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FILES

Minutes of Executive Board Meeting 76/54

10:00 a.m., March 31, 1976

H. J. Witteveen, Chairman
W. B. Dale, Deputy Managing Director

Executive Directors	Alternate Executive Directors
J. Amuzegar	C. P. Caranicas
P. Åsbrink	J. H. Kjaer
S. Y. Cross	
J. de Groote	H. G. Schneider
N. Deif	M. Finaish
B. J. Drabble	D. Lynch
R. Gavaldá	S. Sevilla
	W. M. Tilakaratna
A. Kafka	W. Temple-Seminario
	M. Wakatsuki
	Sein Maung
	T. de Vries
H. R. Monday	
	E. O. de Toledo
E. Pieske	G. Laske
	P. J. Bull
	R. Guarnieri
	J. Foglizzo
R. J. Whitelaw	R. S. Deane
	S. Nana-Sinkam

W. L. Hebbard, Secretary
B. J. Owen, Assistant

Also Present

Embassy of Turkey: M. Akinci, Counsellor for Financial and Economic Affairs; C. Alper, Financial and Economic Counsellor. African Department: L. Dini, Deputy Director; C. L. Merwin, Deputy Director; E. L. Bornemann, C. A. François, P. Gibeault, J. R. Hill, S. B. Kjellstrom, S. P. Leite, V. R. Sertic. Asian Department: L. Lipschitz, D. A. Scott. European Department: L. A. Whittome, Director; B. Rose, Deputy Director; L. Alexander, W. Day, E. Gurgen, P. Hedfors, G. Tyler, A. C. Woodward. Exchange and Trade Relations Department: C. D. Finch, Deputy Director; D. K. Palmer, Deputy Director; W. F. Hughes, K. M. Huh, Z. Iqbal, S. Mookerjee, B. Nowzad, T. P. Sweeney. Legal Department: G. P. Nicoletopoulos, Deputy General Counsel; R. C. Effros, P. R. Lachman, A. Liuksila. Middle Eastern Department: J. W. Gunter, Acting Director; A. S. Gerakis, B. A. Karamali, A. Kayoumy, S. Thayanithy. Research Department: C. F. Schwartz, Deputy Director; L. U. Ecevit, L. M. Goreux, M. Gurfinkel, B. Gurgen, H. R. Heller, Z. Hodjera, N. Kaibni, G. Khatchadourian. Treasurer's Department: D. S. Cutler, R. H. Miller, A. Watkins. Internal Auditor: J. W. Lowe. Personal Assistant to the Managing Director: D. W. Green. Advisors to Executive Directors: J. K. E. Cole, F. K. Hussein. Technical Assistants to Executive Directors: V. Alipui, V. Amiel, S. Arancibia, E. Avillez, M. Berger, D. Berthet, T. Bilget, A. Doizé, B. Goos, G. Heyden Q., R. Khonsary, H. Kuroda, E. Leung, C. Lohmann, A. G. Morris, A. B. Nymark, C. C. Ozumba, S. K. Panya, M. Pietinen, E. Sacerdoti, S. B. Satyal, S. P. Upasani, A. van Dorssen, L. F. Vílches, M. A. Wasfy, P. Zimmer.

1. FINLAND - 1976 ARTICLE XIV CONSULTATION AND REVIEW UNDER STAND-BY ARRANGEMENT, AND INTENTION TO REQUEST PURCHASE UNDER OIL FACILITY

The Executive Directors considered the staff report and proposed decision for the 1976 Article XIV consultation with Finland, together with a review under the stand-by arrangement (EBS/76/137, 3/17/76), and the intention by Finland to request a final purchase under the oil facility (EBS/76/118, 3/12/76). They also had before them a report on recent economic developments in Finland (SM/76/55, 3/24/76).

The Deputy Director of the European Department said that a number of comments had been received from the Finnish authorities, and that corrected pages to both EBS/76/137 and EBS/76/118 would be issued shortly. None of the changes affected the conclusions in the two reports. However, the estimates for the volume of 1975 oil imports given in Table 2 of EBS/76/118 should be revised to read 12,830 tons, with total net imports being 12,700 tons; the value figure should be SDR 946 million, with total net imports amounting to SDR 933 million. Finally, the revised price of imported crude oil was about $11.90 a barrel. The Finnish authorities had also suggested a number of revisions in Table 4 of the summary balance of payments, but those did not affect the financing figures in item 16 of that table or the measurement of Finland's need to use the oil facility.

Mr. Åsbrink made the following statement:

> I, and I am sure the Finnish authorities, wish to thank the staff for a set of very clear documents which give an undistorted picture of the economic developments and prospects in Finland last year and for the immediate future. Neither the authorities nor I myself have any quarrel with the staff appraisal and the proposed decision in EBS/76/137, but since both real and financial developments last year diverged to such a significant degree from the outlook prevailing during May 1975, a few comments may be in order.
>
> It is not to be denied that price developments in Finland have been less than satisfactory during the last couple of years. To some extent this undoubtedly reflects the priority given to the maintenance of a high level of employment and the relative success achieved by the Finnish authorities in this respect. However, in addition to this traditional trade-off between capacity utilization and price stability, certain structural features of the Finnish economy probably have to be taken into account in an assessment of the price performance. Although extensive industrialization has taken place since the Second World War, Finland is still an important primary producer as illustrated by the fact that wood and wood products account for some 50 per cent of commodity exports.

This means that Finland has been exposed to the sharp movements in prices (and turnover) in commodity markets over the last three or four years. These movements strongly affect the structure of relative prices (and incomes) in the domestic economy, and the general experience under modern economic conditions is, I think, that the re-establishment of more normal price relations tends to occur through an increase in those prices and incomes that have lagged behind rather than through, more or less balancing upward and downward movements of all prices and incomes, or, in less obscure language: adjustment takes place through inflation.

In this respect I believe Finland has shared the experience of many other primary producers.

The staff has rightly pointed out the special factors that led to last year's larger than expected deficits in the current account and in the Central Government finances. The shortfall in export volume was twice the amount expected. Foreign borrowing proved easy, contributing to a rate of credit expansion higher than was originally foreseen. The staff seems to feel that the Central Bank's reaction to this came late, but it must be borne in mind that unemployment was becoming a cause for general concern and that the strength of the private sector's investment activity was learned only gradually. The latter factor, both surprising and desirable in a world of ailing business confidence, in my opinion justified some accommodation in financial flows.

As in many other countries, fiscal and monetary policies in Finland are complicated by the necessity of pursuing several basic objectives simultaneously, objectives that are not always so easily reconciled. The policies Finland needs for the immediate future must sustain employment, reduce the current account deficit, and finally curb inflation. A critical question for the outcome of the program now outlined is whether the rise in exports aimed at and hoped for can be achieved, which again depends primarily on the speed of recovery in Finland's main markets. Export developments will further have a direct impact on employment prospects. Securing a reasonable level of employment and providing in the medium term for a reasonable growth in private consumption carries a particular importance in the Finnish setting, in view of the fact that differences in earnings and employment levels between Finland and Sweden provide an incentive for emigration with all its negative consequences for the medium-term growth potential.

In the opinion of the Finnish authorities a desirable policy mix in 1976 would not call for greater monetary stringency. The degree of monetary restraint is now such that additional liquidity curbs would hamper the employment situation and undermine future economic growth.

As regards fiscal policy, the Finnish parliament has yet to finalize a supplementary budget designed to carry out the employment program referred to in the staff report. While a number of tax increases to finance the program have already been agreed on, the question of an increase in the turnover tax has been detached from the package and postponed, due to strong political opposition, with a corresponding reduction on the expenditure side of the supplementary budget. The authorities thus remain committed to the overall fiscal objective outlined in Governor Koivisto's letter.

It is the authorities' view that monetary and fiscal policies will have to remain restrictive in the longer run as well, so as to free, during an upturn, resources for the improvement of the external balance.

Mr. Cross commented that the clear increase in Finland's oil import costs, despite reduced consumption, made it possible for him to support Finland's intention to use the oil facility. The low level of gross reserves reflected a need for adjustment assistance. Yet he shared the staff's concern about the Finnish authorities' performance under the stand-by arrangement and the prospects for implementation of the 1976 financial program. For instance, imports had increased by 9 per cent, in spite of import restrictions; there had been a slight decline in exports, in contrast to a predicted increase and despite claims of adequate competitiveness; and consumer prices had risen by 18 per cent, although the increase in wholesale prices had been more moderate. Those developments were at least in part attributable to the rapid increase in wages and the larger than projected budget deficits.

In general, Mr. Cross considered, the appropriateness of a program that afforded priority to the maintenance of employment at unusually high levels by the standards of most countries was open to doubt. The staff had noted the difficult political situation in Finland. But many countries were faced with strong pressures to reduce unemployment while having to accept stringent programs to correct deficits. He hoped the Finnish authorities would take careful note of the staff's conclusions, to the effect, first, that the measures to reduce the budget deficit were a reasonable beginning but did not go as far as was desirable; and, second, that the incomes policy for 1976 did not hold out the hope that inflation could be reduced to acceptable levels. The staff should follow events closely in case Finland decided to draw under the stand-by in 1976.

Mr. Bull remarked that he could agree with the general drift of Mr. Cross' comments, although he would place a different emphasis on the political constraints on economic policy in Finland. As the staff report clearly explained on page 2 of EBS/76/137, those constraints were extremely difficult in Finland; and although policies during 1975 had left much to be desired, judgments of what had been achieved in the past and what could be achieved in the future must be seen in that light.

