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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 92/96

10:00 a.m., July 29, 1992

R. D. Erb, Acting Chairman

Executive Directors	Alternate Executive Directors
	B. R. Fuleihan, Temporary
	T. P. Thomas, Temporary
	Duan J., Temporary
	G. C. Noonan
	Q. M. Krosby
	S. B. Creane, Temporary
	J. Prader
E. A. Evans	
R. Filosa	J. Papadakis
	A. F. Mohammed
I. Fridriksson	
H. Fukui	
B. Goos	
J. E. Ismael	
	J. C. Jaramillo
	I. Martel
	O. Kabbaj
	T. Berrihun, Temporary
D. Peretz	P. Wright
G. A. Posthumus	Z. Trbojevic
	N. Toé, Temporary
A. Torres	
A. Végh	A. G. Zoccali

L. Van Houtven, Secretary and Counsellor
K. S. Friedman, Assistant

Also Present

Administration Department: H. J. Struckmeyer, Deputy Director; A. Dawson, S. Griesdorf, P. J. McPhillips, H. Wiesner. European Department I: M. S. Russo, Director; M. C. Deppler, Deputy Director; G. C. Anayiotos, C. Atkinson, G. Bélanger, T. Krueger. European Department II: T. Shikado. External Relations Department: M. R. Kelly, Deputy Director; S. W. Kane. Fiscal Affairs Department: S. E. U. Ahmad, E. A. Conrad, R. Hemming. The IMF Institute: P. B. de Fontenay, Director; A. Lanyi, Deputy Director; E. Croce, W. G. L. Evers, C. J. R. Morris, S. Nawaz, C.-H. Wong. Legal Department: D. K. Jeffrey. Policy Development and Review Department: S. Kanesa-Thasan, H. M. Flickenschild. Secretary's Department: J. W. Lang, Deputy Secretary. Southeast Asia and Pacific Department: I. Hussiada. Statistics Department: J. B. McLenaghan, Director. Treasurer's Department: D. Williams, Treasurer; M. M. Nielssen, M. G. Papaioannou, G. S. Tavlas. Bureau of Language Services: P. Delannoy. Office of the Deputy Managing Director: A. Wright, Special Advisor; J. Hicklin. Advisors to Executive Directors: M. A. Ahmed, P. Bonzom, L. E. Breuer, M. Galán, A. Gronn, Y.-H. Lee, F. A. Quirós, S. von Stenglin. Assistants to Executive Directors: S. Al-Huseini, D. A. Barr, J. H. Brits, N. A. Espenilla, Jr., H. Golriz, K. M. Heinonen, O. A. Himani, K. J. Langdon, W. Laux, R. Meron, J. A. K. Munthali, E. Quattrociocche, S. Shimizu, Tin Win, R. Thorne.

1. GREECE - 1992 INTERIM ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1992 interim Article IV consultation with Greece (SM/92/138, 7/8/92; Sup. 1, 7/9/92; and Sup. 1, Cor. 1, 7/10/92).

Mr. Papadakis made the following statement:

Introduction

On behalf of the Greek authorities, I wish first to congratulate the Fund staff involved in the mission to Greece for the quality of their work. This is reflected in the adequate and fair analysis presented in the mission's report. I want, furthermore, to express my authorities' appreciation for the constructive and frank discussions held with the Fund mission during the consultations in Athens.

Greece entered the 1990s with serious macroeconomic imbalances and structural problems. In early 1990 inflation was running at 23 percent and the current account deficit and the PSBR were at nearly 7 percent and 22 percent of GDP, respectively. The new Government that emerged from the April 1990 elections, after taking some emergency measures to control the situation, prepared a "Medium-term Adjustment Program, 1991/93" aiming at fiscal consolidation, monetary stabilization, and structural reform.

Macroeconomic developments and policies

The new policies and rising confidence contributed to reversing the previous disturbing trends. In 1991, inflation fell from 23 percent to 18 percent, unit labor costs in manufacturing grew by less than 11 percent compared with 21 percent in 1990, the current account deficit narrowed by more than half to 2 percent of GDP, and the basic balance recorded a considerable surplus compared with large deficits in the previous two years. Developments so far in 1992 show that inflation (already down to 15 percent in June) will be further reduced to around 12 percent by the end of the year while the current account deficit will be contained to 1.4 percent of GDP. These developments are driven by the further reduction in the budget deficit and the continuing anti-inflation stance of monetary, exchange rate, and incomes policies.

The authorities consider that, notwithstanding the significant improvements achieved so far in the overall economic performance, a lot remains to be done, especially in the fiscal area, in order to place the economy permanently in a noninflationary growth path consistent with the medium-term objectives and goals. In response, they have redoubled their efforts to further tackle fiscal imbalances, the scale of which has proved to be much larger than earlier anticipated. Also, in the last nine months, important legislation has been passed and measures taken that increased the momentum in the crucial area of structural reforms. The authorities remain committed to lead Greece to the EMU by undertaking the painful adjustment required to satisfy the convergence criteria established in Maastricht. To this end, while precipitating the implementation of difficult measures and strengthening the ingredients of the policy framework, the authorities are preparing a Convergence Program to be submitted soon to the Community. This program will become the basis for the conduct of economic policy in the medium term and serve as a blueprint for further action in the areas of public finances and structural reform.

The main budgetary problems in 1991 emerged on the revenue side. Despite additional revenue from the imposition of a 10 percent withholding tax on interest from deposits and the large increase in the tax component of oil prices, budget revenues, although increased by 2 percentage points of GDP in 1991, as in 1990, still were some 4 percentage points less than originally budgeted. The initial expectations about the pace and the results of campaigns on privatization, combating tax evasion, and sale of land bonds, proved to be too optimistic. In contrast, on the expenditure side, improvements were broadly in line with expectations, although interest payments grew faster than originally expected, owing to the persistence of high interest rates and the sharply reduced access of the public sector to preferential borrowing from the banking sector. On a cash basis, expenditure growth fell below that of GDP (for the first time since 1987) and below the forecast in the 1991 budget. Owing to a strict incomes policy in the public sector, the wage bill grew as targeted, at a rate markedly below that of GDP. Pensions paid directly by the budget recorded the lowest growth rate in the last 15 years.

The 1992 budget has been designed to achieve significant improvements on both the revenue and expenditure sides, while safeguarding the credibility of budgetary policies by basing the projections on more realistic assumptions. The budget envisages a further 4.2 percent point reduction in the deficit/GDP ratio (a 6.6 percent point reduction, net of capitalized interest), to 11.5 percent of GDP in 1992 (7.5 percent, without capitalized interest). Broadly half the improvement in the deficit will come from the increase in revenues and half from the decrease in expenditure, in terms of GDP. Budgetary developments in the first months of 1992 point to increased vigilance. Corrective measures are promptly examined and will be introduced, if the need rises, to attain the fiscal targets. The staff projections of net PSBR in 1992 represent 2 percentage points of GDP of deviation from the authorities' target. It is the firm commitment of the authorities not to allow slippages of that magnitude to occur. Already, additional expenditure cuts of Dr 100 billion were introduced and the Ministry of Finance expects a primary surplus of 1.5 percent of GDP.

Preparations for the 1993 budget are now under way. The Minister of National Economy, who is going to play a more upgraded role than in the past in the budgetary process, is committed to preparing a 1993 budget that will put Greece on a sustainable path of convergence in order to meet the Maastricht criteria. Regarding medium-term prospects, the authorities estimate that, if the 1992 targets are achieved, then a primary surplus of 5-6 points of GDP, on average for the period 1993-96, will be both realistic and sufficient to put the Greek economy on the Maastricht convergence path.

Ongoing significant changes in the financial system have required monetary policy to act more flexibly in attaining its stabilization objectives. In view of considerable shifts in velocity triggered by financial innovation, the authorities have closely monitored both traditional and newly defined broader monetary aggregates as well as the level of interest rates and other relevant variables to ensure the consistency of monetary policy with inflation and external objectives. Although the monetary targets for 1991 already reflected a restrictive monetary stance, fiscal considerations obliged the Bank of Greece to further tighten monetary policy in the course of the year. In the event, the rates of growth of M3 and of domestic credit expansion, especially to the public sector, were considerably lower than the initial monetary targets. The further slowdown also reflected a sharp shift of the nonbank public's demand for financial assets from bank deposits to treasury bills, which brought to an end a practice that prevailed throughout the postwar period, whereby bank credit constituted the main source of government borrowing, fueling inflationary pressures.

