrimental consequences for the international competitiveness of the Spanish economy that would prolong unnecessarily the present balance of payments problems.

It had already been pointed out in the discussion of the most recent Article IV consultation with Spain, almost exactly two years previously, that the country had to prepare its economy for entry into the European Community, Mr. Laske recalled. That prospect called for enhanced international competitiveness, increased flexibility, and greater responsiveness of the economy to changing circumstances. Rigidities continued to exist, both in the financial system and in industry, although a number of them, for instance, with respect to interest rates, had been eased. The restrictiveness of the import regime had to be mentioned in that context. As for the financial system, it appeared from the staff report that there was no effective secondary market in Spain for medium-term and long-term securities. The question therefore arose of what the authorities, and perhaps the financial community itself, could do to promote the development of such a market, which would tend to mobilize additional private savings to meet the financing needs of industry as well as of the public sector. Furthermore, the apparent resistance of the commercial banks to the issuance of short-term government securities to nonbanks suggested that the commercial banks wanted to preserve their near-monopoly position in lending to the public sector. Did the authorities intend to go ahead with the sale of short-term securities to the nonbank public?

A potential conflict obviously existed between the outlook for fiscal policy and the chosen monetary stance, Mr. Laske added. The continuation of high public sector deficits, financed heavily by the Central Bank, would work against the stabilization effort: pressure would be put on available resources, private business might be crowded out of the financial markets at a time when more private investment was needed, and capital inflows might be induced. Considering the ongoing need to strengthen international competitiveness, the appreciation of the peseta that might result from sizable capital inflows would be unwarranted. Of course, upward pressure on the exchange rate could be checked by exchange market intervention, but the liquidity effect would not be in conformity with the restrictive stance of monetary policy that was indicated on other grounds. On balance, therefore, all considerations seemed to point to a strong need for fiscal restraint, and the inordinate amount of uncertainty to be found in that area was a cause for voicing serious concern.

The tripartite agreement on wage policy was without doubt a big step forward in reaching the social consensus without which the foundation for a stable recovery of the Spanish economy would be laid in quicksand, Mr. Laske said. However, certain elements of the agreement, welcome and necessary as it was, seemed to carry considerable risks. First, there was the indexation clause. It was true that the clause would be triggered only if the official inflation target of 12 per cent was not met. Although inflation had been reduced considerably over the previous two years, to bring it down to that level from the 14.5 per cent recorded in 1981 might well be a much tougher job than the one that had been carried out so far. Second, the budget was to assume 90 per cent of the employer's contribution to social security premiums for newly hired workers, the Government's objective being to create 350,000 new jobs. The outcome might be considerable cash expenses, as well as additional borrowing needs, for the Government. Furthermore, the authorities seemed to be contemplating an increase in aid to industries facing financial difficulties; apart from the considerable budgetary costs that might be involved, the indispensable modernization of Spain's industry, to make it more productive, would tend to be impeded.

As other Directors had pointed out, Mr. Laske concluded, the policies that the authorities had implemented over recent years in a difficult political environment had led to admirable results. He wished to express appreciation for the way in which the authorities had handled their problems and to convey his best wishes for their further success.

Mr. Gabriel-Peña noted that the Spanish economy had been suffering from low economic growth and high unemployment since 1975. It had not adjusted well to the first oil shock, and the external position had been further deteriorated by the second oil price increase, which had led to a shift in the current account balance from a moderate surplus in 1979 to a deficit in 1980 and 1981. The task of the authorities had not been made easier by the rising import trend stemming from the integration of the economy with the world market and, as Mr. Buira had indicated, from the need for a peaceful transition from the old regime to a new political and social order.

The problems of inflation, unemployment, and external imbalance had been addressed in a well-balanced fashion, Mr. Gabriel-Peña continued, and recent economic data pointed toward some improvement in the achievement of needed adjustment. First, the rate of increase in domestic prices had been declining from 24.5 per cent in 1977 to 14.5 per cent in 1981, and the rate was expected to be lower in 1982. Clearly, that trend reflected the well-managed monetary policy and an improved performance recently in the leveling off of labor costs. A better price performance could also be expected if the fiscal deficit were kept at a moderate level and its financing were accompanied by an upward turn in the savings ratio, which since 1981 had no longer been falling, in keeping with the financial liberalization that was taking place.

Second, the employment problem confronted the authorities with a tremendous task, due to the increasing rate of unemployment since 1978, Mr. Gabriel-Peña said. The authorities' policy stance was the right one at the present cyclical conjuncture because, as they were aware, their fight against unemployment had to be combined with a policy of allocating resources efficiently and of holding real wages below increases in productivity in order to achieve a further liberalization of the trade regime and to reduce the fiscal burden of helping ailing industries.

Third, Mr. Gabriel-Peña noted that the authorities had made significant progress in correcting the external imbalance. The gradual depreciation of the effective exchange rate, along with a continued reduction in the increase of domestic costs, had improved the merchandise balance in 1981. Further improvement was expected in 1982 if exports continued to respond to the firm financial and economic policies, and, of course, if the balance of payments burden were reduced as energy imports responded to the decrease in oil prices and the energy conservation policies in place since 1979. If additional allowance was made for the improvement in the services account, the authorities might be borne out in their expectation of a reduction of the current account deficit from the 2.8 per cent of GDP registered in 1981.

The authorities were to be commended for their exchange rate and interest rate policies, Mr. Gabriel-Peña commented, which had facilitated the financing of the current account deficit and created a positive overall balance for 1981. Reserves in November 1981 had reached the comfortable level of being equivalent to about four months' imports, excluding moreover 14.6 million ounces of gold.

In conclusion, Mr. Gabriel-Peña expressed his belief that the Spanish economy was on the right track toward adjustment and his sincere hope that the authorities would succeed in spurring economic growth and creating employment.

Mr. Taylor considered that the staff report was incisive and the report on recent economic developments extremely comprehensive. It was less satisfactory to note, as Mr. Laske had pointed out, that the most recent Article IV consultation with Spain had been held two years previously, although he understood that there had been informal discussions toward the end of 1980. He acknowledged that there were pressures on the staff, and even perhaps special circumstances in the case of Spain, but a two-year interval between consultations seemed long, bearing in mind that Spain was an important industrial country, going through a difficult period of transition and preparing for entry into the European Community.

The Spanish authorities had made significant progress on a number of fronts in the previous year or two, Mr. Taylor continued. Their policy response to the second oil shock had been more realistic than after the first oil shock. As had already been pointed out, inflation had fallen from the high levels of the late 1970s. The shift to a supply-oriented strategy was particularly welcome, and much in line with the emphasis notable in recent speeches by the Managing Director on the need to remove rigidities in industrial economies. He urged the authorities to take further steps in that direction along the lines advocated by the staff at the end of its appraisal.

The Spanish authorities had difficult policy dilemmas to deal with, Mr. Taylor continued. As the staff had judiciously put it, a delicate balancing of priorities was called for. The unemployment rate at 15 per cent was understandably liable to generate pressures for government action, but premature reflation would provide at best short-lived gains. The main priority therefore would have to continue to be the struggle against inflation, which remained fairly high. The National Employment Agreement was a useful and interesting initiative, although it obviously entailed certain risks. The inclusion of an automatic wage adjustment clause could introduce undesirable rigidities that might in some circumstances weaken the effectiveness of the exchange rate as an instrument for adjustment; the associated commitment by the Government to increase public investment might take the form of make-work projects, as the staff had indicated. As for subsidies to ailing industries, the state was not always best at selecting investment projects, and the outcome of such subsidization would not necessarily be a better allocation of resources. Certainly, it would be helpful to have a more up-to-date view of the likely development of wage policy after 1982.