In general, Mr. Bull considered, the main burden during the past year had fallen on monetary policy, where Finland's performance had not been unsatisfactory. He wished, however, to confine his remarks to prospects for 1976. It was encouraging to note on page 12 of EBS/76/137 that "the Finnish representatives were emphatic in stating that extra expenditures would only be undertaken if adequate revenues to finance them were available." He hoped they adhered to that intention. He had also noted that the policies being followed by the authorities provided for a decline in final domestic demand of about 1.5 per cent in 1976 and of over 5 per cent in total domestic demand, contingent of course on a slower rise in wages. He wondered how successful those policies were likely to be. In particular, the money released from the import deposit scheme during 1976 would provide a further inflationary boost unless care was taken to sterilize it. In that connection, he doubted whether he would go so far as the Finnish authorities in suggesting that there would be no need for greater monetary stringency in 1976, as reported by Mr. Åsbrink.

Incomes policy was another area of concern, Mr. Bull continued. The agreement concluded in February 1976 looked hopeful; but it allowed for the renegotiation of wage rates in September 1976 to compensate for unforeseen price developments. Therefore, it was all the more important for Finland to pursue strict monetary policies, to the extent that political constraints permitted, if inflation was to be overcome and if incomes policy in 1976 was not to be as unsuccessful as in the previous year when wages had risen by 21.8 per cent compared with the original projection of 10 per cent.

Mr. Pieske observed that the attainment of Finland's economic goals for 1976 as described by the staff, namely, sustaining employment, reducing the current account deficit, and moderating wage and price inflation, in that order, seemed likely to be very difficult in Finland's present political and economic circumstances. Those conflicting goals were reflected in what seemed to be somewhat contradictory measures of demand management. On the one hand, there was the February employment and incomes agreement, a faster rise in public expenditures--18 per cent--than the rate of inflation forecast at 12 per cent to 13 per cent, and a budget deficit that seemed higher than desirable in the view of the staff. On the other hand, monetary policy had until recently been geared toward a sharp deceleration of credit expansion. On the whole, the least that could be hoped for was a determined effort to execute the present program, as the staff had said. The budget deficit should be maintained within the indicated figure of around Fmk 1 billion and should be financed from private savings rather than by money creation. Additional resources accruing from the reduction of tax arrears should be used to reduce the budget deficit, as indicated in paragraph 7 of the policy statement of the Government of Finland, rather than to finance additional expenditure, as suggested in the statement on page 12 of the staff report (EBS/76/137). Also, he hoped that the plan to limit the net domestic assets of the banking system, as described in paragraph 8 of the policy statement, would be carried out, and that the liquidity effect of the release of import deposits would be effectively neutralized. It should be recalled that the limits set in the May 1975 policy statement of the Finnish authorities had been substantially exceeded. For instance, net central bank credit to the Government had been three times as much as originally planned, as Table 4a in the staff report showed. In that connection, he wondered whether there was any contradiction between the statement in paragraph 8 of the letter from the Finnish Government--on reductions of rediscount quotas or use of other means to neutralize the effects of the release of import deposits--and Mr. Åsbrink's comment to the effect that any additional liquidity curbs would hamper employment and undermine future economic growth.

The determined execution of the intended measures of demand management, Mr. Pieske believed, moderate as they were, were as important as the third policy element, the prices and incomes policy, which, helpful as it might be in braking inflationary expenditures, could not be a substitute for firm demand management.

On the external side, there was an urgent need to reduce the current account deficit, which at 8 per cent of GNP was excessive, Mr. Pieske considered. Relatively optimistic projections had been made for 1976, but he wondered whether more recent data were available, and if so, whether they indicated the extent to which those forecasts might be realized. Exchange rate developments in Finland were puzzling. On the one hand, the Finnish markka had been surprisingly steady since the middle of 1970, having effectively depreciated by no more than 3 per cent, despite rates of price and wage inflation that were far above those of many of Finland's trading partners. On the other hand, the staff had observed in the report on recent economic developments (SM/76/55) that the competitiveness of Finnish exports and the market shares of exporters had been maintained. Also, imports in nominal and in real terms had increased more slowly than domestic demand, which would again not indicate an overvalued currency. Nevertheless, there was something to be said for a more flexible exchange rate policy, which might encourage exports from nontraditional sectors. At any rate, a significant reduction in the current account deficit was extremely urgent, and if the present balance of payments projections did not materialize, further measures should be considered. Finland's foreign exchange reserves were low, its short-term external liabilities were high, and foreign indebtedness could not continue to increase at the present rate without impairing the commendable international creditworthiness of Finland. Under the circumstances, he understood the temporary and partial maintenance of the import deposit requirements beyond the date at which it was originally to have been abolished. At the same time, he supported the schedule for phasing out the requirements.

Mr. de Vries considered that the Finnish authorities' performance in 1975 had in general been quite satisfactory, with one major exception. He had been pleased to note that the effects of the world recession had been effectively limited and that unemployment had risen only slightly. Investment activity in the private sector had been strong, which was both surprising and desirable in a world of ailing business confidence. On balance, the Finnish authorities had steered a sensible course, having in mind the ever present danger of losing their most skilled workers to Sweden. As Mr. Åsbrink had stated, Finland's policies were designed to sustain employment, reduce the current account deficit, and finally, to curb inflation. He could agree with those objectives and also with Mr. Åsbrink's opinion that the chosen policy mix in 1976 would not call for greater monetary stringency than planned. If the Finnish authorities were able to carry out the program, it would be adequate to the task.

He had asked himself, Mr. de Vries continued, whether one reason for Finland's success, compared with other countries, in maintaining a satisfactory level of employment had been its trade with the centrally planned economies of eastern Europe. But he had found to his surprise that the CMEA countries accounted for only about 20 per cent of Finland's foreign trade, even though their share had increased while that of the OECD had fallen as a result of the recession.

Attention had already been drawn by Mr. Pieske to the unsustainable deficit on current account, Mr. de Vries noted, which was the one unsatisfactory development in 1975. The sharp fluctuation in demand for Finnish export products was one cause, and it was to be hoped that Finland's export performance would be better in 1976. Another cause was the higher rate of inflation in Finland for the past one or two years than in its trading partners, combined with the effective stability of the exchange rate. Although the staff considered that Finland's exports were still competitive, it was stated on page 23 of the report on recent economic developments that a precise judgment in that respect was not easy to make. Primary products were still priced competitively, but there were signs of reduced competitiveness in labor-intensive export industries. Full employment, rising incomes, and growth might call for increased exports from those industries. Therefore, in a world of greater exchange rate flexibility, he wondered whether the policy of the Finnish authorities with regard to the effective rate of the markka was in accordance with their twofold aim of sustaining employment and reducing the current account deficit.

Finally, Mr. de Vries said, it would be interesting if the staff could shed any light on one feature of Finnish economic policy which led to different results in Finland from those in the Netherlands. With a strict price ceiling in effect, and with increases in wages and real disposable incomes in order to keep workers from leaving Finland, investment was still strong. In the Netherlands, similar policies had led to an erosion of business profits and a reduction in investment.

Mr. Drabble noted that Finland had clearly suffered both because of its heavy dependence on export of primary products, which had been seriously affected by the world recession, and because many of its industries were energy intensive. The sharp increase in the cost of oil imports had obviously had a major impact on the economy.

He had little to add to what other Executive Directors had said about demand management, Mr. Drabble continued. Some of the shortfalls in fiscal policy in 1975 were understandable, in the light of the political circumstances. Therefore, it seemed to him to have been all the more important that monetary policy should have been used to the full to counteract problems in other areas of the economy. He would have welcomed a fuller discussion in the staff papers of the use of interest rate policies with respect to demand management. Table 14 in the report on recent economic developments (SM/76/55) showed that interest rates were not low in Finland but that they were rather inflexible. Taking into account the high domestic rate of inflation, the lack of a more active interest rate policy might have contributed to the overshooting of credit expansion by the banking system, as well as to the extension of credit by groups other than the banks. Also, he wondered whether the persistently strong private investment performance might not have been subject to better control if interest rate policy had been more flexible.

The extension of the import deposit scheme was of concern in relation to monetary policy, Mr. Drabble agreed with the staff. Implemented in the first instance partly as a way of helping to tighten the monetary situation fairly quickly, it was inevitable that in its unwinding, the increase in liquidity that had originally been taken up would have to be dealt with. Since the balance of payments position had turned out to be more unfavorable than expected, he understood the need to extend the scheme but there had been a full year to prepare for its removal, and he wondered why the authorities felt the need for even more time, and why conventional methods of tightening monetary policy had not been more effective.

The significance of the trade agreement with the Soviet Union was, Mr. Drabble understood, that Finland could count on an assured expansion of its market for exports in order to compensate for the increased cost of oil imports. Although the data for 1975 were still preliminary, it would have been interesting to receive an analysis of Finland's trade, exclusive of that with the Soviet Union; it was probably unnecessary to exclude trade with other CMEA countries, where the factors affecting trade movements were presumably comparable with those affecting trade with OECD and other countries. Of course, the important question was the competitiveness of Finnish industry and how well its export market shares had been maintained. The seriousness of that problem was difficult to assess from information that included exports covered by the Soviet trade agreement.

In conclusion, Mr. Drabble considered that it was important for the Finnish authorities to make the maximum effort to turn around their economic situation in 1976 in order to be able to benefit from the ongoing improvement in the world economic environment.

Mr. Nana-Sinkam said that he had noted the large increase in Finland's oil imports in 1974 and the efforts made by the authorities to reduce oil consumption in 1975 by more than SDR 150 million. He hoped that the energy conservation program would not have a detrimental impact on the productive sectors of the economy. While he understood the staff's concern about Finland's performance under the present stand-by arrangement, in the conditions of stagflation that had characterized the world economy in 1975, the Finnish authorities had turned in a commendable performance.

The Deputy Director of the European Department, chief of the mission to Finland said, in response to Mr. Cross, that the staff would certainly continue to follow developments in Finland closely, although it should not be taken for granted that there would be purchases under the stand-by arrangement, which was viewed by the Finnish authorities as a form of stand-by assistance in the strict sense of the term.