Real interest rates increased further in 1991, in order to secure the targeted disinflation, especially in view of the ongoing financial deregulation, and to contain the balance of payments deficit during a period of further liberalization of current transactions and capital movements. To meet liquidity shortages some banks were obliged to use their overdraft facility with the central bank at high penalty rates and to borrow heavily from the interbank market, thus pushing interbank rates up to nearly 30 percent twice in 1991, one third above the average level in 1990-91. Yields on government paper have remained high and have risen further in real terms, as the treasury bill rate fell by only 1 percentage point in 1991 compared with the 5 percentage point reduction in the inflation rate. Similarly, nominal bank lending rates to the private sector have remained very high and, in real terms, have increased further from their already high level. The problem, however, of crowding out the private sector was relatively less acute in 1991, as financial liberalization allowed greater access by domestic firms to foreign credit sources. An increased proportion (over 35 percent in 1991, compared with 16 percent in 1990) of new bank loans to the private sector was made in foreign currencies at interest rates well below those for drachma loans, when allowing for the depreciation of the drachma.

The 1992 monetary program is consistent with a further slowdown in inflation by 6 percentage points, to 12 percent by year-end. The deceleration of credit expansion to the public sector will continue in 1992, facilitated by further financial deregulation and an appropriate interest rate policy. The Bank of Greece has announced that real interest rates are likely to remain high to further dampen inflationary pressures and maintain favorable balance of payments conditions. While the wide interest rate differential vis-à-vis the Euro-market, adjusted for the expected depreciation of the drachma, contributes to strengthening confidence and stimulating sizable inflows of foreign funds, the authorities also recognize that the current level of interest rates, especially lending rates, could eventually become a disincentive to investment and affect debt dynamics adversely. They consider it, however, premature at the present juncture to allow any relaxation of credit conditions, in view of the sensitivity of the balance of payments to interest rates and the ongoing liberalization of capital movements that reinforces the external constraint on monetary policy. The Bank of Greece believes that the general level of interest rates will tend to decline as the PSBR is being reduced and inflation expectations subside.

There is also scope for a reduction in bank lending rates, as a result of the phasing out of required bank holdings of below-market rate paper, which allows banks more room for reducing spreads and cutting lending rates. This trend is reinforced by important steps taken by the banks to further improve their portfolios and reduce their cost structure resulting from past lending and hiring practices, which were imposed on banks by the priorities of government policy that prevailed in the 1980s.

Exchange rate policy will continue to be broadly non-accommodating to inflation differentials. While the authorities recognize the importance of avoiding losses in competitiveness, they are encouraged by the fact that, so far, this policy has contributed positively to the stabilization drive by dampening inflationary expectations, imposing discipline on firms and unions concerning price and wage adjustments, and strengthening the inflow of private foreign capital. It remains important to avoid any pressure from imported inflation, to maintain without any noise the hard-won credibility of the monetary stance, and to provide an acceptable and credible external anchor for policy in the future. Financial discipline has been reinforced further by the liberalization of long-term capital transactions by residents abroad (to invest in housing and long-term securities) and by the full liberalization of all current transactions. As of July 7, Greece has accepted Article VIII status.

The marked improvement in the balance of payments recorded in 1991 was driven mainly by the invisibles and the long-term capital accounts; the trade deficit narrowed slightly, as a result of the sharp decline in import growth and an acceleration in export growth. The invisibles' surplus grew strongly, owing to EC transfers and private transfers (mainly Greeks residing abroad). Tourism and shipping receipts were sluggish, affected by the Middle East crisis in the early part of the year and by the Yugoslav crisis during the high season.

These developments resulted in a sharp decline of the current account deficit, which more than halved to $1.5 billion, or 2 percent of GDP, compared with 5.5 percent in 1990. This was more than fully covered by private investment in 1991, thus turning into positive the balance on official settlements (+$1 billion, compared with -$0.9 billion in 1990). Foreign long-term investment grew significantly in 1991, mainly reflecting portfolio investment and acquisitions by foreign firms of existing Greek companies. The surplus of the basic balance permitted a reduction in net official foreign borrowing. Foreign exchange reserves increased sharply to $6 billion, one half above their average level in the previous two years. Receding expectations of a step devaluation and the response of investors to depreciation-adjusted interest rate differentials continued to be the major factors behind balance of payments improvements. Also contributing, in 1991, was the weakness of domestic demand and the decline in relative unit labor costs. Developments so far, in 1992, suggest that the current account deficit will be squeezed further, to $1.2 billion, or 1.4 percent of GDP, a record low for the last 25 years.

Regarding incomes policy, the automatic wage indexation system for civil servants, which in the past was frequently applied also in the private sector, was abolished in 1991. In free negotiations with the employers, the unions signed a national collective agreement, for the first time covering a two-year period (1991 and 1992), with increases well below prospective inflation in both years. For central government employees, basic wage rises were limited to 8 percent in 1991, paid in two equal installments in January and July. Approximately the same wage policy was followed by public enterprises and entities. In 1992, wage limits in the public sector were made tougher than those incorporated in the budget. The budgeted 6 percent increase in basic wages in 1992 (in two installments) was withdrawn, public wages were frozen, and the government decided instead to implement its past promise to extend the special lump-sum adjustment to the remaining categories of central government employees who did not obtain it in 1989-90. This, together with the seniority-related wage drift and the carryover effect from 1991, will lead to a growth in average earnings of less than 9 percent in 1992 (compared with a 15.5 percent expected increase in the average annual CPI). In March 1992, a decree was passed forbidding increases in basic wages in public enterprises and banks (which were earlier planned to be about 8 percent), which together with wage drift and carryovers will limit their average wage increases to 8 percent in 1992.

Structural reform policies

Despite strong opposition from vested interests within the administration, the authorities have progressed considerably in overcoming strong systemic inertia and bringing about the required political consensus for implementing radical reforms in public administration and the civil service. Three major laws were passed in the past two years dealing with the reorganization of the administration and the public sector in general, while a new civil service code is being prepared to address remaining problems. Significant improvements have also been achieved on the organizational front, such as simplifying procedures and delegating authority, strengthening the role of administration "controllers" in charge of evaluating the efficiency of government departments, rationalizing recruitment procedures and criteria, moving public sector employees between departments, agencies and institutions, and narrowing the loopholes for overmanning.

The authorities have further strengthened their emphasis on combating tax evasion. Since the turn of 1991, important measures have been taken and stricter controls exercised on tax statements of households and companies. The requirement to justify sources of finance when buying expensive items (e.g., houses, cars, and boats) was introduced, the "objective" values of real estate, which are used as criteria for assessing taxes on real estate transactions and rent incomes, were raised consider-ably (from 10 percent for the poor to 100 percent for high-income districts), and the "objective" value system was extended to many more cities besides Athens and Salonica. The threshold "objec-tive" value for buyers and owners of other expensive items was further increased by 60-160 percent in 1992. The cross-checking of information has been extended and additional measures taken to bring into the tax net some categories of professionals (e.g., farmers, building traders, and small shopkeepers) who previously avoided tax filing.

The pilot project of computerizing tax offices was completed in 1991, and full-scale implementation is now in progress. About 125 tax offices, mainly in large cities, will be computerized by the end of 1992, and almost all tax offices by the end of 1993. The recent tax law simplified and rationalized the income tax structure, while introducing severe penalties for tax evaders. The authorities are confident that, as a result of all these actions, budget revenues from combating tax fraud and evasion will increase considerably in 1992.

The authorities remain committed to their extensive privatization program. Nineteen companies were privatized in 1991, the majority of them in the industrial sector, with some belonging to the service sector, including a bank. In addition, a number of nonviable, debt-accumulating firms were closed down. Delays were encountered in 1991 in privatizing relatively larger public companies, owing to a long list of adverse factors that seem to have been initially underestimated: (a) legal obstacles, owing partly to claims by previous owners (i.e., owners before the firms were brought under state control); (b) administrative deficiencies and inexperienced coordination between the different public bodies responsible for privatization; (c) initial overestimation of the market value of some firms, taking into account their debts; (d) opposing public opinion based on the belief--influenced in some cases by inflated asset and income accounts presented by the Boards of the individual firms--that a low price would correspond to a sell-off of "valuable" public assets; and (e) strong political and labor union opposition reflecting the fear that an inevitable restructuring of privatized firms would lead to job cuts.

The authorities have succeeded in gradually overcoming these difficulties, and the privatization program for larger companies got a real start in 1992. In February 1992, the cement company, AGET-Heracles, the largest European cement exporter and a very profitable firm, was sold to an Italian cement company. In April 1992, the loss-making Elefsis Shipyards was sold to an important shipping concern. Scaramanga Shipyards, Syros Shipyards, and Piraiki-Patraiki (the largest textile company in Greece) are also well advanced in the process of being sold or liquidated. A minority share of the Greek Sugar Industry (EBZ), owned by the Agricultural Bank of Greece, has been acquired by the private sector. The two state-owned refineries have also been added to complete the privatization list of large commercial enterprises. Counting also the relatively smaller firms, the total list contains about 70 firms to be privatized and as many to be liquidated over the next few years. The sale of shares of the Telecommunications Organization (OTE) to a strategic partner has been assigned to Credit Suisse First Boston, and the transaction is expected to be completed by mid-1993.