It was encouraging to note that the authorities seemed determined to reverse what the staff had described as a steady deterioration in the public finances, Mr. Taylor continued. The fiscal deficit projected for 1982 was not unduly large, on the face of it, but it was based on the achievement of the employment target in the National Employment Agreement. There had been a rise in unemployment since June 1981, and he wondered whether there was any indication yet of an upturn in employment. Furthermore, there was surely a significant risk of expenditure overrun, as in 1981, when the overall deficit had reached almost twice the budgeted amount. Projected transfers to the state enterprises in the 1982 budget were significantly higher than in the initial budget in 1981, and reference was also made in that respect in the staff report to supplementary appropriations; he wondered whether the latter were likely to represent a threat to the fiscal objectives. It was also notable that social security benefits as budgeted would account for as much as 46 per cent of current expenditure. In view of the acknowledged need to reduce inefficiency and waste in the administration of the social security program, the appointment of a reform commission was timely. It would be interesting to have an idea of the speed with which the commission was to work and when it might lead to results. He had noted that some thought had been given to inducing the private sector to assume a larger role in the provision of what would be termed social security services, and wondered whether that was a feasible objective.

As for monetary policy, Mr. Taylor observed, the considerable success of the authorities in keeping to their targets for monetary growth could be jeopardized if the government deficit, which was largely financed from the central bank, continued to rise. The staff had emphasized in its reports that the deficit had put the financial system under considerable strain and had perhaps at times led to some crowding-out of private investment through credit rationing. If that situation continued, or led to large capital inflows and thus to an appreciation of the exchange rate, the Government's hopes of a better performance for private investment and exports could be endangered. Again, the need for a firm hold on the fiscal position was thereby underlined, as was the suggestion voiced during the discussion of giving more consideration to liberalizing and modernizing the financial system. The proportion of bank deposits directed to what were called privileged circuits remained rather high--over 20 per cent--and the provision of that kind of guaranteed financing permitted the sectors of the economy that were so favored to operate with less than maximum efficiency. He agreed that much had already been done, but there was still scope for freeing interest rates and, in particular, for more deliberate and urgent moves to relax the regulations governing the operation of foreign banks in the country, moves that would of course be required anyway as Spain moved toward joining the European Community.

On energy policy, Mr. Taylor remarked, while the recent fall in international oil prices should provide some assistance to the trade account and somewhat more room for maneuver, it should not weaken the effort to achieve greater energy conservation. As a matter of fact, primary energy consumption had been reduced only marginally in Spain since 1979, and there might be something to be said for further incentives to economize on energy use and find alternative sources of energy.

Referring to external policy, Mr. Taylor said that he agreed with the view of the authorities that a lasting improvement in competitiveness would best be achieved through steady pressure to reduce domestic costs and prices. Nevertheless, there would be a need for supplementing that approach by continued flexibility in the management of the exchange rate.

The proposed moves to reduce the effective protection of the Spanish economy, which he endorsed strongly, might also in due course help to improve industrial efficiency.

Spain continued to avail itself of the transitional arrangements of Article XIV, Mr. Taylor noted. Could the staff say whether or not the authorities were thinking about moving toward Article VIII status and whether or not there were any obstacles to such a move?

In conclusion, Mr. Taylor observed that, although there was a difficult task ahead for the authorities, an appropriate combination of demand restraint and supply-side measures to deal with deep-rooted structural weaknesses would take them a long way toward meeting their medium-term objectives. The authorities had demonstrated their ability to manage the economy in a prudent and well-directed way, and his chair wished them every success as they steered the country toward membership in the European Community.

Mr. Erb remarked that Spain had indeed been in a difficult economic position in the previous several years. As Mr. Buira had noted, in assessing the performance of the Spanish economy, Directors should keep in mind that the progressive political and social transformations that had taken place had made economic management more difficult.

He was in general agreement with the staff's appraisal of the suggested economic policies for 1982 and beyond, Mr. Erb said. It was important for the authorities to continue their attempts to reduce Spain's relatively high inflation rate. The GDP deflator had fallen from the 20 per cent rate of 1978, but the decline seemed to have stalled at about 12 per cent, the rate of inflation during the previous two years and the rate projected for the current year. The authorities were moving in the right direction by reducing the rate of growth of monetary aggregates, although if monetary growth was to be in the range of 15 per cent in 1982, as suggested in the staff report, it seemed unlikely that inflation would be reduced more than slightly. As for the appropriateness of monetary-based targeting in an economy like Spain's, it had seemed satisfactory to him, and the staff had laid out the basic reasons why it had been a reasonable approach in the past in the interesting analysis in Appendix V. He would pose the question raised by Mr. Polak slightly differently and, looking to the future, would ask what implications the financial liberalization of the domestic economy--assuming that progress was made in that respect--would have for the monetary targeting procedure. In addition, there was the question of the longer-term implications of further integration with the real as well as the financial sectors of other European economies for the relationship between monetary aggregates and the overall economy in Spain, and the effect on future monetary policy.

The Spanish representatives and the Fund staff had suggested that the size of the fiscal deficit had been and was expected to remain a problem for monetary management, Mr. Erb noted. Therefore, the increase in the budget deficit as a percentage of GDP in 1980 and in 1981 was worrisome;

despite fairly buoyant revenues, the deficit was still budgeted to remain high in 1982. It seemed essential to contain the growth in social expenditure by the Government if the deficit was to be narrowed. In its analysis of the impact of fiscal policy in Appendix III, the staff had concluded that two opposing hypotheses with respect to the impact of the fiscal deficit on private investment could be developed equally convincingly. He would prefer for the staff to state more specifically its judgment on the impact of the budget deficit and budget financing on private investment. In addition, as noted in the last sentence of Appendix III, the crowding-out of private investment from the financial markets was perhaps as important a notion as the potential crowding-out effect of the growth of government expenditures on the economy. He himself would have referred to the longer-run effects on resource allocation and growth as depending on both the level and composition of government outlays, because the crowding-out could affect private sector investment, not only in industry and equipment, but also in human capital and in two ways: financially and through an increase in the level of taxes.

The movement of energy prices to market levels had been desirable, Mr. Erb considered, and the flexible exchange rate policy had had a beneficial impact, by preventing an even worse deterioration of the current account position. In addition, the Government seemed to be making some progress on the wage front. Despite the progress made on the structural side, however, future economic growth, a reduction in the rate of unemployment, and a fairly rapid integration of the Spanish economy with the European Community would require equal attention to be focused on structural rigidities, important as macroeconomic policy was, and especially the need to reduce the fiscal deficit and the growth of money. In that respect, the staff had cited in the last paragraph of its appraisal the areas where more could be done. He hoped that greater attention would be paid in subsequent Article IV consultations to the structural adjustments that needed to be made. Additional technical analyses would be helpful, similar to those in the Appendices attached to the report on recent economic developments, and covering not only the liberalization of the financial system but also the impact of the level as well as the structure of taxes on savings and investment and the allocation of resources in the economy. The Government should likewise be encouraged to move more rapidly to liberalize imports.

In conclusion, Mr. Erb expressed agreement with Mr. Taylor that Spain was a country where consultations should perhaps be held at least once a year. Because of Spain's transition in coming years to membership in the European Community, it might even be appropriate for special studies to be made on an interim basis.