Many Executive Directors had expressed concern about the exchange rate policy pursued by the Finnish authorities, the Deputy Director noted. But the staff view was that because of the remarkable behavior of export prices, the profitability of Finnish export industries had not been impaired, except in the case of labor-intensive industries, which tended to be in difficulties in many industrial countries. It was not a question that could be seen in isolation from the wage developments under way in Finland. The remarks of Executive Directors underlined the necessity for action both by the Government and by other sections of the community to ensure that the rate of wage increase was brought down. Doubts had been voiced about the effectiveness of the present incomes policy; he could only hope that they would prove to be unjustified.

Another area of concern had been whether monetary policy would be undermined by the termination of the import deposit scheme, the Deputy

Director added. The amount outstanding on deposit at the end of February had been of the order of Fmk 1,300 million, which was equivalent to between 3 per cent and 3.5 per cent of the monetary liabilities of the banking system. If the import deposit scheme had been terminated all at once, the whole amount would have been released over a period of six or seven months. The schedule actually adopted had the effect of making about one third of the amount repayable in the remainder of 1976, and the other two thirds in the first seven months of 1977. The Bank of Finland was acutely aware of the relationship between that schedule and the desire to follow a firm monetary policy. The Governor of the Bank of Finland had stated plainly that the release of the import deposits would increase liquidity, although it was desirable to keep the market tight to help eliminate inflation and keep down the current account deficit. Therefore, the access of commercial banks to central bank credit would have to be reduced pro tanto with the decline in import deposits.

In response to Mr. Pieske, the Deputy Director said that he discerned no contradiction between the statements in the letter from the Government of Finland and the staff report about the degree of monetary stringency and Mr. Åsbrink's opening remarks, which in his view simply indicated that the Finnish authorities would not wish to follow a program of restraint that went beyond the measures described in the staff paper.

The reason for the strong investment boom in the last two years, the Deputy Director said in reply to Mr. de Vries, was simply that, despite the alleged strictness of price control, there had nevertheless been a rapid rate of price increase.

As for making demand management generally, or monetary policy in particular, more effective, the Deputy Director explained in response to Mr. Drabble's questions that there was a long tradition in Finland of relatively sticky interest rates, which were, moreover, a subject of intense political debate. Also, Finland was a country where financial markets were relatively undeveloped. Measures that might have been used in 1975 to prevent the degree of monetary ease that had occurred included the obvious one of a more effective control of capital inflows from abroad, a step that the Finnish authorities had taken in September. A main reason for the undermining of monetary policy had been the inflow of money both directly to the private sector and through the banks from abroad. It was not until late in the summer that the Finnish authorities had realized what was happening and had then taken action to check it.

Mr. Åsbrink remarked that although he understood the reasons for the criticisms that had been made of Finnish policy, it should be remembered that Finland was in a rather special situation. The staff had made an appropriately modest reference to the country's political difficulties. He would like to add that not only was Finland a young country, but its constitution combined the features of the U.S. system, with a strong President, and those of a European system, where government was based on parliamentary majorities. The political system had to function in a country where the left was represented by three parties whose different attitudes were rooted in Finnish history, and where separate parties also existed to represent the small Swedish minority, in addition to various others for the Finnish majority. Understandably, there had been frequent recourse in those circumstances to caretaker governments. On the whole, the system had functioned well.

The fact that the Finnish and Swedish labor markets were almost one market, to the disadvantage of Finland, had often been mentioned, Mr. Åsbrink recalled. The Swedish labor force included about 400,000 Finns, who had been educated and trained in Finland. At a time when Finland no longer had a raw material base for expanding its forestry industries, so that expansion had to take place in other sectors of the economy, such as engineering, it was losing mechanically skilled workers to Sweden, which no longer had an agricultural labor reserve to draw upon. Finnish economic policies were naturally affected by such a development.

In conclusion, Mr. Åsbrink thanked Executive Directors for their comments, which he would convey to his authorities.

The Executive Directors concluded their consideration of the report for the 1976 Article XIV consultation with the Fund and of the review under the stand-by arrangement, and turned to the proposed decision on Finland's intention to request a purchase under the 1975 oil facility. The decision was approved, with amendments to show the amount of the final purchase and to correct the date of the letter setting forth the repurchase terms.

The decisions were:

a. 1976 Article XIV Consultation

1. This decision is taken by the Executive Directors in concluding the 1976 consultation with Finland, pursuant to Article XIV, Section 4, of the Articles of Agreement.

2. The rate of increase in domestic demand declined from about 6.5 per cent in real terms in 1974 to about 3.5 per cent in 1975 and, with a fall of over 15 per cent in the volume of exports of goods and services, gross domestic product remained unchanged. Unemployment, which fell in 1974 to the unusually

low rate of 1.7 per cent of the labor force, increased to 2.2 per cent in 1975 and by January 1976 is estimated to have reached a seasonally adjusted level of over 3 per cent. At the same time, the increase in consumer prices, with wages rising sharply in 1975, amounted to nearly 18 per cent, a little higher than in 1974.

3. The deficit on current account increased from about SDR 1 billion in 1974 to about SDR 1.8 billion in 1975, the equivalent of over 8 per cent of GDP; the increase in the net inflow of long-term capital rose from about SDR 200 million to over SDR 1 billion. There was also a substantial inflow of short-term capital in 1975 and the overall deficit amounted to about SDR 250 million. Gross official convertible reserves fell in 1975 by SDR 117 million to SDR 401 million at the end of the year, equivalent to less than one month's merchandise imports.

4. The balance on the government cash accounts changed from a surplus in 1974 to a deficit in 1975, which was equivalent to about 2 per cent of GDP. The financing of a substantial part of this deficit through the central bank, and the much larger than expected inflow of foreign capital, made monetary conditions easier than had been intended, and net domestic assets of the banking system rose by 26 per cent against 24 per cent in 1974. The Fund supports the efforts being made to contain the rise in government expenditure in 1976, and to reduce the government deficit. It welcomes the intention of the Finnish authorities to follow a policy of credit restraint in order to help reduce the rate of price inflation and bring about a sharp reduction in the current account deficit of the balance of payments. The Fund believes that continued vigilance will be needed to support the 1976 incomes policy settlement.

5. The Fund regrets the decision of the Finnish authorities to postpone from March 24, 1976 until the end of the year the termination of the import deposit requirement introduced in March 1975 but welcomes the decision to phase out the requirement according to a fixed schedule. Finland still maintains some restrictions on current international transactions for balance of payments and other reasons, and the Fund hopes that these restrictions can be relaxed as the balance of payments position improves. The Fund believes that the remaining bilateral payments arrangement with a Fund member should be eliminated.

Decision No. 5025-(76/54), adopted
March 31, 1976

b. Oil Facility - Intention to Request Purchase

1. The Fund has received a letter dated March 10, 1976 from the Governor of the International Monetary Fund for Finland informing the Fund of Finland's intention to request a final purchase under Executive Board Decisions No. 4634-(75/47), adopted April 4, 1975 and No. 4954-(76/16), adopted February 11, 1976. Finland has made representations in accordance with paragraph 5 of Executive Board Decision No. 4241-(74/67), adopted June 13, 1974.

2. In March 1975 Finland introduced a new restriction on imports as described in EBS/75/173. Finland has stated that the measure, which is in the form of an import deposit requirement, is only temporary and it intends to remove it by the end of 1976. Finland has taken other measures which should permit it to remove the import deposit requirement in accordance with its intention. The Fund finds that the restriction is not being maintained inconsistently with the understandings set forth in paragraph 2 of the Rome Communiqué of the ad hoc Committee of the Board of Governors on Reform of the International Monetary System and Related Issues and in Executive Board Decision No. 4134-(74/4).

3. The Fund determines that a purchase in an amount equivalent to SDR 115.11 million would be in conformity with the decisions cited in paragraph 1 above, agrees to the purchase, notes the representations made by Finland in accordance with paragraph 5 of Decision No. 4241-(74/67), and grants the necessary waiver of the conditions of Article V, Section 3(a)(iii) of the Articles of Agreement on the repurchase terms set forth in the letter dated May 21, 1975.

Decision No. 5026-(76/54), adopted
March 31, 1976

2. MOROCCO - PURCHASE TRANSACTION - FIRST CREDIT TRANCHE, PURCHASE TRANSACTION - COMPENSATORY FINANCING, AND INTENTION TO REQUEST PURCHASE UNDER OIL FACILITY

The Executive Directors considered staff analyses and recommendations with respect to requests expected to be received from Morocco for a purchase equivalent to about SDR 40.96 million corresponding to the enlarged first credit tranche, and for a purchase under paragraphs 2, 3, and 4 of the Decision on the Compensatory Financing of Export Fluctuations (EBS/76/108, 3/15/76; EBS/76/152, 3/29/76), together with the intention by Morocco to request a purchase under the oil facility (EBS/76/107, 3/11/76).

The Chairman explained that the necessary cable designating the currencies to be purchased in the first credit tranche and compensatory financing drawings had not yet been received.

Mr. Laske observed that although Morocco had ambitious development plans, they appeared to be within reach because of the favorable general economic conditions. The Moroccan balance of payments had been badly hit in 1975 by the deterioration in Morocco's terms of trade and the steep decline in exports of its major export commodity, phosphates, where no substantial improvement was expected. However, the outlook for agriculture in 1976 was better as a result of favorable weather conditions and, consequently, the reduction of subsidies on imports of agricultural products, which should make it possible to purchase more investment goods abroad. The policies outlined in the letter from the Minister of Finance appeared to be appropriate. The current account projections, however, depended to a large extent on the availability of foreign assistance and borrowing abroad. As far as the domestic side of the program was concerned, he had noted with relief the decline in subsidies, in relation to total government expenditure. It would be recalled that he had expressed concern about the extent of subsidies on consumption expenditures when the Article XIV consultation report had been discussed.