In addition, final bids for the sale of two licenses for mobile telephones have already been received, and the transaction is expected to be completed by October 1992. Connected with these developments was the recently passed law establishing the regulatory framework for telecommunications and setting up an independent regulatory body. The law, agreed upon by the European Commission, establishes one of the most modern regulatory environments for telecommunications in the EC.

The computerized monthly reporting system introduced in 1991 to monitor the finances of public enterprises and entities has already yielded positive results reflected in the reduction of their deficits. The accountability of their chief executive officers (CEOs) has increased, slippages from their agreed annual budgets were broadly avoided, and the companies were obliged to accept stricter controls by the authorities in both the design and the execution of their budgets. In April 1992, a law with immediate effect was passed empowering the Minister of National Economy to impose limits on the wage bills of all public enterprises and entities, under penalty of dismissal and fines amounting to one year's salary for CEOs and other senior officers. The law was subsequently extended also for 1993 and 1994. Since the law was passed, the Minister of National Economy has set limits on the wage bill of all major public enterprises and entities, in consultation with their CEOs. For the total of 25 major public enterprises and entities, the wage bill will show zero increase in 1992, while in ten of them it will show a considerable reduction--up to 21 percent--in nominal terms. In some cases, complying with the limits implies shedding excess labor. This is coupled with a second campaign to reduce total expenditure in public enterprises and entities and to further improve their financial results. In the case of public enterprises, an increased dividend is expected. Concerning public entities, the social security reform process is now gaining momentum, as the Government has been actively engaged in negotiations with the social partners on the basis of the reports from the Tripartite Committee and the technical assistance Fund mission to Greece on social security.

To determine and implement measures for longer-lasting improvements in the operation of major public enterprises, the authorities in 1992 have sought the assistance of international consulting, legal, financial and audit firms. Their terms of reference include the following: (a) conduct a business review, including the main control and reporting systems of each company, the organizational structure, the linkage between operational systems and financial reporting, in all cases identifying areas of weaknesses, developing practical recommendations and proposals for the implementation of such recommendations; (b) conduct an evaluation of senior management and recommend changes in the event that the present management is considered inadequate; and (c) audit the accounts, on the basis of internationally accepted accounting practices, to bring out into the open any hidden subsidies and to force action on the deficits. In a separate endeavor, international auditing firms were hired to provide a full inventory of stocks held by agricultural cooperatives, whether on account of the Greek state or the EC, in order to increase the transparency of the cooperatives' accounts and ensure an efficient intervention mechanism to implement the Common Agricultural Policy while avoiding future liabilities for the state.

Market deregulation gathered momentum in the past 18 months, with the authorities taking a series of important measures, including the phased out elimination of rent controls (remaining rent controls on low-income housing will also be eliminated by mid-1993), the deregulation of the oil market, the elimination of price controls, and the dismantling of regulations that protected closed industries, trades, and professions. Deregulation did not immediately lead to greater competition, which explains much of the stickiness of the inflation rate in the later months of 1991, and on several occasions the authorities threatened to take sanctions against monopoly practices, in accordance with competition laws. These tensions have tended to subside in recent months, providing the authorities with the opportunity to proceed even further. In May 1992, all price controls on goods and services produced by the private sector were eliminated (with the only exception of pharmaceuticals). Likewise, the administrative fixing of profit margins for some trades and products has been ended, and controls for "excessive profits" have been eliminated. In addition, a law was passed in June 1992, whereby administrative barriers to competition (including those that apply to professional associations) are to be eliminated by a series of Presidential Decrees. Already two such decrees were issued in July.

Financial liberalization has been viewed by the authorities as the means to improve the functioning of financial markets and resource allocation, to induce financial discipline, and to enhance the effectiveness of monetary policy. The supplementary reserve requirement for investment in treasury bills has been gradually reduced from 40 percent in January 1991 to 25 percent of deposits "at the margin" in February 1992. This ratio will be 15 percent by the end of 1992 and will be completely abolished by mid-1993. As for the "stock" of past obligatory holdings of treasury bills, banks were offered the option of converting it into negotiable government bonds of varying maturities (3 to 8 years) with an interest rate pegged to the yield of treasury bills plus 2.5 percentage points. The primary reserve ratio was maintained at 9 percent, with a view to containing liquidity trends. The conversion of treasury bills into negotiable bonds reduced sharply the banks' total obligatory investment in treasury bills, facilitating greater diversification and flexibility of bank portfolios. It also enhanced the scope for effective open market operations. In response, the Bank of Greece has been more active in market interventions and has further narrowed the windows through which banks and public sector financial institutions can obtain liquidity.

Further measures have been taken to reduce the public sector's privileged access to bank finance. The obligation on banks to earmark 9 percent of the increment in deposits to finance public enterprises and entities was abolished. The proportion of deposits earmarked for loans to small and medium-sized manufacturing companies (SMEs) was reduced from 10 percent to 7 percent in July 1992 and will also be phased out. To ensure that, in the interim, these funds are being used for their intended purpose, their temporary investment in government paper was prohibited. In addition, to reduce the subsidy component of the interest rate on bank loans to SMEs, this interest rate was raised to that of 12-month treasury bills (i.e., an increase of 4 percentage points). All remaining interest subsidies on deposits and bonds issued by some public sector financial institutions were abolished. Following these measures, about 90 percent of total bank credits are now at market rates. By the end of 1992, less than one third of new bank deposits will be allocated administratively, compared with roughly two thirds a year ago. These trends will continue, as the authorities' objective is to eliminate completely all administrative credit controls and to put on equal footing all loan recipients as well as the public sector's specialized institutions vis-à-vis private banks.

The authorities are fully aware that financial liberalization implies an increased need for strong prudential requirements and improved bank control and supervision, especially in the context of the EC single market. In July 1992, the Parliament voted a new banking law incorporating the EC's Second Banking Directive. The law goes beyond the Directive in that: (a) it provides for the elimination of monetary financing of budget expenditure in two phases, namely, the current 10 percent of the annual increase in budget expenditure that can be financed by the central bank will be halved as of January 1993 and completely eliminated as of January 1994; (b) it repeals the law providing that the Minister of Finance votes by proxy on behalf of the pension funds in the annual meeting of banks in which pension funds own substantial shares; (c) it stipulates that banks are prohibited from accruing on their books interest on loans that are not serviced for more than 11 months; (d) it liberalizes consumer credit; and (e) it permits the opening of foreign exchange accounts by Greek residents in domestic banks with no restrictions as to the source of the foreign exchange. In addition, the Bank of Greece has been tightening its controls over state-controlled financial institutions to avoid the moral hazard involved in the operations undertaken by the Government to improve their balance sheets. As indicated by the staff, changed lending practices and tighter prudential controls would minimize the associated risks and would avoid similar problems in the future. The authorities will exercise extreme caution in allowing an expanded role for the specialized institutions, which should be under the same prudential and regulatory regime as competing banks.

All these activities reflect the fact that the Greek stabilization and structural reform process, despite some initial delays, has now entered the phase of maturity and dynamism. The authorities have succeeded in increasing public awareness of the need to attack, in a fundamental way, the long-standing macroeconomic imbalances and structural rigidities. Despite the inevitable uncertainties created by potentially destabilizing political tension in the Balkan region, and despite the economic burden this implies for the Greek economy, the authorities remain committed to continuing their endeavors to consolidate public finances, disinflate the economy, and complete their ambitious program of structural reforms. They are determined to ensure that the medium-term orientation of policies is maintained and translates into prompt, concrete, and consistent action.

Mrs. Krosby made the following statement:

Undeniably, there has been some improvement in the economic situation in Greece over the past two years. As we know, positive economic growth resumed, the inflation rate slowed, the current account deficit retreated, and the net public sector borrowing requirement narrowed. But we are yet confronted with two questions. First, is the health of the economy improving as much as might be suggested by these statistics, and if so, is that improvement sufficient? And, second, if it is not, is the current policy package adequate to the challenge?

The answer to the first accentuates the importance of the second answer, but, basically, the responses to all the questions would seem to be negative. Regarding its overall health, the economy is still growing at a crawl, with the small positive outturn due to a rebound in the agricultural sectors, as industrial output dropped and the unemployment rate continued to rise. As to whether the improvement achieved so far is sufficient, the charts comparing economic performance in Greece over the past ten years with that of Portugal suggest it is not. And when considering whether the current policy package will suffice to stabilize the Greek economy, or bring it within sight of the goal of EC convergence, the medium-term scenarios in the staff report show that convergence or economic stabilization under the current policy plan is not likely in this century.

I will briefly add detail to support these thoughts in a moment, but our basic conclusion I would like to state up front: we urge the Greek authorities to have no misconceptions regarding the urgency of the economic situation, and, correspondingly, new corrective measures are immediately needed. From this perspective, the absence of a medium-term economic program until this fall is unsettling and essentially means that 1992 is basically a lost year for serious economic adjustment efforts.