Mr. Costa considered that the reasons for the various signs of disequilibrium in the Spanish economy during the second half of the 1970s had been clearly explained by the staff. As for more recent developments, important measures had been taken since the beginning of the 1977/78 stabilization effort, in both the monetary and the real sectors of the economy, to curb inflation, stimulate domestic production, and improve the balance of payments position. The increase in public investment and the fiscal incentives granted to private enterprises, particularly in energy-related fields, would help to widen the supply base of the economy and reduce the short-term trade-off between growth and inflation. The social agreement on real wage increases would also contribute to the stabilization effort by moderating domestic consumption and restoring profit margins so as to induce a higher rate of private investment in the longer run.

It would be difficult for the authorities to meet their intention, which he supported, Mr. Costa said, of reducing the public sector deficit for 1982, particularly because of the increase in public investment and improvements in unemployment compensation and other social benefits. Greater participation by the private sector in the provision of social services would be welcome because it would avoid involving the public sector in an excessive fiscal burden in that respect.

As for monetary policy, Mr. Costa continued, it had to be acknowledged that the authorities were strongly determined to control the rate of expansion of monetary aggregates and to fulfill the monetary targets in 1980 and 1981. As the staff had mentioned, that had been an important reason for the reduction of inflation from 24 per cent in 1977 to 14 per cent in 1981. As Mr. Buira had pointed out, Spain was one of the few countries in the world in which inflation had declined significantly over the past four years. The authorities had also moved steadily in the direction of a flexible interest rate policy, the general upward trend in interest rates, together with the falling rate of inflation, having most likely accounted for the marked decrease in the income velocity of broad money during the years 1978 to 1980. That positive attitude on the part of the authorities led him to encourage them to push on to the complete deregulation of financial markets. There might be some room for upward adjustment in the rates on savings and short-term time deposits in order to stimulate household savings, which had been falling in terms of GDP since 1978, as shown in Table 2 of the report on recent economic developments.

The adjustment of petroleum prices between 1979 and 1981 had brought the domestic cost of energy into line with its opportunity cost, Mr. Costa observed. The more liberal attitude toward commercial policy implied by the reduction in import tariffs should be extended to eliminating quotas and other nontariff barriers. The present drive to improve the competitiveness of exports, based on a strategy of reducing real labor costs and floating the peseta to avoid any major appreciation of the domestic currency, was welcome.

Finally, Mr. Costa said, although much remained to be done, recent economic developments in Spain showed that remarkable progress had already been made under the stabilization program. He commended the Spanish authorities for the brave measures they had taken and for their determination in implementing them.

Mr. Pritchett thanked Mr. Buira for his thoughtful statement, including his focus on the difficult process of transforming political and social institutions, and said that he was in general agreement with the staff analysis and findings.

Of the three basic issues that he wished to discuss, Mr. Pritchett mentioned first the key economic indicators. As the staff had observed, substantial progress had been made in the recent past in reducing high rates of inflation in Spain. The rate of consumer price increase had dropped steadily from 20 per cent in 1978 to 14.5 per cent in 1981. During that three-year period, when inflation rates in many countries had increased substantially, Spain's progress had been significant. But the successful fight against inflation, basically through demand policies, had not been without cost to the domestic economy. Real GDP growth rates had averaged only 1 per cent over the previous three years. As a result, the unemployment rate had climbed from 7.7 per cent in 1978 to 14.6 per cent in 1981, a rate significantly above that observed in other industrial countries.

On the external side, Mr. Pritchett added, changes in the balance of payments had been associated with exchange rate movements. The strong performance of the peseta during the 1978-79 period had led to a weakening of the competitiveness of Spanish goods and services. Consequently, the current account had deteriorated significantly; in 1981, the deficit had been 2.8 per cent of GDP. The recent movement toward more competitive exchange rates had led the staff to suggest that an improvement in the balance of payments position in 1982 would rest in part on a strong export performance. The indication by Mr. Buira that there had been an "approximate balance on current account in the first quarter of 1982" was welcome news.

The second basic issue concerned monetary policies, Mr. Pritchett continued. The key factor contributing to the economic slowdown in Spain and the decline in inflation had been restraint in monetary policy. The authorities had reduced the growth of monetary aggregates over the previous three years or so, and were to be commended for their firm intention of steadily reducing the growth targets for broad monetary aggregates (M-3). Because monetary policy was the most important policy tool being used by the Spanish authorities to combat inflation, he wished to focus on two aspects of the monetary analysis: Appendix V and Chart 4 of the report on recent economic developments. Appendix V provided an analysis of monetary policies in Spain based on equations developed by the staff. Since monetary policy played such a major role in the control of inflation, he hoped that, as feasible, monetary models--particularly as they improved and evolved over time--would be employed for each major country. Chart 4 showed monthly changes in M-3 based on three-month averages, and displayed graphically how volatile that broad definition of money could be in the short run. Moreover, it could be observed from the chart that short-term movements had exceeded the target range on a significant number of occasions. In short, the control of broad monetary aggregates in the near term in Spain, as elswhere, seemed inherently difficult. In addition, the relationship between those aggregates and price movements and real economic activity did not appear to be as stable as might be hoped. Fortunately, the Spanish authorities had taken a conservative gradual approach in their attempts to reduce inflation mainly through monetary policy, and that approach seemed to have been successful.

As for international monetary policy, Mr. Pritchett commented, the staff had observed that the Spanish authorities had attempted in 1981 to moderate the decline of the peseta against the U.S. dollar, at least until December. Since the competitiveness of Spanish exports was still an open question, the reasons for such an attempt were unclear. In any event, international reserves had edged downward in 1981. The staff might perhaps comment on the specific policy steps--such as changes in reserves--that they had had in mind in referring to attempts to moderate declines in the peseta/dollar exchange rate.

The third basic issue was structural, Mr. Pritchett remarked. He welcomed the policy adopted for 1982 of halting a further rise in the high rate of unemployment while still seeking to reduce inflation. The concomitant shift of policy focus toward a more supply-oriented strategy was also welcome. The tripartite agreement between employers, contractual workers, and the Government provided for wage gains below the expected rate of inflation in the current year. As Mr. Buira had noted, it was difficult to see what other policies could have been followed, at least by Spain. The success of the incomes policy might have broad positive ramifications and become part of a general movement in other countries toward following reasonable incomes policies. Over time, wage gains should ideally be brought into line with productivity gains. The structural issues discussed in the last paragraph of both the staff appraisal and Mr. Buira's statement were quite important. He hoped that the structural rigidities and impediments to economic efficiency that were described would be reduced. An analysis in the next consultation report of the incentives to economic efficiency that were likely to be brought about by Spain's entry into the European Community would be welcome.

Finally, Mr. Pritchett concurred with the proposed decision, in which the Fund noted its satisfaction with the maintenance by Spain of an exchange system that was free of restrictions on payments and transfers for current international transactions.

Mr. Legarda joined others in considering that Mr. Buira had focused rightly on the essential role of a peaceful transition from the old regime into a democracy, a remarkable process but one that had by no means been costless. In fact, as Mr. Buira had mentioned at the beginning of his statement, that process had added to the problems of economic management so that developments could not be understood unless account was taken of the influence of political changes and the understandable priority given to them. Against that background, Spain's macroeconomic performance had been commendable: inflation had declined steadily, although it could stand further reduction, and, while the economy was not growing at its full potential, it was not recording negative growth rates. The moderation of real wage rates seemed to be at the center of Spanish policies, as had been required after the initial surge in expectations and in consumption following the liberalization of the political and social structure. In its appraisal, the staff had also singled out the question of real labor costs. As Mr. de Maulde had indicated, there was a trade-off between employment and wages, which fortunately had found a social consensus.