The realization of the ambitious development plan would be dependent on the containment of public and private expenditure and on the generation of additional domestic savings, Mr. Laske noted. Although the necessary foreign financing for the investment program might be forthcoming, he doubted whether a doubling of the investment effort in one year was physically possible, taking into account the availability of human and other domestic resources. The adjustment in interest rates in response to credit demands, and the intention to follow more flexible credit policies, would be a great contribution to a more effective allocation of resources and to the generation of private savings.

In conclusion, Mr. Laske said that he could agree with the general direction of the Moroccan program and that he was prepared to support the requested purchases in the first credit tranche and those under the oil facility and the compensatory financing decision. Nevertheless, he hoped that the Moroccan authorities would move cautiously in the implementation of their development program and be mindful of the position of the balance of payments.

Mr. Foglizzo commented that against a disturbed international economic background, Morocco had clearly achieved a satisfactory rate of growth in 1975. Gross domestic product had risen by 3 per cent and the rate of inflation was only 8 per cent, well below the 14 per cent level registered in 1974. The balance of payments deficit of SDR 21 million was not very large, although it went somewhat beyond the approximate balance forecast by the staff in the 1975 Article XIV consultation report (SM/75/162, 6/26/75; and Sup. 1, 9/30/75). However, despite the overall satisfactory performance, there remained some areas of concern for 1976, all the more so since the prospects for phosphate prices were not very bright.

He had no difficulties with the requests by Morocco to use the Fund's resources, Mr. Foglizzo continued. If approved by the Executive Board, they would constitute an important part of the financial program described in EBS/76/108. Furthermore, the requests illustrated the willingness of the Moroccan authorities to return quickly to the surplus balance of payments position they had enjoyed between 1969 and 1974, and to remain in close consultation with the Fund. In that regard, he had noted that the Government had endorsed most of the views expressed in the Executive Board and by the staff during the 1975 Article XIV consultation discussion (EBM/75/164, 10/8/75). He had been pleased to note that, on the expenditure side of the 1976 budget, greater emphasis had been placed on productive expenditures, that the cost of subsidies on imports of essential commodities was to be reduced by 33 per cent in 1976, and that all remaining subsidies would be removed at an early date. The proposed increase in government capital expenditure meant that the overall deficit would double during the present year, but he welcomed the reduction in recourse to the banking system, to be limited to DH 970 million or 20 per cent less than the 1975 level. The overall deficit would be financed mostly by foreign assistance and by borrowing on the international market, a policy that had been favored during the debate on the 1975 Article XIV consultation report, since Morocco's foreign indebtedness was relatively low and the maturity of its debt structure favorable. Such borrowing would permit the financing of important productive investments. The authorities had already revised lending rates upward and were ready to contemplate further interest rate increases, a step in the right direction that would undoubtedly encourage domestic saving and improve the allocation of banking resources.

He had been convinced of the case for export shortfall, as described in the staff paper on Morocco's request to draw under the compensatory financing decision, Mr. Foglizzo said. Apparently Morocco would have a shortfall even without taking into account phosphate exports, which represented 45 per cent of total export earnings. As pointed out in EBS/76/152, Morocco's average annual export earnings for the two post-shortfall years would have to reach a level of SDR 1,183 million, a requirement that was likely to be met easily since the average prices forecast for phosphates in 1976-77 and 1977-78 of SDR 28 and SDR 30 per ton were on the pessimistic side, in his view.

Finally, Mr. Foglizzo said that he had no problem with the proposed drawing under the oil facility, and he relied on the Moroccan authorities' ability to cope with the temporary difficulties facing them in the period ahead.

Mr. Kafka gave his full support to the three requested drawings, which seemed to be amply justified. Referring to paragraph 10 of the letter from the Minister of Finance, he said that he could understand that under certain conditions a government might wish to state that it did "not intend either to impose new, or to intensify existing, restrictions on payments and transfers relating to current international transactions or on imports of goods." Also, he could understand such a statement where, as in Morocco, use of the Fund's regular resources was being made simultaneously with a drawing under the oil facility, or where an oil facility drawing remained outstanding, because a similar undertaking would have been given in that connection. But he sought assurance that the staff was not introducing a new policy of demanding such declarations regarding imports even when the conditions he had mentioned did not apply, for instance, in stand-by arrangements.

Mr. Bull considered that the pace at which economic activity in Morocco was being accelerated might well pose dangers for the future. So far, the Moroccan authorities had managed to finance the development effort, and the proposed drawings under the oil facility and the compensatory financing decision would be helpful. Moreover, Morocco had no serious external debt burden at present. Unless cautious policies were pursued in the years ahead, however, financing problems might arise, particularly if world interest rates rose above the currently low levels.

Mr. de Vries stated that he supported the three proposed decisions. He agreed with the remarks of Mr. Foglizzo and Mr. Bull. A satisfactory rate of growth had been registered and price increases had been curbed. The Moroccan authorities had taken to heart a number of recommendations made at the time of the Article XIV consultation discussion, for instance, in the field of price subsidies. They had embarked on an ambitious development program, which would require careful management if it was to be brought to a successful conclusion. As for Mr. Kafka's remarks on paragraph 10 of the Minister of Finance's letter, Mr. de Vries commented that the policy outlined in that paragraph had seemed to him to be both sensible and welcome.

Mr. Guarnieri declared that he shared the misgivings of Mr. Kafka with respect to the statement in paragraph 10. It was highly relevant to seek assurances that such an undertaking on the part of the Moroccan Government was due exclusively to their intention to request a purchase under the oil facility.

Mr. Cross observed that Morocco's oil import costs had of course increased; a number of measures had been adopted to reduce the consumption of petroleum products, but there continued to be some subsidization, although at a reduced level, which might be a factor in the adjustment problem in that sector of the economy. The volume of petroleum imports was increasing despite efforts to develop alternative domestic sources of energy, presumably because of the determination to push ahead with large increases in public investment. Morocco's favorable external debt structure permitted recourse to considerable foreign borrowing, but he asked whether the measures to be adopted to stimulate domestic savings would be adequate to the task. Other speakers had already commented on the fairly substantial deterioration projected for the balance on current account and the problems that might result in the medium-term future, as well as on the question whether the development program might not prove to be overambitious.

On the compensatory financing drawing, Mr. Cross noted from EBS/76/152 that the Moroccan authorities could have adjusted the price of phosphate rock earlier in the price downswing. The question was whether a country might not itself be causing the volume of exports to fall by pricing itself out of the market. He wondered whether the staff could comment on the extent to which the shortfall of export earnings had been beyond the control of the authorities, and how the calculation of the amount to be compensated had been affected. In moving ahead under the compensatory financing program, such questions would have to be examined carefully.

Finally, Mr. Cross inquired why, as stated on page 12 of EBS/76/108, Morocco's net receipts from services were forecast to show a large deficit for the first time, due to expanded government expenditure abroad.

Mr. Nana-Sinkam supported the three proposed decisions. Also, he shared Mr. Kafka's view regarding paragraph 10 of the letter from the Moroccan Government. He joined in the hope that the statement had been included because of Morocco's drawing under the oil facility and that it would not become a precedent for drawings in the first credit tranche.

Mr. Monday also extended his full support to Morocco's requests for drawings in the first credit tranche, under the compensatory financing decision, and the oil facility. He wished to associate himself with Mr. Foglizzo's comments. He would await with interest the answer to Mr. Kafka's question concerning the introduction or intensification of existing restrictions on the importation of goods, but for the time being he reserved his position in that connection.

Mr. Deif added his support to Morocco's requests for drawings. He was grateful to Mr. Kafka for drawing his attention to paragraph 10 of the Minister of Finance's letter, which he had initially taken to refer only to the oil facility purchase. It would be of particular interest to member countries negotiating stand-by arrangements to learn whether or not such a policy statement was likely to be called for.

The staff representative from the African Department, responding to comments about the ambitious development program that Morocco was pursuing, said that it should be kept in mind that, until fairly recently, investment activity in Morocco, particularly in the public sector, had been relatively low. As mentioned in various earlier staff reports, there was room for Morocco to step up its development effort, and an ambitious move forward was planned by the authorities under the new 1973-77 Plan. For various reasons, the main one being the delay in the adoption of the Plan, little investment had taken place in its first year--1973--when the ratio of investment to GDP was a little over 11 per cent, a low figure relative to other rates in the region. In the last two years of the Plan--1976 and 1977--the Moroccan authorities were determined to make up for lost time. Some of the projects presently being implemented were very capital intensive; for instance, a large oil refinery was being constructed, and Morocco was moving into the field of processing phosphate products, with two large factories for producing phosphoric acid and finished fertilizer. The authorities also had plans for a steel industry. According to the staff estimates, the ratio of investment to GDP had risen to 24 per cent in 1975, a large increase over 1973, but the level was still not high. Although the ambitious investment effort would bring certain pressure to bear on Morocco's resources and on its balance of payments, the Moroccan authorities, having achieved a certain momentum in their development effort, were reluctant at the present stage to put on the brakes too suddenly just because of declining export receipts from phosphates. The country was well endowed with technical and infrastructure facilities, together with a large supply of labor, so that the substantial increase in investment should not be difficult to absorb. Of course, there was always the possibility that the ambitious targets might not be fully met.

In reply to Mr. Cross, the staff representative from the African Department noted that the increase in government expenditure under the services category was perhaps related to the general security situation in the region. As for measures to stimulate domestic savings, the Moroccan authorities had a number of proposals in mind. There was a longstanding effort to undertake a comprehensive tax reform, but progress had been relatively slow so far. A beginning would be made in 1976 to increase revenue from that source. Other efforts had been made in the monetary policy field to raise interest rates, and results had been fairly good.

The staff representative from the Research Department said that it was not easy to answer Mr. Cross' hypothetical question about the possible results of an earlier reduction in the price of phosphate rock. A distinction had to be made between short-term and long-term elasticities in the demand for the commodity in assessing the impact within the shortfall year and in the postshortfall period.