A bright spot is the improved performance on monetary policy. Here, targets have been met and, most striking and possibly important of all, the dependence on monetary financing of the deficit has been sharply reduced. The task could not have been made easier by missing the budget deficit target in 1991 and will be equally complicated in the future by the potential for continuing large fiscal deficits. Furthermore, the high real interest rates net of taxes needed to attract public interest in the Treasury paper are unsustainable, as the Greek authorities acknowledge. It also, by shifting money demand, complicates monetary policy decision making and fudges the understanding of the true degree of tightness of monetary policy.

While the aim to completely stop banking financing is impressive, the deadline for this goal--1994--is not, particularly as net repayment of public sector debt to the banking sector is a common and successful staple of Fund programs. Progress in liberalizing other aspects of the financial system, while highly welcome, likewise should be accelerated and concluded. Examples here include the still high percentage of new bank deposits--42 percent--that must go to prescribed lending, the continued supplemental reserve requirement, and the continued financing of state-controlled financial institutions without corresponding changes in their lending practices. The financial sector, while strengthened by the incremental reforms, remains weak. The withholding tax on bank deposits and the access to borrowing abroad at lower interest rates together are likely to increase disintermediation of the banking system, further weakening the financial sector. We would agree with the staff that one of the benefits of liberalization is greater transparency of the underlying situation, but it is not clear from the overall policy response who is newly attentive as the monetary authorities likely always were of the true status of the economy.

Of most immediate concern to us is the apparent shift in policy priority away from rapid fiscal consolidation. Following the inability to meet the relatively ambitious fiscal targets set for 1991, the current target is a disappointment. It is unfortunate that the Greek authorities must confront a large public debt burden that can only be corrected by large surpluses in the current budget less interest payments. Nonetheless, the current fiscal situation does exist and should be addressed appropriately.

Unfortunately, the 1992 budget target is even less ambitious than originally planned, and the measures envisioned are once again unlikely to be sufficient for reaching this outcome. An uncomfortable number of budgetary measures are temporary and will provide one-time only relief; others are of an ad hoc and economically inefficient nature. The withholding tax on bank deposits falls into the latter category, and the proceeds of privatization, once they fully materialize, fall into the first. More focus should be placed on structural expenditure cuts, for example, in the public entities, which would seem to be prime ground for retrenching. The cuts in wages achieved to date are important, but the wage bill is still large as a percent of GDP. The next step should be bold movement to cut the levels of public sector employment.

Any increase in revenue ideally should come from a broader tax base, where more evenhandedness in the distribution of the tax burden is needed, and privatization. Still, given last year's performance on tax administration and collection, the authorities' expectations for revenue from cutting back on tax evasion seem optimistic. Until it is clear how fiercely the new higher penalties will be enforced, we caution against a repeat of high expectations. For this reason, and given the existing fiscal crisis in Greece, even this chair finds the timing of the decision to cut sharply tax rates before other measures are firmly in place a cause for concern. While we might be more optimistic than the staff about the eventual potential benefits from the tax cuts, it would have been significantly more prudent to have a stronger support fiscal net in place first.

The practice of interest capitalization relieves the short-term cash constraint and, therefore, potentially delays and increases the necessary adjustment. Therefore, we would strongly advise the authorities to begin to include interest capitalization in their own fiscal and monetary data. Its importance--4 percentage points of GDP in 1992--cannot escape the economic authorities, and its inclusion in official data would help to increase transparency of the economic situation and, therefore, help in the design of the appropriate policy response.

The discussion of financial policies leads to one thought about the decline in the inflation rate in 1991. While some might argue that the decrease was due to inflationary expectations improving, given the tight monetary policy apparently followed, one might argue instead that it is the persistence of a lack of confidence in anti-inflationary policies of the authorities that keeps the inflation rate higher than it otherwise might be. In any case, market confidence is best won by a solid record of meeting ambitious and appropriate targets.

On structural measures, while recognizing that this was an interim report, we would have welcomed more analysis of progress to date, given the importance of removing structural rigidities for future economic growth. On privatization, we would like to note briefly that selling large stakes of public enterprises to other enterprises or financial institutions that are state-controlled does not equal privatization. The Greek authorities have to take a number of steps to improve competition, including removal of price controls, but further enhanced market competition is needed, as collusive behavior persists in different sectors of the economy. The authorities are also urged to move quickly to complete the delayed reform of the social security system.

Finally, turning to the external sector, it appears that the improvement in the current account is less structural and more a result of relatively ephemeral causes. The trade and tourism balances were roughly unchanged in 1991 compared with 1990, but that uncertain performance was masked by a large increase in EC inflows. This effect is somewhat alarming, given that EC inflows were meant to contribute to strengthening the economy, but instead have allowed the external account improvement to become a contributing reason for slowing economic adjustment. All of these factors suggest that the narrowing of the current account deficit in 1992 expected by the authorities would be optimistic.

We agree with the staff assessment that a discrete change in the exchange rate is warranted before the drachma is locked into the ERM. It would not seem responsible to discuss use of the exchange rate as an anchor if it is not the equilibrium rate. Real wage cuts can only go so far in improving competitiveness, which, the staff report points out, is essential for sparking exports and, consequently, is necessary for renewing healthy economic growth. Before any exchange rate adjustment, ideally, strong financial policies would be in place to offset any inflation impact. But those policies should be in place anyway for convergence and joining the ERM.

Some here today might recall our concerns last year regarding the availability of EC financing that essentially took the place of possible access to a Fund facility. Our particular concerns with respect to the Greek economy were two: (1) that the policy mix was not optimal; and (2) that the program as it stood might suffer lapses without strong conditionality. In the event, both of our concerns unfortunately proved correct. Fund conditionality would possibly have made a difference. While Greece might have as easily broken off a Fund program, as it has decided not to apply for the second tranche of the EC loan, one might argue that in the meantime economic adjustment might have been better focused and more strongly implemented. Instead, the level of EC financing, much higher than what the Fund could have offered, in effect negated any need for the Greek authorities to implement fully the EC program.

Beyond the particular case of Greece, our concerns regarding the EC loan went further, and we believe it would be useful to repeat briefly our belief that the large size of the EC loan, several multiples of Greece's quota, was inconsistent with the catalytic role of Fund policy advice and potentially undermines the Fund's role as the world's central institution for balance of payments conditionality.

In the absence of more formal Fund monitoring of the economic situation in Greece, we thought it useful to have a Board discussion of the interim Article IV consultation report. It also serves to support our belief in the importance of the Fund surveillance process as well as our relief that the exceptional bicyclic process will be shortly ended.

Finally, we would like to make clear that we welcome the direction and commitment evident in the Greek Government's policies and the progress made so far, particularly in bringing down the inflation rate. We note with pleasure Greece's assumption of Article VIII status. However, this year's report has done little to allay the concerns this chair raised last year: events in the interim have confirmed the staff's advice in last year's Article IV and underscored the superior job that the Fund, as an economic institution with superb technical expertise, can perform. Important steps have been taken, as Mr. Papadakis's statement makes clear, but progress so far has fallen well short of what is needed, and unless Greece moves fast to take the immediate and energetic action required across a broad front, we fear that it will become increasingly marginalized within the EC and the world economy. To catch up with its EC colleagues, we strongly hope that Greece will intensify cooperation with the Fund, build on progress made, and undertake the bold comprehensive measures the Fund seeks.

Mr. Goos made the following statement:

I think that the staff report on this year's Article IV consultation makes very disappointing reading. It is highly appropriate that the report has been put on the agenda of the Board. The report vindicates fully the concerns expressed by the staff and the Board at the previous consultation discussion that the adjustment measures contemplated by the authorities at that time would be insufficient to meet the--admittedly--ambitious fiscal targets for 1991. As a result of this, the PSBR remains at disquieting levels, total public debt continues to snowball, and inflation, notwithstanding its more recent decline, remains excessively high.

There were, of course, a number of positive developments, notably in the external current account position, and in particular in the strong showing of international reserves. However, in the absence of a more radical adjustment course, even those improvements will likely be short-lived. This is clearly demonstrated by the results of the staff's "muddling through scenario," which indicates that the PSBR will rapidly grow to one third of GDP over the next five years, that public debt will reach the staggering figure of 168 percent of GDP in the same period, and that the external current account deficit will double to 5 percent of GDP.

Against this background, it is most unfortunate that this year's budget not only is giving rise to the same concerns expressed last year about the feasibility of the deficit target, but also--and even worse--the target seems to reflect a substantial relaxation of the consolidation path originally envisaged under the authorities' medium-term adjustment program.

All this is difficult to reconcile with the authorities' continued commitment to join the ERM and EMU. Obviously, the task of preparing the country for those moves will become ever more demanding the longer the necessary adjustment is being postponed--and not only in a technical sense as a result of the vicious circle of large public deficits and accelerating debt-service payments, but also as a result of the threatening erosion of confidence in Greece's economic policies. Time is running short for the authorities if they want to demonstrate their ability to turn the economic tides.