Attention had rightly been called by Mr. Erb to the existence of structural rigidities, Mr. Legarda continued. Those were numerous, as the staff had pointed out, and no less important than other problems, although they might be more diffuse. But he was not certain that it was within the province of economists to advise member countries to relax regulations governing the operations of foreign banks. Many member countries undertook various efforts at different stages of economic development to reform the banking and financial system--including nationalization--for social and political reasons, and the staff would not be called upon to give a view. He certainly accepted the main thrust of the staff's suggestion that the financial system should be liberalized, and also accepted the need for both the fiscal effort described by the staff and by Mr. Buira and the liberalization of the import regime.

In various recent discussions, Mr. Legarda recalled, the matter of measuring competitiveness had been raised. The use of relative prices had been described as a rough-and-ready device, but one that the staff might confess in private was often the only measure available to them. However, Spain did have more direct data, and its effective exchange rate could be measured on the basis of export unit value and unit labor costs, not merely on relative prices.

Tourism had traditionally enabled Spain to cover its trade deficit up to 1979, as could be seen from Table 13 in the report on recent economic developments, Mr. Legarda observed. But in 1980, as a result of either a sudden jump in imports or the continuing steep rise in imports, income from tourism, which had simultaneously leveled off, had failed to cover the trade balance. He wondered whether tourism could be expected to continue to discharge its traditional role, or whether it would perforce record a relative decline and thereby underline the importance of promoting competitive export commodities. On a related point concerning investment, some income from tourism that had previously been recorded in the current account had been moved to the capital account; as mentioned in footnote 3 to Table 13, real estate investment--including no doubt the purchase of summer or retirement homes--was covered by the item on direct investment. As could be seen by a comparison of direct and portfolio investment for 1978 and 1979 with the merged figure for those two items for 1980 and 1981, direct investment appeared not to have increased, and he wondered whether it too was leveling off or slackening.

Spain was still passing through a period of transition, Mr. Legarda commented, during which it had received moral and material support from its neighbors and friends. Many of the social and political changes that had been taking place over the years had been the culmination of a general process of modernization. One manifestation of that process was the movement of men from the services sector into industry, and the movement of women from domestic service into public service. All in all, trends in the Spanish economy and the authorities' policies were encouraging.

Mr. Diao said that he had no major difficulties with the staff's analysis and shared most of the views expressed by the staff in its appraisal. The Spanish authorities were to be commended for the determination that they had shown over the previous several years in their efforts to bring about a viable structural transformation of Spain's political, social, and economic systems.

The economic and financial policies initiated under the 1977-78 stabilization plan had enabled the authorities to meet with significant success in the adjustment process, Mr. Diao considered. Indeed, a viable external financial position had been promoted, the upward trend in the rate of increase of labor costs had been reversed, and the profitability of private enterprises had been restored. Inflation had been markedly reduced from 24.5 per cent in 1977 to 14.5 per cent in 1981. All those favorable developments had been conducive to the important upsurge in economic activity that had been witnessed since 1980, when the real rate of growth had trebled. Although the pace of economic activity had become hesitant in 1981, it was reasonable to expect greater momentum for growth from the overall strategy and sound policy mix formulated by the authorities for 1982 and for the medium term.

Their commendable achievements in the process of adjustment had not blinded the authorities to the serious problems still facing the economy, Mr. Diao added. The rate of inflation was still high and the level of investment inadequate, while unemployment had been moving toward socially unacceptable levels. Along with the staff and other observers of the Spanish economy, the authorities were fully aware that the solution to those problems would require substantial efforts with a view to significantly stepping up the mobilization of investment to a level that would allow the authorities to deal with the unemployment problem. He agreed with the authorities that at the present juncture top priority should be accorded to the promotion of employment opportunities, and that to intensify traditional demand management policies in an attempt to reduce inflation would exacerbate the already serious unemployment problem. In that connection, he welcomed the shift in emphasis toward supply-side policies. The tax reductions accorded to private enterprises, as well as the increased incentives for investment, were a clear indication of the appropriate direction of the authorities' policies. Those steps, coupled with advances made in the field of labor relations, as well as the increased investment effort by the public sector, would likely enhance investment activity and help to improve the employment picture. Nevertheless, he agreed with the staff view that, despite the acuteness of the employment situation, the authorities should resist the temptation to channel investible funds to public sector programs of a make-work character; public investment outlays should be directed toward productive activities.

As for fiscal policy, Mr. Diao continued, the authorities were committed to the same cautious stance that they had followed in the past. The fiscal deficit was small in relation to GDP, but the concern over its being kept in check was well taken, in light of the great need to generate public savings and to avoid preempting the private sector's use of credit so as to encourage a higher level of productive investment. On the revenue side, the efforts to increase the efficiency and buoyancy of the tax system were greatly welcome; on the expenditure side, the authorities seemed aware of the need to control the growth of government expenditures and to generate public savings for investment purposes. The 1982 budget gave evidence of that awareness and of the intention to promote sound budgetary management.

Sound monetary policies had been responsible for bringing the inflation rate down to its present level, Mr. Diao observed. The monetary authorities had met with considerable success in their task of keeping the growth of monetary aggregates within the established targets. The upward adjustment of interest rates was encouraging as it would facilitate the mobilization of domestic savings and contribute to the efficiency of the banking system. No doubt the authorities would pursue even further the effort to liberalize and modernize the entire financial system.

Appropriate trade and exchange policies had resulted in a much improved performance of the external sector, Mr. Diao noted. The authorities rightly believed that greater competitiveness of Spanish exports would be promoted through a steady deceleration of domestic costs and prices, as Mr. Buira had put it, together with flexible management of the exchange rate.

As for official development assistance, Mr. Diao stated, Spain's not being a member of the Development Assistance Committee was no excuse for its unacceptably low level of overseas development assistance. As a former colonial power, Spain could not avoid its obligations vis-à-vis its former colonies, which appreciated Spanish assistance. His authorities in Equatorial Guinea had in fact expected much of Spain; they had been disappointed, and had asked him to inquire why the Spanish authorities had not been more forthcoming and why the two countries had recently been experiencing difficulties in their economic and financial relations.

Mr. Caranicas considered that the problems of the Spanish economy that the Executive Board had examined during the past few years--inflation, unemployment, low profitability, a sizable external payments deficit--remained almost intractable, with the exception of the level of inflation, which had declined, probably due also to adverse world economic conditions. In addition, business investment was still sluggish. With so many uncertainties ahead, including even rumors that elections would take place at the end of 1982, confidence was lacking. The slow pace of investment was reflected in the high level of unemployment, the two elements being interrelated. The lack of buoyancy, to say the least, of world trade and the gloomy international outlook did not make for a good prognosis.

Investment had been declining for a number of years, Mr. Caranicas noted, and the authorities would have to do a good deal more to facilitate a revival of domestic investment. There were probably still significant obstacles to private investment, such as regulations restricting labor mobility or requiring enterprises to keep more workers on their payrolls than were actually needed. A particularly important factor in the revival of investment would be the stimulation of savings. Generally speaking, it seemed to have been easier to liberalize Spain's political structure than its economic system. True, there had been some opening up of the economy, especially in the banking sector, which had been deregulated and exposed to foreign competition with immediate success. A number of multinational corporations had also made investments in Spain in anticipation of the country's acceptance into the European Community, a phenomenon also observed in Greece. Nevertheless, internally the system was rigid, from the point of view of local entrepreneurs, and foreign companies seemed able to establish themselves more easily than Spanish companies.