To consider the short-term effect, the staff representative continued, during the period 1972-75 demand appeared to have been price inelastic. Large percentage variations in prices had affected the volume of shipments by only a small percentage. Importers could not shift immediately from one source of supply to another. Consequently, reducing prices earlier in the shortfall year would have probably led to a percentage increase in volume lower than the percentage price decline, so that the level of earnings in the shortfall year would have probably been reduced.

On the other hand, the staff representative considered, the long-term price elasticity was likely to be high. If the Moroccan authorities had not taken that view, it would not have been rational for them to reduce prices at the end of 1975. An earlier price reduction might of course have resulted in slightly higher export earnings during the postshortfall period. Combining the short- and the long-term effects, a price reduction made earlier within the shortfall year might have increased the value of the calculated shortfall. The main reason for the shortfall was the high value of export earnings during late 1974 and early 1975.

Finally, the staff representative agreed with Mr. Foglizzo that in making a projection for phosphate earnings in the two postshortfall years, the staff had purposely made fairly conservative assumptions regarding Morocco's share in phosphate exports and the prices for phosphate rock.

The Deputy Director of the Exchange and Trade Relations Department, in response to Mr. Kafka's question about the inclusion of clauses similar to that in paragraph 10 of the letter from the Moroccan Minister of Finance, explained that it had long been the practice to refer to imports in stand-by arrangements where the adjustment was likely to be difficult, although the practice had not become universal until recently. Following the Rome communiqué and the emphasis given to restraining the level of import restrictions, such clauses had become normal practice in stand-by arrangements and drawings in the first credit tranche.

The subject of restrictions was of particular importance to the Fund, the Deputy Director continued, because of the desire to maintain an ample and free flow of goods between members. There were major issues at stake, which the Executive Board might well need to debate more widely. The last occasion on which the matter had been raised was in connection with the final review of the oil facility.

Mr. Kafka responded that the stand-by arrangement with the United Kingdom contained no undertaking not to introduce import restrictions; it stated only that the U.K. Government had the firm intention not to introduce payments restrictions. A one-world approach, which was the proper attitude for the Fund to take, had been successfully maintained so far. But serious questions would be raised if certain countries were to be exempt from undertaking not to impose import restrictions, but not others. The Executive Board should discuss the issue at the earliest opportunity.

The Chairman noted that it was doubtful whether a uniformly rigid line of conduct could be expected of all member countries, irrespective of their circumstances. The issue raised by Mr. Kafka was important and should perhaps be discussed at a later date on the basis of a staff paper.

The Deputy Director of the Exchange and Trade Relations Department added that it had been the understanding with the U.K. authorities, as well as with the Moroccan authorities, that there would be consultations with the Fund if trade restrictions were imposed. The exact wording of such clauses in connection with the use of credit tranches had varied from country to country in accordance with the circumstances.

Mr. de Vries said that he was satisfied with the explanations of the Chairman and the staff. The subject should perhaps be reserved for a more general discussion, but in advance of that debate, he wished to state that the effort of the Fund to avoid the general imposition of payments restrictions was one of the few of its old tasks left, and it should be carried out rigorously. The question of uniformity of treatment might be discussed, although in his view it was a technical problem, and the policy of the Fund should be unreservedly in favor of the greatest freedom of trade and payments.

Mr. Kafka observed that it was doubtful whether the Fund normally had jurisdiction over trade restrictions and whether such clauses should be included in stand-by arrangements.

Mr. Amuzegar, responding to comments made by Executive Directors about the overambitiousness of Morocco's development program, recalled that similar doubts had been cast by the World Bank on Iran's development goals in the 1960s, but they had always proved to be unfounded.

In reply to Mr. Kafka, Mr. Amuzegar gave an assurance that paragraph 10 in the letter of the Minister of Finance had been included because the three requests were covered by the one letter. The reference to import restrictions was therefore applicable to the oil facility drawing only, and would not prejudice the future policy of the Executive Board.

In response to Mr. Cross' question about the price of phosphates, Mr. Amuzegar mentioned that it was difficult to determine the income and price effects on exports of minerals, including phosphates. During 1974, when the price of phosphates had been increased several times, exports had increased, an indication that price elasticity was low or nonexistent. Moreover, the prices of phosphate rock had always lagged behind the price of superphosphates, which did not form a great part of Morocco's exports. It was therefore difficult to claim that a lower price would have resulted in a lower shortfall, particularly taking into consideration the decline in exports of other products, which represented 55 per cent of Morocco's total exports.

The Moroccan authorities had taken all the factors he had mentioned into account, Mr. Amuzegar observed, and had drawn up their development plan in close consultation with the Fund, taking into consideration many of the recommendations made by the Executive Board in the discussion of the 1975 Article XIV consultation report.

In conclusion, Mr. Amuzegar thanked Executive Directors for their support of Morocco's three drawings from the Fund.

The Executive Directors then turned to the proposed decisions.

The Chairman noted that the formal requests from Morocco to draw in the enlarged first credit tranche and to purchase under the compensatory financing decision were expected shortly. He suggested that the decisions be adopted in principle, with the formal decisions being taken on a lapse-of-time basis, as soon as the appropriate communication was received. The exact amount of the purchase in the first credit tranche would be made known at that time.

The Executive Directors accepted the Chairman's proposal.

The Executive Directors then turned to the proposed decision on Morocco's intention to request a final purchase under the oil facility, which they approved.

The decision was:

1. The Fund has received a communication dated February 5, 1976 from the Government of Morocco informing the Fund of Morocco's intention to request a purchase equivalent to SDR 18 million under Executive Board Decisions No. 4241-(74/67), adopted June 13, 1974 and No. 4634-(75/47), adopted April 4, 1975. Morocco has made representations in accordance with paragraph 5 of Decision No. 4241-(74/67).

2. The Fund determines that the purchase would be in conformity with the decisions cited above, agrees to the purchase, notes the representations made by Morocco in accordance with

paragraph 5 of Decision No. 4241-(74/67), and grants the necessary waiver of the conditions of Article V, Section 3(a)(iii), of the Articles of Agreement on the repurchase terms set forth in the letter dated February 5, 1976.

Decision No. 5027-(76/54), adopted
March 31, 1976

3. OIL FACILITY - PEOPLE'S DEMOCRATIC REPUBLIC OF YEMEN - INTENTION TO REQUEST PURCHASE

The Executive Directors considered the intention by the People's Democratic Republic of Yemen to request a final purchase under the oil facility, together with the staff's analysis and recommendation (EBS/76/97, 3/10/76).

Mr. Amuzegar observed that satisfactory progress was being made under the financial program agreed upon between the People's Democratic Republic of Yemen and the Fund. Several measures had been taken to improve the balance of payments. No new restrictions had been introduced, and existing ones had not been intensified. Thus, he considered the request of Yemen to use the oil facility to be justified.

Mr. de Vries recalled that the Port of Aden had at one time been an important source of foreign exchange income. With the reopening of the Suez Canal, that potential seemed to have returned, and he would be interested in learning whether the authorities of Yemen were taking full advantage of it. He had no difficulty with the proposed decision.

Mr. Cross also supported the requested purchase. He had noted that Yemen had exceeded its projected current budgetary expenditures, because of an increase in civil service salaries, a matter of some concern, since the financial program had been adopted in connection with Yemen's earlier first credit tranche and oil facility drawings. On the other hand, he agreed with the staff that the excessive increase in domestic liquidity was largely due to the balance of payments deficit having been less than forecast. Domestic credit expansion was to be held down, and he hoped that the additional steps being contemplated would succeed in restraining current expenditures, expand Yemen's export potential, and result in the discovery of domestic petroleum resources.

The staff representative from the Middle Eastern Department, in reply to Mr. de Vries, said that there was considerable potential for an increase in foreign exchange receipts with increased activity in the Port of Aden following the reopening of the Suez Canal. However, by the second half of 1975, the increase in traffic since the Canal had reopened had been considerably less than expected.

With regard to the increase in civil service salaries, the staff representative observed that it was the first increase since 1972, despite the inflationary trend since then, and it amounted to only 5 per cent.

The Executive Directors then turned to the proposed decision, which they approved, amended to show the amount of the final purchase.

The decision was:

1. The Fund has received a communication dated March 8, 1976 from the Government of the People's Democratic Republic of Yemen informing the Fund of Yemen's intention to request a final purchase under Executive Board Decisions No. 4634-(75/47), adopted April 4, 1975 and No. 4954-(76/16), adopted February 11, 1976. The P.D.R. of Yemen has made representations in accordance with paragraph 5 of Executive Board Decision No. 4241-(74/67), adopted June 13, 1974.

2. The Fund determines that a purchase in an amount equivalent to SDR 7.42 million would be in conformity with the decisions cited above, agrees to the purchase, notes the representations made by the P.D.R. of Yemen in accordance with paragraph 5 of Decision No. 4241-(74/67), and grants the necessary waiver of the conditions of Article V, Section 3(a)(iii), of the Articles of Agreement on the repurchase terms set forth in the communication dated June 19, 1975.

Decision No. 5028-(76/54), adopted
March 31, 1976

4. TURKEY - 1976 ARTICLE XIV CONSULTATION, PURCHASE TRANSACTION - COMPENSATORY FINANCING, AND INTENTION TO REQUEST PURCHASE UNDER OIL FACILITY

The Executive Directors considered the staff report and proposed decision for the 1976 Article XIV consultation with Turkey (SM/76/51, 3/17/76), together with the staff's analyses and recommendations with respect to a request for a purchase under paragraphs 2, 3, and 4 of the Decision on the Compensatory Financing of Export Fluctuations (EBS/76/141, 3/19/76; Cor. 1, 3/22/76; and Sup. 1, 3/29/76) and the intention by Turkey to request a purchase under the oil facility (EBS/76/131, 3/12/76; Sup. 1, 3/19/76; and Sup. 1, Cor. 1, 3/22/76). They also had before them a report on recent economic developments in Turkey (SM/76/56, 3/25/76).