From what I have said so far, I think it is clear that I can fully endorse the thrust of the staff appraisal, and, therefore, there remains very little for me to add in terms of specific policy issues. I would certainly hope that the authorities' convergence program will fully reflect the staff's recommendations, notably in regard to fiscal policy. I also hope that the program will be finalized very soon. True, the size of fiscal adjustment advocated by the staff for this and next year is quite appalling; but it is at the same time clearly inevitable if a credible start is to be made toward sustainable fiscal consolidation. Obviously, fiscal reduction of the magnitude proposed by the staff will have to rely predominately on cuts in government outlays, with no expenditure items being spared. Unfortunately, according to my calculations, less than one third of the planned budget improvement for this year is to fall on expenditure cuts, while the remaining two thirds is expected to come from an increase in government revenue. Considering the size of the PSBR and the uncertainties arising from financial sector liberalization, monetary policy seems to have been rather successful in containing, and more recently reducing, inflationary pressures. Further progress in financial sector reform will no doubt be essential to improve the effectiveness of monetary policy and to be able to cope with the growing integration of Greece into the international financial markets. I therefore welcome the authorities' intention to further move ahead in this area.

In this context, I was struck by the extent of the consolidation operations necessitated by the nonpayment of state-guaranteed debt and the rescheduling of compulsory credits of the order of 10 and 13 percent of GDP, respectively, as well as of the recapitalization of several state-controlled financial institutions. Those operations clearly demonstrate the high costs of administrative interference in credit allocation. As an aside, the staff's observation that the rescheduling operation was attractive for the Government because of the possibility it provided to capitalize interest payments for a "mere" 12 to 18 months suggests that the financial situation of the country might be even more precarious than suggested in the paper. Needless to say, I am concerned about the exclusion of capitalized interest payments from the official budget presentation and monetary data. Maybe Mr. Papadakis or the staff could enlighten us on the motives behind this unusual approach.

Having said that, I should like to endorse the staff's cautioning against premature expectations that interest rates might soon decline. Apart from the reasons mentioned by the staff, it should be kept in mind that lower interest rates, in particular for longer-term maturities, need to be earned, in the sense that they can only be expected to decline if the Government pursues persistently credible stabilization policies; hence, the level of interest rates should be considered as a useful, objective gauge for the appropriateness of financial policies rather than an object for manipulation. I am glad to note from Mr. Papadakis's statement that this view seems to be shared by the Bank of Greece.

Also on monetary policy, I endorse the staff's advice to closely monitor monetary developments, including M4, in order to avoid any buildup of an inflationary potential.

On external policies, I think I can be brief and refer mainly to what I said in my last statement on exchange rate policy. At that time, I had warned against a policy of gradual devaluation and endorsed the idea of a step devaluation, provided it was accompanied by strict financial discipline. Moreover, in order to enhance the credibility of a devaluation strategy it would be highly advisable if the authorities announced from the outset that they would no longer be willing to accommodate future inflation differentials through further exchange rate action, and that they discontinue monetary financing of the budget. In this latter regard, I was also pleased to note from Mr. Papadakis's statement that his authorities intend to stop monetary financing of the budget by 1994, but I wonder whether they should not accelerate that deadline in order to underline the credibility of their stabilization strategy. I would caution against unduly optimistic expectations about the likely effects of a devaluation on inflation and the external current account. Looking at the steep jump in domestic inflation, by almost 7 percentage points, in the wake of the significant depreciation of the drachma in 1990, the projected price differentials between scenarios 2 and 3, peaking at some 2 percentage points in 1993, might underestimate the inflationary impact of a step devaluation.

Similarly, scenario 3 might overstate the relief to be derived from a devaluation for the external current account in particular, inasmuch as it does not seem to make any allowance for the well-known J curve effect in 1993; consistent with that, and as observed also by Mrs. Krosby, more than half of the improvement observed in the current account deficit last year can be traced to an increase in EC transfers rather than to the preceding depreciation. This pattern, incidentally, seems to hold also for the current account deficit expected for this year, which would improve by much less than the expected further increase in EC transfer payments. These observations lend additional strength to the call for stronger adjustment efforts; it would also be an illusion to expect that future current account deficits could be financed in a durable manner by external capital inflows of the size experienced last year.

On structural policies, I should simply like to endorse the staff's recommendations, perhaps with special emphasis on privatization and social security reform. In general, I felt greatly encouraged by Mr. Papadakis's report on his authorities' efforts at structural reform, and I hope that they move swiftly to implement their reform intentions.

Finally, although I do not share all of the concerns expressed by Mrs. Krosby on the EC loan, I remain of the view that the Greek authorities would greatly benefit from closer cooperation with the Fund, whether they pursue their adjustment and reform efforts in the framework of a Fund financial arrangement or in the context of enhanced surveillance. Such closer cooperation would, however, need to be based on a detailed and credible outline of the necessary adjustment and reform measures, supplemented where appropriate by convincing prior action; and it would need to be preceded by efforts to improve the quality of statistical data to meet the standards that normally apply for industrial countries.

I join Mrs. Krosby in commending the authorities for having adopted Article VIII status, and I would certainly hope that they will live up to the expectation raised in last week's press release (92/58) that Greece in having done so "gives confidence to the international community that it will pursue sound policies."

Mrs. Martel made the following statement:

During last year's Article IV consultation on Greece, this Board stressed the rationale behind the very ambitious but most necessary program of adjustment and reforms that had been devised by the Greek authorities. However, in 1991 and 1992, i.e., just a few months before the completion of the European single market and a few years before the entry into effect of EMU, Greece continues to register the weakest overall economic performance in the EC. Consequently, in the absence of appropriate measures, the gap between Greece and the rest of the Community could widen further.

In such circumstances, it is very clear that, as stressed by the staff, and by Mr. Papadakis, measures have been taken by the authorities in order to reverse the trend toward the deterioration of the situation, those steps are not sufficient to meet the challenges of the next few years, and immediate and strong actions are required, most notably in the fiscal area. I would like to elaborate briefly on those three points.

The staff rightly recalls that the authorities took "some important steps," especially in the wake of the agreement on the 1991 EC loan. These steps involved, inter alia, a degree of control of public wages, some revenue measures, the implementation of a strict monetary policy, and, last but not least, a series of structural reforms aimed at liberalizing a highly regulated economy. I refer especially, first, to the reduction in administered allocation of financial deposits (indeed, the compulsory financing of public enterprises by the banking sector was abolished last year), second, to the considerable liberalization of prices, and, third, to the now completed lifting of restrictions on current international payments.

These welcome steps did produce some positive results. Indeed, in various areas, they contributed to stopping the deterioration that had been registered earlier. Monetary aggregates have been kept well within the targets. Inflation has declined from more than 20 percent in 1990 to around 15 percent in mid-1992. The total public sector deficit has been reduced by 2 points of GDP and is now mostly financed by the nonbank private sector. The authorities have thus gone some distance toward the elimination of the monetary financing of the budget, which is, by the way, one of the prerequisites for participation in the EMU. Moreover, due also in part to the rather lackluster growth performance, the current account deficit has been cut by more than half in terms of GDP.

Stopping the deterioration is not enough, however, not only because the performances remain very poor if compared with those of economic partners but also because the current policy stance will have to be reinforced if Greece is to meet the three main challenges it has to face now or in the medium term. These challenges are the snowballing character of the debt problem; the potential contra-diction between relatively lax financial policies and otherwise well-taken liberalization measures; and the need to improve competitiveness in the context of the single market.

The debt situation is certainly the most obvious and immediate of these challenges. In spite of the improvement in the primary deficit, the public debt/GDP ratio again worsened last year, and the first staff scenario clearly shows that continuation of current policies would lead to further, even more unsustainable increases. The only bright spot might be the slight decline in public enterprises' and public entities' debt in 1991, but this trend seems to be due mainly to the transfer of debt to the Central Government. In any case, the seriousness of the situation is epitomized by the decision to capitalize interest in 1991 and probably also in 1992. We fully concur with the staff that what is now needed is a "clearly declining debt/GDP ratio." Because of the imperative to maintain an adequate level of real interest rates, and because of the poor short-term growth prospects of the economy, there is no other avenue for achieving such a reduction in the debt ratio than the implementation of very tight fiscal restraints.

These fiscal restraints are also needed in order to meet the second challenge. Indeed, the present situation, in which exchange controls have been lifted and the policy mix is disproportionately biased towards monetary policy, is clearly unsustainable in the long term. In addition, measures aiming at internal liberalization, notably in the financial markets, will, sooner rather than later, make more apparent the high cost and difficult financial structures of many economic agents, which will increase the pressures on the balance of payments.