The economy of Spain had been dealt with at length by previous speakers, and its problems examined thoroughly by Mr. Buira and the staff, Mr. Caranicas commented. He would therefore confine his remarks to two points, the first of which concerned the public sector. Mr. Buira had pointed out that the budget deficit was a matter of concern for the authorities, even though it was rather low by present-day standards, but that it "...should not be seen as a result of a relaxation of fiscal discipline." Certainly, the fiscal situation had not been allowed to get out of hand, although fiscal management posed a key issue that would have to be resolved. It was clear that part of the increase in the budget deficit over the previous few years had been due to the operation of automatic stabilizers, generated by the high level of unemployment. There would thus seem to be room for substantial improvement in certain areas.

It was understandable that the authorities felt the need to strengthen the social consensus by increasing the role of the state in the redistribution of incomes, Mr. Caranicas went on. However, as the staff had correctly pointed out, devoting resources to unproductive uses might impair the medium-run growth potential of the economic system. In particular, he was somewhat worried and would like to have clarification from the staff on the size and extent of what had been termed, on page 6 of SM/82/43, "...aid to ailing industries, partly in fulfillment of commitments for industrial restructuring...." Did the staff feel that such subsidies were being used in an effective manner and were likely to contribute to building self-sustainable and productive industries? Would it be possible for the Fund to suggest alternative policies to restore the viability of troubled industries? As for the social security system, he shared the staff's concern about the need for improvement, and asked whether or not any new developments had emerged in recent months that had not been covered in the staff report.

His second point concerned the steady decline in the savings ratio, which might make the management of the public deficit more difficult, Mr. Caranicas stated. That matter had been dealt with, particularly by

Mr. de Maulde, Mr. Polak, and also Mr. Laske, who had commented on ways to improve and diversify the channels and instruments for financial savings, the need for which was demonstrated by the current account deficit of the balance of payments. In the early 1960s, the ratio of savings to GDP had been almost 23 per cent; it had fallen to 11.3 per cent of GDP in 1975 and was at present only 7.2 per cent of GDP. He invited the staff to explain some of the main reasons for that constant decline: was it in any way connected to the poor employment situation, and did the staff feel that the range of currently available financial instruments, and the structure of interest rates, were suitable enough to counteract the decreasing savings trend? According to Table 29 of the report on recent economic developments, interest rates were on the whole negative in real terms. Perhaps the Spanish authorities should be encouraged to deregulate interest rates while at the same time developing a broader short-term market for government bonds, as mentioned in the staff report. Those two actions could certainly help to make financial savings more attractive at a time when the budget deficit was imposing a strain on available resources.

In sum, Mr. Caranicas concluded, important progress had been achieved in many sectors, particularly in the growth of exports, over the previous two or three years. Such positive developments, as well as the continuing interest of foreigners in direct investment, illustrated the underlying potential of the economy for growth. The realization of that potential, if adjustment continued and on the assumption of a more favorable international economic environment, would depend also on sound policy measures to correct the macroeconomic imbalances that had developed over the years.

Mr. Casey remarked that he had great difficulty in understanding why the inflation rate had fallen in Spain. Mr. Buira had described the steady decline of inflation over the past four years as a remarkable performance in the face of a growth of real wages, which apparently had not been dampened by the high unemployment. The inflation rate had also fallen despite exchange rate depreciation and higher import prices. The answer was not to be found in the stance of demand management policies, for fiscal policy had been expansionary, and monetary policy, although reasonably sound, had at best been accommodating. Indeed, it appeared from page 57 of the report on recent economic developments that the approach of the monetary authorities had been to allow the growth of M-3 to rise above the upper limit, if prices rose faster than expected. The tradition of the Central Bank was also to lend to the Government. Thus, monetary policy had been accommodating rather than tight. In addition, the ratio of savings to GDP had been falling, implying at least some pressure from the increase in consumer demand in relation to supply, which suffered from structural constraints and from inadequate productive investment.

In short, Mr. Casey noted, not only were few, if any, of the normal means of reducing inflation present, but most economic developments in Spain seemed to point to a higher rate of inflation. Yet the rate had actually fallen steadily. Conceivably, the measured rate of inflation, which could of course be affected by harvests and other microeconomic developments, did not give a true picture of the underlying trend rate of inflation. Alternatively, there might still be hidden inflation in the system. The service sector in Spain accounted for a high proportion of GNP of about 60 per cent, and the difficulties of measuring the implicit price deflator of services were notorious. To conclude, the confusion about the underlying rate of inflation suggested to him that the authorities should adopt a cautious demand management approach in the future.

The Deputy Director of the European Department, referring first to the broad-ranging discussion of fiscal policy, said that an attempt had been made in Appendix III to determine to what extent the present fiscal deficit could be said to be attributable to cyclical conditions. It had to be acknowledged--and without looking at detailed numbers--that a considerable part of the increase in the deficit was ascribable to cyclical factors. But it was necessary to be cautious about drawing policy conclusions from a statistical exercise that, first, rested partly on an estimate of potential GDP, and second, did not distinguish between discretionary actions and the operation of automatic stabilizers, as noted in the footnote on page 84 of the report on recent economic developments.

The concern of the staff about fiscal policy was not so much with the deficit in 1981 or 1982, the Deputy Director added, as with developments over the previous several years. First of all, there had been a tendency for the current budget to move from surplus into deficit; the predicted restoration of a current surplus in 1982 was uncertain because the budget in Spain was forecast on an unusual basis. Second, the deficit had risen with great speed, as indicated in Table 23 of SM/82/45. Third, the actual deficit in 1981 had been almost double the forecast deficit, due partly to the large increase in unemployment, which could be described as cyclical. However, it was by no means clear that such factors had caused the whole of the increase in the deficit in the previous year, and the fiscal situation would have to be watched carefully in coming years.

As for the relationship between fiscal policy, domestic savings, and external adjustment, the Deputy Director continued, the staff's view was that domestic savings were clearly inadequate at present; the current account deficit was of a size that could not be sustained indefinitely, and, in addition, fixed investment was much lower than it should be in the long run. Thus, the staff would agree that there was a need to increase domestic savings. One way to do so would be to aim in the medium run at restoring a current account surplus in the Spanish budget. Furthermore, the Spanish financial system had still not been fully liberalized, and steps such as the freeing of interest rates, and the development of a healthier and wider market in government securities, would be an important part of a general policy of increasing domestic savings. As for the role of foreign banks, the political aspects of any decision were of course entirely a matter for the Spanish authorities. In saying in its appraisal that consideration should be given to allowing foreign banks to have a freer hand, the staff had been referring from a purely economic point of view to one way in which the financial system could be made more competitive.

No more information on the review of the social security system was available to the staff than had already been provided in the staff report, the Deputy Director said. As for whether it would be feasible to supplement official social security with private social security arrangements, the general intention of the Spanish authorities was to provide certain minimum levels of assistance in the various social fields, and to ensure that the private sector developed other insurance arrangements to promote supplementary services.

The question of how to deal with ailing industries plagued almost all industrial countries, the Deputy Director noted. In Spain, capital transfers and subsidies to public enterprises had increased from Ptas 267 billion to Ptas 466 billion between 1978 and 1981. That aid should be seen as part of the process by which Spain was attempting to grapple with the need for structural reform while avoiding, if possible, steps that would increase unemployment in the short run. The staff position was one of concern with medium-run progress toward phasing out ailing industries and making sure that resources flowed into economically efficient industries.