Mr. M. Akinci, Chief Counsellor of Financial and Economic Affairs, and Mr. C. Alper, Financial and Economic Counsellor, of the Embassy of Turkey in Washington, were present.

The staff representative from the European Department observed that on March 15, 1976 the official buying rate for the lira had been changed to LT 15.50 per US$1, implying a depreciation in terms of the U.S. dollar of just over 3 per cent. At the same time, other official quotations had been adjusted, thereby bringing the cross rates between them more in line with those prevailing in exchange markets abroad. The change was a continuation of developments in 1975, when the dollar/lira rate had been adjusted five times. The staff took the latest move to be in line with the undertakings in the letter from the Minister of Finance (EBS/76/131) to maintain a realistic exchange rate and to avoid broken cross rates, which had been a problem in the past.

Mr. de Groote made the following statement:

May I first pay tribute to the staff for the useful papers it has presented on the Turkish economy. My Turkish authorities, again this year, have greatly appreciated the presence of the Fund mission in Ankara at the time when critical choices were under consideration. The missions's recommendations had a decisive influence on the Program.

I shall direct my remarks first at the divergence between the present balance of payments situation and last year's expectations and, second, at the necessity to appraise the economic policies in Turkey within the framework of fundamental social and political options. These options are essential for an understanding of the reasons for the shortcomings in last year's economic performance, and of the appropriateness of the present policy targets.

1. On the occasion of last year's consultation, I mentioned that the year 1975 would submit economic policies to a severe test. Turkey was indeed faced in 1975 with a number of problems that were beyond the authorities' control. The fact they were not alone in such a predicament only aggravated the issue. Some of these problems, one obvious example of which was the continued impact of the increase in oil prices, required the Turkish economy to follow a difficult adjustment path to a new set of external realities. Others were expected to be temporary, but proved equally difficult to deal with, because recession affected adversely the two major contributing sources of foreign exchange: the external demand for Turkish exports and the demand from Western Europe for the services of Turkish workers declined simultaneously.

Meanwhile, the cost of imports rose rapidly. The authorities, in conformity with the expectations generally prevailing at that time, did regard these problems as temporary. Lacking the luxury of hindsight available to all by now, they had reasons to believe that the worst was over by mid-1975 when the economic program was revised.

On the basis of the staff's analysis, the large balance of payments deficit of last year can almost entirely be explained by these external developments. However, as the staff rightly points out, the twin problems of relatively high domestic inflation and unemployment rates were not due to external factors only. The situation was further aggravated by the political background. Having all the characteristics of an extended election year, it singularly narrowed down the options open to policymakers and the Administration, and it made it even more difficult than usual to find a proper trade-off between growth, unemployment and inflation.

2. This brings me to the fundamental consideration that should continuously inspire all economic policy decisions in Turkey, namely that priority has to be given to economic development and that Turkey's options are a developing country's options. In the country's development strategy under successive governments, the accent has always been on rapid economic growth with the special implication that the combined employment creation capacity of the industrial sector and services, plus the demand for the Turkish workers from abroad, has to be sufficiently high to absorb those that are being displaced from the agricultural sector and those entering the labor force so that an increase in the unemployment level can be avoided. This policy constraint becomes even more pronounced for the reason that an unemployment benefit system covering the entire labor force does not exist, and cannot possibly be put into operation unless one is prepared to finance such a scheme by money creation. The latter would feed inflationary pressures much more than the present policy based on a trade-off between some inflation, some unemployment and a policy of sustained growth.

3. The performance of the Turkish economy last year should be appraised against the international background, the domestic political situation and the permanent economic policy constraints I have just mentioned.

The permanent economic policy objective has been amply satisfied for the second consecutive year: real GDP increased by 8.5 per cent in 1974, and by 9 per cent in 1975. This remarkable achievement has occurred during a period of world-wide recession and increased prices for imported energy, so that it was accompanied by a substantial current account deficit. The issue for financial and monetary policies was, therefore, to counterbalance the liquidity destruction effect of the current account deficit with an appropriate expansion of credit to the public and private sectors. It is obviously difficult to achieve fine tuning between these forces acting in opposite directions on net internal liquidity creation. The excess of credit expansion during 1975 over the initially envisaged ceilings for both public and private sectors was due to contingent factors. In the public sector, it resulted from the additional stock requirements of the Agricultural Agencies, after a record harvest. In the private sector, on the other hand, it is related to the large Turkish Lira counterparts of Convertible Accounts. While these accounts were re-established in early 1975 as a means of financing the current account deficit, the domestic currency counterparts were used by the commercial banks to expand domestic credit. However, in the particular area where the authorities were not subject to extraneous factors, namely, public spending, they had underspent the budgetary appropriations by 16 per cent and were thus able to stay within the ceilings they had established earlier. This implies a brave stance by a coalition Government, subject more than ever to the will of a slim parliamentary majority.

4. The experience acquired last year in dealing with the problems has led directly to the major commitments of the present program outlined in EBS/76/131. After having carefully reviewed the issues with my Turkish authorities in Ankara, I am of the opinion that the present policy objectives represent a fair balance between the need to press further ahead with growth options and the necessity for more restraint in demand management. Appropriate fiscal and monetary policies will continue to be directed toward a correction for the balance of payments through proper demand management techniques with no recourse to trade and payments restrictions. It seems to me that the success of the Program will depend on an adequate growth of public savings and on the careful scrutiny of the balance of payments situation so that excessive liquidity creation due to a greater than expected improvement in balance of payments can be avoided while, on the other hand, if a tendency to a more pronounced deterioration than envisaged in the program occurs, this would be all the more reason for strict adherence to the credit targets. My authorities completely agree with this assessment.

Some information is already available as to the tendencies in the beginning of this year. My authorities have asked me to transmit to the Board the following recent information: both the transit cargo fares of the State Railways and the prices charged by Sumerbank have been raised last week; Sumerbank sells a great range of textiles, leather products and other consumer goods. The combined annual yield of these measures, as an addition to the State Economic Enterprise's gross income level, are estimated to be at least LT 1 billion. On the other hand, during the first two months of this year, exports reached $526.6 million and the trade deficit dropped to $218.9 million. During the same period of 1975, exports amounted to $236.7 million and the trade deficit was $477.5 million. These encouraging trends for the trade account are not, however, reflected yet in the reserve position.

Mr. Cross commented that the decline in Turkey's export receipts in 1975, compared with their strong growth in recent years, appeared to provide justification for the compensatory financing purchase. He was prepared to support the drawing, but he asked for an explanation of the decline in the unit value of Turkey's cotton exports, which had amounted to 40 per cent in 1975, since the world price for cotton had not fallen to that extent.

As for Turkey's intention to request a purchase under the oil facility, Mr. Cross considered there was clear evidence of the need. Probably the rates charged for electricity should have been raised much earlier. More important was the failure to keep public sector borrowing from the central bank and credit to the private sector within the prescribed limits of the program established in connection with the August 1975 purchase under the oil facility. The question might be raised whether that greater expansion of credit was either necessary or desirable. Possibly, the inadequate pricing policies of the state economic enterprises had contributed in large part to the budget deficit and thus to a larger than expected financing requirement. He noted that the Turkish authorities had proposed a new program in connection with their intention to make a final purchase under the oil facility, and he hoped that they would succeed in implementing the measures that the staff report for the 1976 Article XIV consultation suggested would be required in 1976 in order to deal with Turkey's inflation and balance of payments difficulties.

Mr. Laske noted that despite a world-wide slowdown in economic activity and growth, Turkey had managed to achieve high rates of real growth over the last two years. That remarkable performance was, however, marred by the emergence of a number of serious distortions in the Turkish economy, which might well prove hazardous with respect to employment, economic stability, and the external balance in future years. The most striking feature was the deterioration in the external account, where quick remedial action was urgently needed. His authorities were concerned about the strong expansion in public and private consumption expenditures, which had caused high rates of inflation and had definitely contributed, in their view, to the large current account deficit.

He fully agreed with Mr. de Groote's observations on the policy options open to the Turkish authorities, Mr. Laske continued, and he recognized the urgent need to press ahead with the development effort. At the same time, he was convinced that the authorities' aims in that connection could only be achieved if they were realistic and if a proper balance was struck between the objectives of stability and growth. It was true that a major factor in the balance of payments developments of 1975 was of an external nature. Nevertheless, it could not be overlooked that budgetary and credit policies had contributed to the deterioration that had occurred. As mentioned on page 3 of EBS/76/131, Supplement 1, the ceilings in the 1975 financial program for the budget deficit, and for credit to the state economic enterprises and the private sector had been exceeded by substantial amounts. The budget deficit had been almost exclusively financed by the central bank, which had also borne the major burden of financing the heavy operating losses of the state enterprises.

Under present circumstances, Mr. Laske said that his authorities believed that the main emphasis of Turkey's economic policy should be on containing the consumption expenditures of both the private and the public sectors, in order to generate more savings and to provide scope for increased investment. To that end, it would be highly desirable for the authorities to continue their impressive efforts to raise public revenue. In that connection, he welcomed the intention of the Turkish authorities to make further improvements in the tax collection systems.

As for the state enterprises, it was most worrying to note that the authorities were prepared to accept a further deterioration in their profit and loss situation, Mr. Laske observed. Price increases would help to alleviate the situation, but losses were still expected to amount to as much as LT 3 billion, without even taking into account any allowance for depreciation.

Turkey's external reserves had declined in 1975 by a substantial amount, Mr. Laske stated, and almost half the decline in reserves projected for 1976 had taken place in the first two months. Gross reserves appeared to have fallen below the level of convertible lira balances, which were mostly short term and thus subject to rapid withdrawal. He shared the doubts of the staff about the wisdom of the whole convertible lira scheme; it would be highly advisable for the Turkish authorities to replace such volatile and presumably expensive external indebtedness with a more stable form of foreign borrowing. Payments arrears were another facet of Turkey's foreign indebtedness in 1975, and he wondered whether the reserve losses experienced in January and February had resulted from the reduction or elimination of those arrears.