The third challenge is closely related to this last point. A paramount goal of policies should now be to prepare Greece for the intensified competition that will stem from the implementation of the single market. This goal can hardly be achieved without a reinforcement of adjustment and reform policies, as clearly demonstrated, inter alia, by the fact that the ratio of gross fixed investment to GDP for Greece has been constantly below the EC average since 1983. Indeed, private sector fixed capital formation declined by 4 percent last year. Moreover, under the present circumstances, the authorities should view with some concern the current degree of reliance of the Greek economy on EC transfers, which stands at almost 6 percent of GDP in the 1992 budget.

All these arguments clearly point, first, to the fact that, as Mr. Goos has said, the solution to Greece's problems becomes more difficult as time passes, and, second, to the need for immediate and strong actions along the lines--with one exception to which I will return--proposed by the staff. All areas of public policy must be involved.

The bulk of adjustment will have to fall, of course, on fiscal policy. On the revenue side of the budget, a further increase in tax resources must be implemented. In this regard, we fully concur with the staff that, in the current circumstances, no tax plan should be considered that would not be, at the very least, revenue neutral. There seems to be both room and need, in fact, for net increases in resources. I refer especially to the need to increase indirect and property taxes, to make those property taxes broad-based and permanent, to reduce exemptions, and to improve tax administration. The privatization program, which produced disappointing results in 1991, should now be carried out with determination. On the expenditure side, the focus has to be placed now on the number of civil servants and the reform of social programs. In this latter regard, I would be grateful if the staff could give us some insight into the result of the recent FAD mission on pension reform.

On monetary policy, we join the staff in cautioning the authorities against the temptation to go too far in the reduction of interest rates until a proper equilibrium has been found in the policy mix.

In the structural area, and in spite of the progress achieved so far, the economy remains hindered by rigidities. The reduction in the administrative allocation of credit should thus be continued, and the potential adverse consequences of the bailing out of financial institutions should be limited by appropriate measures aimed at ensuring the recovery of loans and at increasing supervision.

These are ambitious fiscal, monetary, and structural stances, which will require deep changes in the behaviors of all economic agents. These changes of behavior could be encouraged by the exchange rate policy. The experience of other EC countries amply shows that the commitment to maintain an appropriate nominal exchange rate can help in this regard. Thus, I have some doubt about the staff position according to which the adoption of such a policy should be postponed until "inflation has come down." It should, on the contrary, certainly be considered even if an appropriate peg could not form an integral and helpful part of the general package of adjustment and reform measures that is now clearly needed.

In conclusion, I am confident that the combined influence of the Fund and the EC will help Greece gather the necessary consensus for action--especially in the perspective of the forthcoming convergence program--and eventually take its full place in the movement toward European integration.

Mr. Noonan made the following statement:

In preparing my statement for the Board today, I have tried to present a balanced commentary, addressing the negative aspects of Greece's performance while also recognizing the positive developments. Thus, I found Mr. Papadakis's detailed statement of the actions taken so far to be both informative and reassuring, particularly as regards the authorities' intentions. On the other hand, the actual performance of the authorities with respect to the fiscal outcome, and in following through on their stated intentions for structural reform, has fallen well short of expectations. Moreover, this performance was all the more disappointing in light of the sizable balance of payments support made available by the European Community last year to Greece, to help ease the burden of adjustment. It was, however, encouraging to read in Mr. Papadakis's statement that the Greek authorities admit that they face serious problems and that considerable work remains to be done to overcome those problems.

As I am in general agreement with the staff's appraisal, I will limit my remarks and focus my comments on a basic theme: it is in Greece's own best interests to implement the policies necessary to achieve the objectives underlying the Maastricht Treaty.

Abstracting from the specific details of Maastricht, its basic objectives are for members to orient policies toward achieving a sustainable public debt/GDP ratio and a solid performance with respect to moving to price stability. These are worthy goals for any country's authorities because the required policies will help to promote stable and sound public finances, which, in turn, are conducive to the saving and investment necessary for healthy output growth in a noninflationary setting. We would therefore urge the authorities to review the pace of progress towards the objectives of their medium-term strategy and, in particular, towards first stabilizing, and then reducing, the public debt/GDP ratio. We would also urge them to review the risk that, if the pace of progress proves inadequate, the dynamics of the debt situation could result in no progress at all being made. This is because improvements in the primary fiscal balance will be offset by increases in debt-service obligations. In this context, I would reiterate Mr. Goos's warning about unrealistic interest rate expectations. It hardly needs saying that a government subject to a popular mandate, and with a record of imposing painful adjustments, needs to make enough progress to be able to demonstrate unequivocally to the electorate that the 43 adjustments imposed have brought about tangible and beneficial results.

A first step in this direction would be to carefully reconsider the staff's assessment that the current policies envisaged by the authorities are unlikely to be sufficient to bring about the projected improvement in the budget deficit for 1992. The staff recommends that in seeking to reduce the size of the deficit, greater emphasis should be put on reducing spending. This seems especially relevant, given the relative size of public expenditure. The table on page 18 gives an outturn estimate for the Central Government's expenditure last year of almost 50 percent of GDP, while the staff notes that public employment actually increased in 1991. I was therefore pleased to note from Mr. Papadakis's statement that additional expenditure cuts of Dr 100 billion have been introduced, and that the authorities are prepared to take corrective measures should there be any slippages.

Nevertheless, the staff's projection that public expenditure in 1992 is likely to remain at 49 percent of GDP is disturbing. Recently, the Managing Director, in the briefing on his meetings in Russia, remarked that Mr. Yeltsin quickly recognized that public expenditure rising to almost 50 percent of GDP did not represent much in the way of progress towards a market economy or, for that matter, in reducing the role of the public sector.

The Greek authorities' plans to constrain expenditure through reductions in nominal wages strikes us as a response to the symptoms of an overinflated public sector, and they may serve only to exacerbate the problem by discouraging qualified employees. Moreover, they do not address fully the underlying ailment. We noted, however, with interest in Mr. Papadakis's statement that, under a new law, significant penalties are being applied to chief executive officers of public enterprises if their wage bills exceed prescribed limits, implying significant labor shedding. We wonder whether a complementary discipline will be applied to what Mr. Papadakis calls the vested interests in the civil service.

There also appears to be room for additional reductions in public expenditures. While we recognize that military expenditure is viewed by some as a sensitive topic, and the staff has gone to great lengths to word this section in that light, we would have preferred the staff to be a bit more candid. At this time, when there appears to be a growing consensus on the need to set policies toward containing the fiscal deficit, the productiveness of current expenditure appears to us to be an important consideration when addressing fiscal adjustment. We were, therefore, disappointed to infer that more emphasis had not been put by the authorities on reducing military expenditures.

Looking ahead somewhat, other reforms, particularly in the area of pensions and social security, are key to providing a sound structure for economic prosperity. We noted with interest the fact that at 15 percent of GDP, Greece is among the leaders in the OECD in its comprehensive pension system. While in general we support such principles, we have stressed, most recently to the countries moving to market-oriented economies, that the provisions made for the populace need to be feasible and in line with a country's potential income--in other words, what it can reasonably afford. With the prospect of an increasingly aging population and the additional burden on expenditures this will impose on the authorities, there is an urgent need to come to grips with the reality of the situation. We would urge the authorities to tackle these issues with resolve and accelerate the pace of reforms. While we do not wish to underestimate the strong opposition to the introduction of the measures recommended by the staff that the authorities are likely to face, we would suggest that the only alternative to action now would be more severe actions later.

In this regard, we were struck by the stark differences in the outcomes of the three scenarios presented by the staff. In the first scenario, the "status quo" scenario, the unsustainability of the government debt and its adverse impact on the poor outlook for growth and inflation are clearly inconsistent with medium-term strategy of noninflationary sustainable growth. In contrast, the two alternatives would indicate that a determined effort at front-loading the adjustments to the government deficit at this juncture leads to about 2 percent stronger output growth, a substantial improvement in inflation in the medium term, and an at least manageable government debt profile compared to the status quo.

In concluding, we would note that having committed themselves to the objective of monetary union in Europe at least in principle--the Greek Parliament is expected to ratify the Maastricht Treaty this week--time is of the essence in implementing policies needed to support that objective. Irrespective of the Maastricht criteria, however, the time to take the action needed to place Greece on a sustainable path, outlined by the staff, has come.

Mr. Fridriksson made the following statement:

I welcome this opportunity to discuss the economic situation of Greece. This year's interim Article IV report makes disappointing reading. Last year's policy objectives, which were backed by a large financial commitment from the European Community, were far from being met, and the second tranche of the EC loan was not disbursed. However, after a long period of misguided and failed policies, which resulted in deep-rooted economic problems, some progress has been made, and I welcome Greece's recent acceptance of the obligations of Article VIII of the Fund's Articles of Agreement.