On monetary policy, the Deputy Director commented that no doubt thought should always be given to the question whether to have a target for domestic credit expansion or an M-3 target, as in Spain, especially in the context of a balance of payments deficit. Nevertheless, looking at the matter in perspective, the Spanish authorities had had an M-3 target for nearly ten years and felt that it had been a successful instrument in helping to bring down inflation. It was not that Spain had had no balance of payments problems in the previous ten years, but rather that those problems had not been as pressing as in many other countries. Beyond that, it was necessary to look at exchange rate policy, which in Spain could be described as a managed float, meaning that it was not entirely free and that there had been some intervention. In that respect, Table 12 of SM/82/45 made it obvious that the dollar exchange rate had been allowed to depreciate over the course of 1981. On the whole, Spain had adhered to its M-3 target while recognizing that adherence demanded, in logic, a completely free exchange rate and, even in practice, a significantly free exchange rate. As had been recognized in the staff report, such a policy could create the well-known conflict between internal and external objectives if the depreciation was so fast that it undermined the policy on inflation. In fact, in light of the discussions with the Spanish authorities, the staff had considered the opposite case of a large overall balance of payments surplus undermining the monetary target, and had tried to indicate that it hoped that the problem would not arise. In sum, it would not seem to be good policy for Spain to change an established monetary instrument unless it was demonstrably shown to be working poorly. In addition, any country with an M-3 target and a balance of payments deficit as well should watch the expansion of domestic credit even if it had a completely freely floating rate.

It would be difficult to look into the future in order to consider the implications of both whatever financial liberalization took place in Spain and the process of integrating the Spanish economy with the rest of the world, the Deputy Director observed. The same considerations would apply to monetary policy when Spain joined the European Community. It would still be necessary to have an exchange rate policy appropriate for Spain. As for what might happen should Spain ever join the European Monetary System, it might be noted that some countries with monetary targets that were not too different from an M-3 target had managed to combine membership of the EMS with a money rather than a credit target.

It might have been more apt to refer in the staff report to an attempt by the Spanish authorities to smooth the decline of the peseta against the dollar, rather than to moderate it, the Deputy Director remarked. The intervention policy of the authorities could broadly be described as one of smoothing the downward fall of the peseta.

A number of questions had been raised about certain provisions of the tripartite agreement and how it was working, the Deputy Director recalled. Mention had also been made of the reference in the staff appraisal to "make-work" public investment programs. The staff had had no intention of criticizing the Spanish public investment program, which was fairly heavily concentrated on the construction of highways and other transport facilities. Although individual projects had not been examined, the discussion on investment that had taken place during the consultations had not lent any support to the belief that investment programs were wholly geared to employment creation; in fact, they were fitted into an overall economic framework. The staff had been trying to find a way to stress that it would take years to solve the unemployment problem, partly because of the intractability of real wages, and to encourage the authorities not to institute programs that might be of short-lived economic benefit without increasing employment in the medium or longer term.

The present wage agreement had so far worked well, the Deputy Director commented. It seemed to have met with a high degree of compliance from labor, and to the extent that success had been achieved so far, the auguries for the future should be good. It would not be possible to say more about the development of wage policies. As for whether or not the employment targets in the national employment agreement were being met, the only definite information covered the three months to September 1981, and together with some indications of what had happened in the last three months of the year, there was some reason to fear that the hoped-for effects on employment had not yet been felt. However, it had to be borne in mind that the public investment programs, one of the main sources of job creation, had, first of all, only recently been established, and second, by their very nature took time to show results. Nevertheless, the question whether or not the employment targets would be met had given the staff some unease about the fiscal outcome for 1982, because the estimates rested on the achievement of certain macroeconomic results that were not certain to materialize.

The interval of two years between Article IV consultations with Spain had not been to the staff's liking, the Deputy Director commented, but it had not been possible to staff a full consultation mission in the last quarter of 1980, due to the heavy workload of the division responsible for Spain. At that time, the staff had accepted the invitation of the Spanish authorities to send a small mission to give policy advice, and the mission had reported to the Managing Director. Subsequently, there had been a change of government, and the Spanish authorities had not considered it timely to hold consultations in the first half of 1981. Spain would not be the only case of an industrial country with an interval of two years between consultations.

It was gratifying to receive recognition of the merit of the report on recent economic developments, the Deputy Director commented. At the same time, the suggestion that such reports cover a wider range of subjects, dealing with structural and other complex issues, would be hard to reconcile with the desire for more frequent consultations. Consultations consisted in essence of the discussions with the member, a staff report, and a report on recent economic developments, a process that consumed much staff time and energy.

The matter of whether the Spanish authorities should consider moving to Article VIII status should probably be taken up with the Spanish authorities in the next consultation discussions, the Deputy Director of the European Department said. The substantive distinction between Article XIV and Article VIII was no longer great, of course; any new restrictions that Spain might introduce would require approval under Article VIII.

The staff representative from the European Department added that, as Mr. Legarda had pointed out, relative consumer prices were not a good indicator of competitiveness, especially with respect to export performance. Some alternative indicators had been given in the report on recent economic developments, but unfortunately the Spanish authorities had not been able to provide even preliminary figures on export unit values in 1981, so that the series stopped in 1980. Unit labor costs on a quarterly basis were also unavailable. Thus, a series of relative wage costs had been used, but it was not a good indicator because productivity had increased quite strongly in Spain, admittedly through the shedding of excess labor.

Several factors had contributed to the rather poor performance of tourism in 1979 and 1980, the staff representative continued, including certainly a loss of competitiveness. However, adverse weather and lack of capacity in the hotel industry had also contributed. For 1981, preliminary indications suggested that there had been a recovery in the volume of tourism, although earnings from tourism had suffered from the J-curve effect following the depreciation of the peseta vis-à-vis the dollar. There was no information on real estate investment per se, because it was difficult to separate it from direct investment. It was clear that the trend in direct investment had been less buoyant than in the past; the reasons for the trend were less clear, and whether it was related specifically to real estate investment was unkown.

The supplementary appropriations for aid to state enterprises and other ailing industries, to which reference was made in the staff report, concerned commitments undertaken in the context of industrial restructuring agreements, the staff representative explained. Those commitments, which had not yet been reflected in the 1982 budget, would apparently amount to about Ptas 60 billion.

A combination of factors was responsible for the decline in inflation in Spain, the staff representative considered. Certainly, in 1979, the appreciation of the peseta had played an important role. Another contributing factor in 1980--although not the only one--had been the excellent harvest, which had led to a significant moderation in agricultural prices. It was clear from Table 11 in the report on recent economic developments that the price deceleration for the nonfood component of the consumer price index had not been marked through 1980 and that it had been primarily evident in the food component. However, in the course of 1981, partly as a reflection of the tightening of monetary policy, there had also been a fall in prices in the nonfood component of the index.

Appendix III of SM/82/45 demonstrated that it was difficult to come to a firm view on the crowding-out effect, the staff representative observed. As Chart 13 of the same paper showed, the decline in investment had begun to some extent even before the budget became quite expansionary, and had also continued steadily during periods when the cyclical effect of the budget had not been as marked or when there had been a withdrawal of fiscal stimulus. Although there was no prima facie case of crowding-out in the past, the staff tended to believe that--as stressed in SM/82/43--the maintenance of a relatively tight monetary target and an expansionary fiscal policy had to result over time in some crowding-out of investment.

The effect of a high level of government expenditure on the tax burden would obviously be of concern in a longer-term perspective, the staff representative from the European Department added, although it should be kept in mind that the tax ratio in Spain was relatively low compared to that of most other European countries. Therefore, there might be some room for increasing taxes, especially by widening the tax base through better tax enforcement, without there being any adverse effects on the incentives to work, save, and invest.