The balance of payment projections for 1976 assumed a substantial increase in exports, a moderate rise in imports, and a strong recovery in workers' remittances, Mr. Laske observed. Certainly, Turkish exports had been badly hit in 1975 by the fall in the price of cotton, imports had been inflated by speculative purchases, and the remittances from workers living abroad had suffered from the recession in the industrialized countries and had been affected by confidence factors. But even when allowance had been made for those unusual circumstances, the expectations for 1976 appeared to be on the optimistic side. The trade figures provided by Mr. de Groote might be taken as an indication that exports were moving well. But they might not do so for long. One of the underlying assumptions for the optimistic export projection was presumably the economic recovery in industrialized countries, which might enable Turkey to sell off most of its cotton stocks. If so, a strong export performance in 1976 would be due to exceptional circumstances, and the prospects for subsequent years would remain an open question. A fair amount of optimism might also have been built into the projections on the import side. Although the speculative buildup of stocks in 1975 might reduce imports in 1976 below what would otherwise have been needed, the ambitious investment plans of the state enterprises and the general need to broaden Turkey's industrial base meant that rising imports of raw materials and investment goods would be required. On top of that, the rapidly rising population might call for imports of foodstuffs. Turkey would also need some good luck for the projections to be realized.

As for workers' remittances, Mr. Laske noted that the reasons for the decline in those transfers in 1975 had not yet completely disappeared. It was evident from Table 11 in the report on recent economic developments (SM/76/56) that since 1973 the broad stream of temporary emigration of Turks to European countries had become no more than a trickle. The earlier flow might not be restored, since unemployment in the major host countries was still higher than average. Incidentally, his authorities had information indicating that workers' remittances from Germany to Turkey in January 1976 had been 50 per cent below the level of January 1975. In that context, he wished to make an observation on the scheme set up by the Turkish central bank in cooperation with one of the larger German commercial banks (SM/76/51, page 17). It seemed as though the Turkish objective was to reinforce gross external reserves, but since the depositors of the savings could continue to draw them in deutsche mark, the Turkish central bank would acquire a mortgaged asset. The deutsche mark balances should therefore be used only to the extent that they were actually converted into Turkish lira, and the Turkish central bank should take the utmost care to maintain a correct balance at all times between the claims on its German partner and its liabilities to Turkish depositors.

Finally, Mr. Laske referred to Turkey's budgetary planning. Large increases were projected both for consumption and for investment expenditure, the figures in Table 5 of the staff report being truly amazing. He agreed with the staff that substantial increases in public revenue were essential for such rates of expansion to be feasible. Also, he associated himself with the view that sizable tax increases were advisable to prevent the planned expenditure from spilling over into a higher demand for imports. Otherwise, the budget deficit might increase by as much as LT 10 billion, and if it had to be financed by monetary means, it would certainly be inflationary in nature and might easily frustrate the desire to check increases in prices. It would be preferable to raise the necessary funds by increasing taxes and the prices charged by public enterprises. In various places in the staff report, it was mentioned that the Turkish authorities did not expect to spend the full amount appropriated, so that to some degree the budgetary targets might not be realistic. It might be advisable to set up realistic objectives that would make the projections as a whole more compatible with each other.

Mr. Lynch said that he was in general agreement with Mr. Laske. The 1976 expenditure program provided for a 44 per cent increase in public expenditures on goods and services, with the increase in expenditures on fixed investment rising by 60 per cent. But the impact of such a program on taxation and pricing policies did not appear to have been borne fully in mind. It seemed unwise to count on total expenditures being below what had been authorized in the programs, as they had been in the past. Another important element in the expenditure program was the finances of the state economic enterprises, which appeared to be getting worse rather than better. Some action had been taken to put them on a sounder footing, but much more attention should be paid to the problem. The Turkish authorities were certainly facing severe difficulties, but unsound policies would not solve them. As the staff had commented, Turkey was well placed geographically and had the resources to benefit from the growth of neighboring countries. Also, the information given by Mr. de Groote at the end of his statement, about trends early in 1976, was encouraging. He hoped that the forward thrust thus indicated would be maintained.

Mr. Foglizzo said that he supported the requests by Turkey for purchases under the compensatory financing decision and under the oil facility. As a result of those transactions, however, the Fund's holdings of Turkish lira would amount to about 300 per cent of quota, a figure that was evidence of the large-scale involvement of the Fund in the financing of its members' balance of payments needs. At the same time, it should be recognized that only first credit tranche conditionality was called for, which in his opinion meant that the Executive Board and the staff would need to scrutinize closely not only the achievements of Turkey but of all member countries in a similar position. It was helpful in that respect to discuss the staff report for the Article XIV consultation together with the recommendations on the proposed drawings. As for Mr. Laske's comments on the extent to which Turkey, and other countries, were using the compensatory financing facility, the result of changing the formula had been well recognized at the time of the decision to modify the facility. However, it would be useful if transactions under the facility were included in the weekly statement prepared by the staff so that it could be ascertained to what extent it had been used and was useful to the Fund's members.

Population and employment were Turkey's most acute problems, Mr. Foglizzo considered. Turkish unemployment was not caused by a lack of job opportunities as much as by, first, a population that was growing at the rate of 2.6 per cent a year and, second, according to Mr. de Groote, by a shift from agriculture to the industrial and services sector, although it appeared from the report on recent economic developments that the proportion of the labor force employed in agriculture had remained at about the same level for the last five years. Of course, the third aspect of the employment and population problem was the employment of Turks abroad, which offered financial advantages but social disadvantages and might also tighten the dependence of the country on external sources of financing. He wondered whether the European countries concerned offered any unemployment benefits for foreign workers laid off in times of hardship.

An awareness of the structural problems that were peculiar to Turkey permitted a better understanding of the priority given by the Turkish authorities, first of all, to an ambitious growth goal--which had, however, been achieved in recent years--and, second, to an ambitious program of public investment, Mr. Foglizzo remarked. Although he could agree with the investment objectives, he wondered whether the 60 per cent projected increase in the public investment program for 1976 could be financed without monetary disturbances which, if they occurred, would have to be dealt with through recourse to both internal and external sources of financing. He had noted with interest that the expenditure commitments of the Turkish Government were systematically below the parliamentary authorizations. As Mr. Laske had remarked, such a practice was likely to introduce distortions in economic analysis, and the legislative might well be in a position to criticize the Government if unemployment increased further and authorizations for spending had not been used. At the very least, Parliament should be asked formally to approve the Government's restraint in making use of appropriations. Given the stability of the agricultural population, the public investment program should be focused on investments with a smaller capital and a higher labor force ratio.

He had been struck by a similarity between the economic situation in three totally dissimilar countries--Algeria, the United Kingdom, and Turkey--Mr. Foglizzo continued. Although they were at different levels of development and had different histories behind them, the public sector was playing an important role in the development of the economies of each of them. The consequence of the existence of a large public sector was the emergence of what was called in the United Kingdom the public sector borrowing requirement, because it was difficult to finance that sector through tax revenues alone. The staff appeared to be somewhat prejudiced against state enterprises and large public sectors, yet it should not be assumed from the outset that the public sector necessarily used resources in an unproductive manner. Certainly, there were risks of the large public sector becoming too large. As in Turkey, there was always an incentive to finance the sector through the creation of money and through central bank borrowing, not to mention the lack of incentive for adjusting the prices of state enterprises appropriately. But there was also a risk in leaving certain important sectors of the economy to private enterprise. Such risks were not always taken into account in consultations with member countries because they had noneconomic aspects.

Nevertheless, Mr. Foglizzo said, he recognized the mistakes and mismanagement of Turkey's state economic enterprises. First, tariffs were certainly too low, and the increase in the electricity rates would be most helpful. Second, the Turkish authorities should avoid central bank financing of the state enterprises. Third, the adjustment of tariffs on the supply side should not be too automatic. For instance, the rise in the price of cotton on the world market had been immediately reflected in the price paid to cooperatives. It would have been wiser to allow for a certain cushioning effect. Although it was easy to make such statements with the benefit of hindsight, he wished to underline that such time lags could be more effectively used by public enterprises than by private ones.

With the help of the Fund, of foreign borrowing, and with some lengthening of the maturity of the external debt, the external sector should not cause Turkey too much difficulty in the coming year, Mr. Foglizzo considered. One problem, however, was the eagerness of the Turkish authorities to guarantee a smooth return flow of workers' remittances from abroad, to which end they had perhaps pursued too rigid an exchange rate policy at too high a level. Nevertheless, he relied on the ability of the Turkish authorities to balance the many relevant considerations in that field.

Turkey's main problem, Mr. Foglizzo believed, was internal. To cope with it, he suggested, first, that tax revenues should be increased, and in that respect the fight against tax evasion would be important. Second, public and private savings should be encouraged. Third, in view of the uncertainties in both the world economy and Turkey's internal position, formalized contingency policies should be developed by the authorities to allow for a flexible response, should monetary disturbances emerge, whichever direction they took. Mr. de Groote had addressed himself convincingly to those policy objectives. If the balance of payments improved as expected, it would be necessary to ensure that there was not much ease in monetary policy; conversely, without the expected improvement in the balance of payments, there would be a greater need to abide by the monetary targets established by the authorities.

Mr. Bull noted that the country's remarkable growth record during a period of world-wide recession, to which Mr. de Groote had referred, together with the declining trend of Turkish exports and receipts from workers' remittances, had undoubtedly resulted in a serious balance of payments problem for Turkey. As for the decline in cotton prices, he was inclined to share the view expressed by Mr. Lieftinck when Turkey had drawn under the compensatory financing facility in November 1975, namely, that a more rapid price adjustment in response to market conditions might have decreased the extent of the shortfall on that account. The decline in workers' remittances had undoubtedly been affected by the rapid adjustment in the economy of Germany.