The year 1991 saw some improvement in monetary policy, inflation receded slightly, and the deterioration of the fiscal balance was halted. Nevertheless, the slight reduction in the budget deficit took place from an extremely high level, and the debt/GDP ratio continued to rise. Could the staff comment on the potential implications of government guarantees on past borrowing of public entities and enterprises? Even though the current account deficit shrank, heavy dependence on potentially volatile invisible transactions creates uncertainty. Large transfers from the EC do not provide a solution to the current difficulties. As mentioned by Mr. Goos, improvements registered over the last year will be short-lived in the absence of much strengthened policies.

I fully concur, therefore, with staff that immediate adjustment efforts are required to ensure the stability of public finances over the medium term and, in concert with wide-ranging structural policies, to lay the basis for sustained growth. The first scenario presented by the staff--assuming gradual fiscal adjustment--illustrates only too well the fragility of current developments, which could lead to a drying up of external financing and force the authorities to introduce abrupt adjustment measures when a crisis emerges.

A report has been submitted to the Government and is expected to form the basis for a convergence program to be presented to the EC. I note the staff's concern over the program's composition and the speed of adjustment. Moreover, the staff feels that the Committee bases its projections on overly optimistic underlying assumptions.

I would urge the Greek authorities seriously to consider implementing economic policies comparable to those illustrated in the staff's alternative scenarios. As the staff notes, a substantial front-loading of the budgetary adjustment will be needed firmly to break away from the current situation. On this basis, the staff suggests an adjustment of the primary fiscal balance of 8-10 percentage points of GDP over the years 1992-93, in order to put Greece on a path towards EC convergence.

I fully agree that front-loaded fiscal action of this magnitude is warranted in view of the imbalances in the Greek economy. A sharp adjustment is of paramount importance to restore credibility to the economic policies pursued by the authorities, and to enable Greece to reap the benefits of European economic integration. Furthermore, I agree with staff that it may be difficult to achieve a timely improvement in competitiveness and profitability by way of strict domestic policies only. Thus, the authorities should not exclude the possibility of a one-step change in the exchange rate.

Against this background, I am inclined to prefer the approach under scenario three in the staff report--that is, an early real depreciation of the drachma combined with tight financial policies to preserve the gains in competitiveness--as the one best suited to rectifying the problems facing Greece. Notwithstanding the urgent emphasis on appropriate macroeconomic policies, it is imperative that, in order for the stabilization efforts to succeed and healthy economic growth to be restored, far-reaching structural reforms be implemented both in the public and in the private sectors. These include addressing the size of the public sector, resolving the problems in tax administration, privatizing public enterprises, liberalizing prices and financial markets, deregulating, and removing obstacles to competition in the economy in general.

Finally, how could such stabilization efforts, complemented by structural reforms, best succeed? In the last two Board discussions on Greece, this chair has encouraged the authorities to seek assistance from the Fund. The imbalances in the economy are at least as deeply entrenched as before, and the Fund could play an important role in the formulation and disciplined implementation of corrective policies. Therefore, I strongly urge the authorities to seriously consider the possibility of entering into an arrangement with the Fund.

The staff has drawn up a clear picture which the Greek authorities should consider very seriously.

The staff representative from the European I Department noted that views had differed on the appropriate choice of exchange rate policy. As the staff had stressed in its report, there must be credible and firm measures in place to address the fiscal deficit and maintain monetary restraint before any consideration could be given to exchange rate action to address competitiveness. Indeed, such policies were a prerequisite for any lasting improvement in competitiveness.

It had been suggested by Mr. Goos that the staff scenarios might have understated the inflationary implications of a one-step exchange rate adjustment, the staff representative continued. But when comparing the scenarios to the jump in inflation in 1989-90, it was important to keep in mind that the jump followed not only a previous devaluation in 1986-87 but also a period of expansionary financial policies with a sharply widening budget deficit during 1988-89, largely accommodated by monetary policy. The third scenario allowed for some worsening of inflation. But the inflationary impact would be limited, since the one-step adjustment would occur in combination with stronger fiscal and monetary adjustment.

The possible use of the exchange rate as a nominal anchor, was a difficult issue, the staff representative continued. At present, the exchange rate was not being used as a nominal anchor, but rather was adjusted to offset--at best partially--the inflation differential. Thus, exchange rate policy was probably not sending a particularly clear signal to the private sector about inflation. However, attempts to use a less accommodating exchange rate policy to combat inflation would cause a deterioration in competitiveness. Given Greece's low income position relative to the rest of the EC, and the country's need for sustained growth if it was to move toward the income levels in the rest of the EC, improving competitiveness must remain an important policy objective. Since 1991, the staff had wondered whether the improvement in competitiveness needed for sustained growth could be achieved by domestic policies alone.

The staff's scenarios did incorporate a J-curve effect, but its impact was limited by other factors, the staff representative continued. Experience suggested that the J-curve effect was relatively weak in Greece.

The Fiscal Affairs Department mission to review the pension system had been successful, the staff representative remarked. The staff had a number of high-level meetings with the authorities, who had found the staff's analysis useful. The staff had analyzed the short-term and long-term difficulties of the system; such analysis had not otherwise been available in Greece. The mission's report had been issued to the press, as the authorities had found it a useful contribution to the public debate on the pension system.

The mission's recommendations were not surprising, the staff representative went on. Basically, the pension system was very generous. Pension outlays were very high and were set to increase over the medium term because of the demographics of Greece. The main problems of the system were on the benefits side, rather than on the contributions side. However, it might be necessary for the authorities to move on both revenues and expenditures in order to address the short-term problems in the system. The authorities had not yet acted in response to the mission's report. It was essential that the pension system lend credibility to the medium-term adjustment effort, and the staff hoped that the needed measures would be introduced shortly.

As to the question of the appropriate definition of the fiscal position, the staff's definition included capitalized and accrued interest, the staff representative commented. The staff believed that including the full implications of government borrowing in the definition provided a better picture of the actual fiscal situation.

The implications of the recent assumption by the Central Government of bad debts covered by government guarantees was that the fiscal adjustment required was even larger than would otherwise have been the case, the staff representative commented. That fact strengthened the case for fiscal adjustment. The staff thought it correct to use a very broad definition of the public sector debt in its calculations of the medium-term debt dynamics. Most of the guaranteed debt was of the public enterprises. The staff's broader definition of public debt would probably cover some of the debt on which guarantees might yet be called in the future. In essence, the medium-term scenarios reflected additional potential bad news by projecting that further guarantees would be called in future.

Mr. Peretz made the following statement:

> I fully agree with Mr. Goos's comments. The present discussion is useful. A year ago we suggested that there might be scope for particularly close monitoring of events in Greece alongside the EC adjustment program. I think that is proving to be the case. I think we need to continue with that.
>
> I certainly welcome the Greek authorities' efforts through the EC program, but it is clear from the staff report and from what others have said today that stronger action is needed. I would like on this occasion to welcome the decision by the Minister of National Economy in Greece to publish the Fund staff report. I think that is a good and welcome sign of some commitment to actually undertake the measures that are recommended. The report and other speakers have set out all the issues and what needs to be done. I would stress myself particularly the need to concentrate on further cuts in public spending. And again I agree in particular with everything Mr. Goos had to say about that.
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> I think we should welcome the further steps toward financial liberalization taking place in the context of moves toward a single European market. I join with others in registering some degree of disturbance about the capitalization of interest on some

government paper. I think that the Fund should strongly discourage this kind of cosmetic accounting device, which does not serve any purpose at all except to confuse.

While I welcome the increased sales of public debt to the nonbank sector, which have been mainly in the form of treasury bills, many of which I take it are fairly short-term bills, I would note that in my own country we actually count short-term treasury bills as part of the wider measure of money, M4. That seems to us to be sensible. I think it is probably the correct way to treat very short-term government paper. I think we should be wary of taking too much comfort from such financing in Greece's case. As the staff says, liberalization in the financial sector means that the monetary aggregate indicators need to be treated with a degree of caution. In the case of Greece, as in many other countries, this points to using the exchange rate as an important indicator of the stance of monetary policy alongside the domestic monetary aggregates.

I join others in welcoming Greece's acceptance of Article VIII status. I hope that the acceptance of this status within a week of removing the final payments restrictions will serve as a useful example to other members of the Fund.

On exchange rate policy, I have very little to add to Mr. Goos's comments, with which I agree. In particular, I am sure he is right to warn that while there may be a case for a step devaluation in the nominal rate at some point before ERM entry, we should not expect too much from nominal devaluations. There are significant dangers there, as the staff representative said. If there is a step devaluation, it would have to be accompanied by even tougher domestic adjustment. Devaluation is rarely, if ever, an alternative to higher interest rates, tighter monetary policy, and tighter fiscal policy. It would not be an alternative as far as Greece is concerned. It would require even tougher domestic policies. For the time being, I would support the Greek authorities in a fairly nonaccommodating exchange rate policy, which they seem to be pursuing.