The Deputy Director of the European Department explained that the bulk of the fiscal deficit was of course financed through the Bank of Spain. The commercial banks seemed to have been successful so far in persuading the Government not to make direct sales of government securities to the public. However, there was some sign that the monetary authorities intended to press ahead in 1982 with the sale of more short-term securities directly to the public, if the latter wished to take them up.

The Deputy Director of the Exchange and Trade Relations Department said that it would be desirable for Spain to accept the obligations of Article VIII. Because for the previous several years Spain had maintained an exchange system free of restrictions, there appeared to be no obstacles to Spain's assumption of Article VIII status.

Mr. de Maulde said that he would like to reformulate his question about full employment and fiscal equilibrium. On the hypothesis that the rate of unemployment in Spain fell to 5-6 per cent, a rate close to full employment, and that expenditure levels and the role of the budget remained unchanged, what would the status of the budget deficit be, in light of the generation of additional revenue?

The Deputy Director of the European Department responded that the staff had not made a calculation of the so-called full-employment budget, but would do so, if Mr. de Maulde wished. The answer to the question posed by Mr. de Maulde would, it should be noted, necessarily rest on a large number of assumptions, most particularly about wages. It would be almost meaningless to construct a full employment budget at the present wage level, which was not likely to lead to full employment. First of all, wages would have to come down, and then the matter of relative rates of taxation on wages and on profits would have to be considered.

The staff representative from the European Department added that the cyclically neutral budget balance indicated in Table 42 of SM/82/45 would be an approximation to the full-employment budget concept. A comparison of that balance with the ordinary overall balance would suggest a small deficit rather than the deficit of 4.3 per cent of GDP if output was close or at its potential. The outcome would of course depend on what was assumed as the potential growth rate for output, but the indication was that the present budget was still providing a considerable expansionary fiscal stimulus.

The Chairman remarked that it was legitimate to ask whether a country with a high rate of unemployment should be advised to reduce its fiscal deficit, but part of the answer could be found in Chart 13 of the report on recent economic developments. Clearly, as a percentage of GDP, the budget deficit had been having positive countercyclical effects from about mid-1975 until 1978-79, and had offset the deflationary effects of autonomous demand. Developments since 1978-79 had become more worrisome because private autonomous demand had been increasing, and the budget had become procyclical. That effect was further illustrated by Chart 15, which showed that in spite of the positive contribution of exports, the budget was still having a procyclical effect. That was why it was so important to consider the crowding-out effect of the budget deficit on investment in Spain. The impression to be gained from the three charts in Appendix III was that the expansionary stance of budgetary policy might have had some impact on private investment. The staff had dealt with those causalities prudently, and he himself would hesitate to respond to the questions that had been raised during the discussion in that respect. Nevertheless, the lines in Chart 14 on the cyclical effect of the budget and of investment urged caution in advising the Spanish authorities to take their budgetary deficit lightly. It was a matter of the structural quality of Spain's economic base. Careful thought should be given before any suggestion was made that the high rate of unemployment required action of a kind which would further enlarge the fiscal deficit.

Mr. de Maulde responded first by cautioning against reasoning post hoc, ergo propter hoc. Furthermore, the charts in Appendix III were not based on the concept of full employment. It was essential, on the occasion of country reviews, to find out whether or not the fiscal deficit derived from the economic situation. It was necessary to be cautious in both directions.

The Deputy Director of the European Department recalled that investment in equipment in Spain had begun to decline in 1975, and had declined in absolute terms for several years. Yet there had either been no budget deficit or a very small one in all those years. Thus, the decline in investment was more easily explained by other real factors, such as the lack of business confidence, and the poor outlook for domestic demand. The staff's concern with crowding-out was not related to historical analysis; it was related to what had happened in 1980 and 1981, but even more to what might happen in 1982. In ordinary national account terms, after declining right through 1979, investment in machinery and equipment had increased by 7 per cent in 1980 and by 6 per cent in 1981. That sign of a recovery in hard-core productive investment in the private sector, along with the trend in exports, had led to a concern about crowding-out, at present and for the future, that in a sense had not been felt three or four years previously.

Mr. Buira remarked that there was obviously a certain correlation, which was apparent from the charts in Appendix III, between the developments mentioned by the Chairman, although it in no way suggested causality. It was interesting to note that monetary expansion had fallen somewhat short of the upper limit of the targets because of lack of demand for credit. Thus, as the Deputy Director of the European Department had suggested, the low level of investment had been due more to such factors as low profitability, the poor outlook for demand, the lack of confidence, and political uncertainties. Having said that, he wished to say that the Spanish authorities shared the staff's concern for the future. They were happy to see some upturn in investment in equipment. Investment as a whole remained low, and investment in construction and in some other sectors also remained low. The substantial increase in real terms of interest rates might also not be contributing to the stimulation of investment. The authorities would watch developments with great care.

On a national accounts basis, Mr. Buira added, it might be noted that the projected budget deficit for 1982 was on the order of 3 per cent of GDP; even if some allowance was made for a deviation from the targeted figure, there would thus be some reduction of the deficit. As for the difference between the estimated and actual budget deficit in 1981, it was largely due to the introduction of measures contemplated in the

National Employment Agreement, as well as to the takeover by the state of the debt of some major public enterprises. The difference was thus one of what was covered under the budget and did not represent a policy of fiscal relaxation. Of course, the lower than projected levels of economic activity necessarily had an impact on costs, including the cost of unemployment benefits. In that connection, Mr. Laske had warned of the budgetary impact of making greater contributions to the cost of employing labor. But the risks ran in two directions: to the extent that budgetary contributions did not reduce the cost of labor, or to the extent that unemployment did not decrease, the full burden of unemployment benefits had to be borne. It was therefore cheaper in budgetary terms to subsidize the employment of some workers than to pay them full unemployment benefits. Mr. Laske had also asked whether the National Employment Agreement should be seen as changing the priority of economic policy, and perhaps as a lessening of the emphasis on inflation. He believed that it could be said, with confidence, that that was not the case. The NEA was seen as one of the keys that would make anti-inflationary policy work more effectively. In the absence of such an agreement, nominal wages would probably increase faster, and unemployment benefit costs would also be higher, as the history of the previous few years probably showed.

In general, Mr. Buira noted, Executive Directors seemed generally to support the policy mix adopted by the Spanish authorities, and had in particular welcomed the monetary policy and the National Employment Agreement. At the same time, they were aware of and concerned about the serious problems that remained, and prominent among them those relating to the low level of savings and investment, and the public sector deficit. The Spanish authorities would be trying to deal with those difficulties carefully. The decline in both public and private savings for a number of years had various causes. Public sector savings had been affected by the decline in activity, the increased cost of unemployment benefits, pensions, and other politically necessary measures to redistribute income. In the private sector, savings had of course been affected by the decline in profitability and the low level of economic activity.

Among the policies that the authorities had already initiated to try to counteract that decline, there was first and foremost the liberalization of the financial sector and the significant increase in real interest rates that had been occurring, particularly in 1981, Mr. Buira remarked. Interest rates on some deposits were still negative, but that was not true of rates on the bulk of deposits. An attempt was also being made to widen the range of lenders to the public sector. Measures had been taken in 1981 to allow foreign banks to operate in Spain, and an attempt was being made to develop a secondary market for public paper, as the recent placement of some Ptas 100 billion in the hands of the public showed. The development of the fiscal situation would also be watched carefully, and additional measures would not be excluded if the authorities considered them necessary. It was encouraging to note that they were doing their best to move forward the introduction of the value-added tax.