Turkey's most urgent task was to improve the balance of payments position and in particular the trade deficit, which in 1975 had been 2.5 times greater than total exports for that year, Mr. Bull observed. The Fund could be of help, and he had studied carefully the request to draw under the compensatory financing decision. The export forecasts of the Turkish authorities, even those that had been examined by the Fund, were on the optimistic side. Although there had been some rise in cotton prices there had been a further drop in the cotton crop, which in 1975 was down by 20 per cent and in 1976 was estimated to be 9 per cent below the 1975 level. While he was prepared to go along with the proposed decision on the compensatory financing drawing, he joined others in expressing concern about the experience with the formula adopted in the December 1975 decision. Like Mr. Foglizzo, he believed that it would be useful to include in the weekly summary of transactions figures on the extent to which the compensatory financing facility had been used. With Fund holdings of Turkish lira at about 300 per cent of quota, the continuation of Turkey's existing policies could lead to severe problems and raise questions about the ability of the Fund to make further resources available in the period ahead.

He had been particularly struck by Mr. Laske's remarks on the convertible lira deposits, Mr. Bull mentioned; they had risen dramatically in 1975, as Table 4 of SM/76/51 showed, totaling more than gross reserves. Those balances were highly volatile, having maturities of less than one year and being withdrawable in many cases on demand. He shared the staff's misgivings on the extent of reliance on such a source of funds, and he would be concerned if the Turkish authorities continued to rely on it during the coming year. The degree of Turkey's general indebtedness and its borrowing prospects in world capital markets meant that if the present rate of economic expansion was maintained, serious financial difficulties might be experienced in the next year or two.

Welcome adjustments were being made in the tariffs of the state enterprises, Mr. Bull said, but the increases had come late and did not go far enough. Although the intention of the Government was to improve the profitability of the state economic enterprises, the 60 per cent increase in public sector investment forecast for 1976 was apparently to be financed mostly be external borrowing, thus reducing the need for central bank financing. He doubted whether that expectation was based on a realistic assessment of the situation, given the existing heavy commitments of foreign banks and the enormous volume of the convertible lira accounts, as well as the weak underlying balance of payments position of Turkey.

Mr. Wakatsuki remarked that the performance of the Turkish economy during 1974 and 1975, when high rates of real growth had been registered at a time of world-wide recession, was remarkable for a non-OPEC country. Inevitably, however, the cost had been high; inflation had increased and the balance of payments position had worsened. The Turkish authorities appeared to be facing limitations on the exercise of their political options as a result of the external payments position. In that respect, he shared the view expressed by the staff in its appraisal, as well as the general tone of Mr. Laske's remarks. Mr. de Groote had said that Turkey's present policy objectives represented a fair balance between the need to press ahead with growth options and the necessity for more restraint in demand management. In his own view, more emphasis on the latter aspect was necessary if external balance was to be restored and foreign confidence maintained.

The program for 1976 envisaged large public sector expenditures, especially on fixed investment, that did not appear to be consistent with the revenue position based on the projected rate of growth of GNP, Mr. Wakatsuki observed. Discretionary underspending was not a reliable safety valve, as Mr. Foglizzo had noted. It was essential to generate additional public savings, either through higher taxation or through public bond issues, as well as to rationalize the pricing policies of the state economic enterprises. The introduction of credit targets was welcome, but it appeared necessary for the central bank to modify gradually, if not to eliminate completely, automatic financing schemes such as the one for agricultural price support. Moreover, as Mr. Laske and Mr. Bull had mentioned, the advantages of the convertible lira scheme in promoting private sector investment should be carefully weighed against the possibility of disruptions in the monetary and balance of payments fields.

The requests for purchases under the compensatory financing decision and oil facility were well justified, Mr. Wakatsuki considered, within the framework of the agreed formulae. He extended his support for both decisions.

Mr. Sevilla said that he believed the Turkish economy faced a complicated set of conditions, particularly as a result of its vulnerability to fluctuations in workers' remittances, which were a major source both of foreign exchange and of potential instability. Perhaps a high rate of investment was in fact the best solution to the unemployment problem, and to the balance of payments problem as well. As the economy was expanding, and prices and rates of investment were rising, future stability could be ensured only if productive capacity was increased and the 13 per cent of the labor force that was unemployed was put to work. Unemployment appeared to be the major problem of the Turkish economy.

Mr. de Vries said that he shared some of the concerns of other speakers about Turkey's difficult situation. Yet, given the political constraints to which Mr. de Groote had referred, Turkey seemed to have done well. Certainly, the increase in the rate of growth was impressive. The perennial problem of the state economic enterprises, which was of course a political question, was of interest to technicians because, in the longer term, public sector activities tended to achieve relatively little growth at the cost of high capital expenditures. He noted that the Turkish authorities intended to pursue their present policies with respect to the state economic enterprises, which were showing losses even without allowing for depreciation, and that they were not prepared to allow substantial price increases. Some increases had been introduced, but he agreed that they were too little and too late.

He had noticed that Turkey would be receiving Fund assistance amounting to three times its quota, under first credit tranche conditionality, Mr. de Vries added. Therefore, although the Fund's drawing policies had been decided on for good reasons, some monitoring of the application of those policies was necessary. The Executive Board had changed the compensatory financing decision in the full knowledge that increased drawings would result. Nevertheless, a continuing review of the effects would not be out of order.

In conclusion, Mr. de Vries commented that in spite of shortcomings in its policies, Turkey was making progress in a difficult situation. Certainly, the industrial countries of Europe were not without blame for the problems being faced by Turkey. He did not expect an early or great resumption of employment opportunities for Turkish workers abroad in 1976, even if economic activity in Europe picked up, because an increase in employment usually followed with a lag.

The staff representative from the European Department, responding first to comments on the balance of payments targets, noted that exports in the first two months of 1976 had been more than double what they had been in the first two months of 1975. The export target for the remaining ten months of the year was a rise of nearly 36 per cent in value terms. While that might be a substantial increase, it seemed to be not entirely implausible, especially if the possibility of sizable wheat exports before the end of the year was taken into account. Again, the import targets seemed low; but, because of the exceptional stockpiling in 1975, amounting to between $400 million to $500 million, they were not unrealistic.

The attainment of the balance of payments targets, the staff representative thought, would be less a question of luck, as Mr. Laske had suggested, than of policy. The outcome would depend on the success of the Turkish authorities in choking off the high rate of stockbuilding in 1974 and 1975, and in avoiding the speculative influences that had had an adverse effect, inter alia, on workers' remittances. The 50 per cent drop in those remittances in the first two months of 1976 could not be entirely explained, he believed, by the decline in employment opportunities in Europe. In agreeing to support the Turkish request for a final purchase under the oil facility the staff had placed a great deal of weight on the assurances provided in the Minister of Finance's letter of March 11, 1976 and in the supplementary letter of March 12, 1976 (EBS/76/131). If the Turkish authorities implemented the program outlined, the targets were reasonable. The assurances to which the staff attached particular importance were those relating to the increase in municipal income, to the raising of electricity tariffs, which was important for a number of other reasons, to the avoidance of supplementary budgets, and to the assurance that budgetary expenditure would be kept below LT 131 billion in 1976.

He did not wish to comment on the constitutional propriety of keeping expenditures below appropriations, the staff representative said. But the staff did consider that it was extremely important for the success of the program that budgetary expenditures should be limited in accordance with the statement in the letter of the Minister of Finance. Finally, great emphasis was also given to the assurances of the Turkish authorities that the exchange rate would be kept at a realistic level and that Turkey would be competitive in international markets.

The staff representative from the Research Department, in reply to the question by Mr. Cross about the 40 per cent decline in the average export unit value of Turkey's cotton exports between 1974 and 1975, against the decline in the average world price of cotton during the same period of 20 per cent, explained that the price had been far from uniform during calendar year 1974. In fact, between January and December of that year, the price of cotton had declined by 45 per cent. It was relevant therefore to consider the time at which Turkey's export sales had been made. Most of Turkey's 1974 exports had been contracted at the price prevailing at the beginning of the year, which explained the large difference between the average export value of 1974 cotton exports and those of 1975. It would be recalled that that was the reason for Turkey's drawing in November 1975 for the shortfall year covering the second half of 1974 and the first half of 1975, when cotton sales had been at a low level.

As for export forecasts, the staff representative from the Research Department commented that Turkey would be entitled to the requested drawing, provided average export earnings in 1976 and 1977 were at least two thirds of the level given by the staff representative from the European Department for the year 1976 alone. Even on the most conservative forecast, the net shortfall would therefore exceed the requested drawing. It should be noted that the proposed drawing represented only 3.3 per cent of Turkey's export earnings during calendar year 1975. Because the maximum a country could draw on account of the quota limitation was generally a small percentage of export earnings and because the price fall in 1975 had been exceptionally sharp, many countries were entitled to draw the maximum percentage of quota permitted.

The Executive Directors adjourned the discussion until the afternoon.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Directors without meeting in the period between EBM/76/53 (3/29/76) and EBM/76/54 (3/31/76).

5. LIBERIA - REPURCHASE

Liberia has proposed that repurchase in respect of the gold tranche purchase equivalent to SDR 1,305,411 on February 22, 1973 (Executive Board Decision No. 3889-(73/16), adopted February 20, 1973) be made not later than July 1, 1976. The Fund agrees to the proposal of Liberia (EBS/76/147, 3/25/76).

Decision No. 5029-(76/54), adopted
March 29, 1976

6. EXECUTIVE BOARD TRAVEL

Travel by an Executive Director as set forth in EBAP/76/64 (3/29/76) is approved.

APPROVED BY THE EXECUTIVE BOARD:
Meeting 76/126, August 23, 1976

WILLIAM B. DALE
Acting Chairman

W. LAWRENCE HEBBARD
Secretary