On the use of either credit or money targets, Mr. Buira indicated that the authorities no doubt had considered the comparative advantage of the different instruments of monetary policy, depending on their priorities. If the final objective was a balance of payments or reserve target, there would be a relative advantage in controlling internal credit. But if the general objective was the fight against inflation--as it had been--the relevant aggregate would be the stock of money.

On the issue of protectionism, Mr. Buira continued, as the staff had pointed out in its reports, Spain's trade barriers were still higher than those of some other industrial countries. The authorities recognized that fact and were committed to a sustained reduction of both the level of protection and the range of the barriers to trade. It was noteworthy that during the previous few years the authorities had made steady and systematic efforts toward changing the trading system and reducing the level of protection, somewhat against the worldwide trend toward neoprotectionism or neomercantilism.

As for overseas development assistance, because Spain was not a member of the Development Assistance Committee, the figures in the reference in the staff report perhaps referred only to financial flows, Mr. Buira remarked. Spain had had a significant program for a number of years under which it provided technical assistance in the fields of agriculture, industry, health, and education, and which had in fact heightened its cultural influence greatly. The Executive Board of the Fund was perhaps not the proper forum to take up whatever differences there might be between Equatorial Guinea and Spain at present. However, it might be noted that Equatorial Guinea had received economic assistance from Spain, not only financial flows but also technical assistance of various kinds. In fact, Equatorial Guinea received assistance in terms of grants at a level that was probably one of the highest received by any country.

It would take some time and thought to deal with Mr. Casey's interesting question, by means of which he had virtually demonstrated that it was impossible for Spain to abate inflation, Mr. Buira commented. Yet even from the basic domestic data in Appendix II to the staff report, it could be seen that wage rates and unit labor costs had declined sharply, as had profits, so that productivity had increased. Another contributing element was probably monetary policy. In addition, if account was taken of cyclical factors, fiscal policy was not as expansionary as it seemed, budget deficits having resulted to some extent from the need for countercyclical spending. The problems with the price indices were probably not much worse than they were elsewhere; in fact, extreme pains were taken in Spain to make the indices as good as possible.

Finally, Mr. Buira thanked Executive Directors for their comments, which he would convey to his authorities, who shared to a considerable extent the concerns expressed during the discussion and would no doubt no grateful for encouragement in the pursuit of their present approach to economic policy.

Mr. Diao remarked that although Spain provided important assistance to Equatorial Guinea, his authorities considered that it was still far from being commensurate with what would be appropriate. Nonmembership in the Development Assistance Committee was not a valid reason for not meeting the accepted development assistance target. The point that he wished to make was that Spain's record of overseas development assistance was poor.

Mr. Buira responded that he understood that aid to Equatorial Guinea was several hundred dollars per capita, a high level by any measure.

The Chairman made the following summing up:

> Executive Directors commended the Spanish authorities on the significant progress that was made in the past two years in adjusting the economy to the consequences of the sharp increase in the relative prices of energy and labor that occurred in the second half of the 1970s. Wage rates had been gradually decelerating, and since 1979 energy policy has been aimed at passing on the full increase in imported oil prices to domestic energy prices. Directors also expressed their support of the monetary authorities in their efforts over the past few years to bring about a gradual reduction in the rate of inflation through a steady deceleration in the growth of monetary aggregates. Despite this progress, however, the Spanish economy continues to be beset by the combination of slow growth--in the last three years output grew on average by less than 1 per cent--relatively high rates of unemployment and inflation, and a significant deficit in the current account of the balance of payments. In the circumstances, they felt that there needs to be a careful balancing of priorities in economic policy, and they generally agreed with the focus of the policy mix.
>
> Directors expressed the view that a major root of the serious unemployment problem is to be found in the excessive increase in real wages in the past few years, and they commended the authorities for their efforts to promote a social pact, "Acuerdo Nacional de Empleo," which targets a significant reduction in real wages in 1982. They cautioned, however, against expectations of a rapid improvement in the employment situation. A premature relaxation of policy would provide only temporary relief and lead to an acceleration of inflation.
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> While recognizing that the size of the current account deficit of the balance of payments remains modest in relation to GDP and is unlikely to pose financing difficulties in the foreseeable future, Directors stressed that this deficit is not the counterpart of a strong investment performance but rather of too low a level of domestic savings. They also noted that the continuation of the deficit at present levels could lead to a burdensome increase in external debt over the longer run.

Directors, in supporting the authorities' determination to maintain a cautious stance of monetary policy, stressed that firm monetary control needs to be supported by an effective tightening of fiscal policy, if an adequate flow of credit is to be provided to the private sector. Directors noted that the 1982 budget targets a significant reduction in the public sector deficit as a percentage of GDP, and hoped that the initial budgetary target could be adhered to. They urged the Spanish authorities to resist pressures for supplementary budgetary appropriations and to strengthen expenditure control. In a longer-term perspective, Directors welcomed the authorities' intention to shift the structure of public expenditure toward greater investment, to undertake a comprehensive reform of the social security system and of its financing, and to strengthen tax administration. More generally, Directors underlined the importance of addressing the problem of the structural rigidities that are still affecting the Spanish economy.

The Spanish authorities were commended for recent steps toward the liberalization of the financial system and encouraged to make further progress in this area. It was pointed out that present institutional arrangements tended to discourage the formation of financial savings. The desirability of fostering competition in the financial system was also noted. Directors stressed the need to create the conditions for a significant increase in nonmonetary financing of the budget deficit. Directors also stressed that the liberalization of the financial system should be accompanied by a number of steps in other areas, in particular with respect to the trade system. They believed that it was in the interests of Spain to make rapid progress in reducing the existing high degree of effective protection because it tends to perpetuate the existence of inefficient industries and hinders progress on the inflation front.

Executive Directors welcomed the flexibility of the Spanish authorities in the management of the exchange rate in the past two years and noted that the depreciation of the peseta during that period, along with the deceleration of labor costs, had allowed a substantial improvement in competitiveness. They expressed the hope that the float of the peseta would continue to be managed in such a way as to give full weight to the need for a strong competitive position.

Finally, several Directors noted the importance that they attached to regular Fund consultations with Spain.

The Executive Board then took the following decision:

1. The Fund takes this decision in concluding the 1981 Article XIV consultation with Spain, in the light of the 1981 Article IV consultation with Spain conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund notes with satisfaction that Spain continues to maintain an exchange system that is free of restrictions on payments and transfers for current international transactions.

Decision No. 7075-(82/33), adopted
March 19, 1982

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/82/32 (3/17/82) and EBM/82/33 (3/19/82).

2. ZAIRE - PURCHASE TRANSACTION - COMPENSATORY FINANCING FACILITY

1. The Fund has received a request from the Government of Zaïre for a purchase of the equivalent of SDR 106.9 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 Zaïre and approves the purchase in accordance with the request.

3. The Fund waives the limitation in Article V, Section 3(b)(iii). (EBS/82/27, Supplement 1, 3/16/82)

Decision No. 7076-(82/33), adopted
March 17, 1982

3. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 81/136 through 81/139 are approved. (EBD/82/60, 3/11/82)

Adopted March 17, 1982

4. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/82/78, Supplement 1 (3/16/82), EBAP/82/80 (3/16/82), EBAP/82/82 (3/16/82), EBAP/82/83 (3/17/82), EBAP/82/84 (3/17/82), and EBAP/82/85 (3/17/82), and by an Advisor to Executive Director as set forth in EBAP/82/81 (3/16/82), is approved.

APPROVED: August 17, 1982

LEO VAN HOUTVEN
Secretary