Finally a word on the Fund's role. I hope there is scope for continued close monitoring by Fund staff of the adjustment process. I wonder whether there may be room for increased coordination between Fund staff and the European Commission staff, for example in giving technical assistance to the Greek Government on macroeconomic policy.

Mr. Posthumus made the following statement:

As is abundantly clear from the staff report for the 1992 interim Article IV consultation, the Greek economy is in a critical condition. This is disappointing. The staff report is very clear, and I understand that the authorities have published it; I hope that this step proves to be helpful.

The fiscal position is unsustainable and calls for immediate action. The staff indicates that budgeted adjustment for 1992 of 3 1/2 percentage points of GDP in the primary balance is inadequate in view of medium-term objectives; at the same time, the staff indicates that this 3 1/2 percent adjustment may not be attained. For a real turnaround, a primary adjustment of 8-10 percentage points of GDP may be required. Such a turnaround is required to break through the dynamics of deficit and debt.

In his statement Mr. Papadakis conveys the opinion of the Greek authorities that a primary surplus of 5-6 percentage points of GDP on average for the period 1993-1996 will be both realistic and sufficient. The Greek authorities do not mention the need of front-loading, however. I would like to ask Mr. Papadakis whether his authorities accept the staff's approach regarding the need for front-loading. In this respect, I note that he praises the adequate and fair analysis in the staff's report, and I agree. But he does not say whether he or his authorities agree with the staff's advice. In my view, the staff's approach should be supported. In addition, I would like to say that in my view the policy target should be the PSBR or the deficit, and not the size of the primary surplus. Talking about a primary surplus wrongly gives the impression that there is a surplus.

I agree with staff that the measures to reduce the fiscal deficit focus too much on the revenue side and too little on the expenditure side. In addition, the revenue measures consist to a large extent of one-off measures, such as privatization and collection of past due taxes. The reform of the corporate and personal income tax, and in particular the reduction of tax rates, is an almost unbelievable measure in view of the large fiscal deficit.

Again, while staff stressed the importance of public sector employment, Mr. Papadakis stresses the results of an incomes policy that in 1991 and 1992 focused on real wage compression. A reduction of real wages may be unavoidable in the short term, but it is not at all certain that it is sustainable in the somewhat longer term.

My final comment on fiscal policy is actually a question about guarantees: in view of the very large consolidation operations because of the calling in of guarantees, are the authorities considering discontinuing the practice of state guarantees to investment loans?

The staff concludes that "the monetary targets were met easily in 1991." Progress has been made towards the reduction of monetary financing of the fiscal deficit, facilitated by high real interest rates, less forced financing by banks, and a more market-oriented system of financial intermediation. We agree that Greece has taken a first step towards a sound monetary sector. As is noted in the report, however, the monetary expansion is underestimated: monetary growth is still 23 percent (as in 1990) if liquid government paper is included. Credit expansion is higher than official Greek data would suggest, owing to capitalization of interest payments. The decrease (3.5 percent) in inflation is relatively small, compared to the high initial level (19.5 percent), and seems to be due mainly to the declining business cycle.

The Greek authorities are aspiring to ERM entry before 1994. We agree with the staff that, to make this a realistic option, much remains to be done by Greece. The character of the EMS has changed since its genesis, and the stability and credibility of the parities have increased. Entry of a new member state that has not yet taken the measures necessary for internal stability would endanger the proper functioning of the EMS. This could be harmful to not only Greece, but the ERM as well. A large devaluation just prior to ERM entry would damage the credibility of Greek ERM membership and fuel domestic inflation, leading to expectations of further devaluations. The same would apply to an early devaluation. On this, I think my position is close to that of Mr. Peretz. If Greece intends to join the ERM, it will have to improve its internal economic performance substantially, with regard to both public finance and inflation.

The improvement in the balance of payments in 1991 is likely to be a much less positive development than the Greek authorities seem to think. The question is whether the improvement is sustainable. The trade account is weak, and emigrants' remittances, as well as rising EC transfers, cannot be counted upon forever. A structural improvement is not visible. If Greece were to require balance of payments support at some time in the future--and I would not really be surprised if this happens--Greece should approach the international organization that has an established record of efficient and successful adjustment programs.

Ms. Duan made the following statement:

We share many of the views and concerns expressed in the staff report and by previous speakers. The Greek economy has shown positive developments in the past year, as evidenced by the improvement in real GDP growth, inflation, and the current account deficit. Nonetheless, what has been achieved so far is still well short of what is required for convergence, as well as for a sound performance of the economy itself. In spite of the various efforts devoted to stabilizing the economy, some of the major problems persist and call for more intensified and comprehensive actions to be taken without delay.

As most of the points I want to make have already been discussed by previous speakers, I will limit myself--for emphasis--to two very brief comments. First, on public finances. As indicated in the report, the ratio of public sector debt to GDP has been high and rising; it reached 116 percent last year. The reduction of both the overall deficit and the overall PSBR was much less than expected. Therefore, stepping up efforts in fiscal adjustment is a matter of urgency, in view of the current situation--which is apparently not sustainable--and also for the purpose of consolidating the improvement in inflation and invigorating the private sector's role in future economic growth.

The authorities have taken various important measures to boost revenue. While encouraging them to press ahead with these welcome efforts, we urge the authorities to place even greater emphasis on the control of government spending, especially grants and transfers, and the wage bill by rationalizing the size of the Government itself. Also, of crucial importance to the present fiscal adjustment and to a fundamental improvement of public finances in the longer term is revitalization of the recently lagging structural reforms of the tax and social security systems. In this connection, we are encouraged by Mr. Papadakis's very informative and helpful statement, which demonstrates the authorities' further efforts and commitment to fiscal consolidation.

Second, on external policies, I note that despite an improvement in the current account, we share the staff's concern about the weakness of the trade account. As Table 22 of the supplemental paper shows, imports have been about three times the level of exports in the past three years--even when growth was slowing down. This points to the importance of maintaining and improving the international competitiveness of the external sector. Necessary adjustments to enhance the productivity and competitiveness of the traded goods sector, and to ensure future growth, should not be delayed by reliance on the invisibles' surplus to obtain a sustainable current account position. Meanwhile, financial policies should be coordinated in such a way that a gain in competitiveness can also be reaped through a fundamental reduction in inflation.

Mr. Fuleihan made the following statement:

Once again, the staff report presents a grim picture of the Greek economy. Despite some positive developments, the total public sector borrowing requirement in 1991 amounted to 17.7 percent of GDP, with a ratio of debt to GDP of 116.2 percent and an inflation rate of 19.5 percent. It goes without saying that the EC-supported, medium-term fiscal adjustment and structural reform program is seriously off track. Indeed, as noted in the staff report, the revenue and overall fiscal targets were far from achieved, structural reform in the tax and social security system lagged, and progress on privatization was minimal. Hence, I endorse fully the staff's view that progress so far has fallen well short of what is needed, thereby necessitating immediate and substantial action in order to strengthen the fiscal adjustment and to consolidate the gains in inflation and the balance of payments.

It is beyond doubt that any country confronting such an economic situation is in dire need of strong, heavily front-loaded, and sizable fiscal consolidation. This, however, is all the more imperative for Greece if, as Mr. Papadakis states in his comprehensive statement, the authorities intend to satisfy the convergence criteria for European Monetary Union. Therefore, I agree with the staff that the budgeted adjustment of 3.5 percent of GDP in the primary balance in 1992/93 is inadequate. Furthermore, I am uncertain that even this limited adjustment could be attained without additional measures, as the higher revenues are based on improved tax administration and collection of past-due taxes, as well as higher privatization proceeds.

It is crucial that the authorities adopt credible measures that stabilize public finances, reduce public dissaving, and place the debt/GDP ratio on an irreversibly declining path. Hence, I agree with the staff on the need for a primary adjustment of about 10 percentage points of GDP in 1992/93, to be partly achieved through significant expenditure restraint. Here, the rationalization of public sector employment and the reform of the pension system are urgent priorities. Thus, I urge the authorities to pay due regard to the recommendations of the FAD technical assistance mission. Moreover, an overhaul of the public enterprise system, along with an ambitious privatization program, represent essential components of any fiscal consolidation program. If these are coupled with significant measures to liberalize and deregulate the economy, they would enhance economic efficiency and foster a supply-side contribution to output.

Regarding exchange rate policy, I note that the authorities' strategy aims at offsetting inflation differentials with EC partners. This real effective exchange rate peg, in the context of the current lax financial policy stance, may inappropriately relieve the pressure for domestic adjustment. Thus, I wonder whether the authorities need to implement tight financial policies before considering the need for any one-step exchange rate adjustment. In this regard, while I agree with the staff that competitiveness is unlikely to be maintained through domestic policies alone; it appears that the authorities are currently placing undue emphasis on external policies.

In conclusion, Greece will inevitably undergo the required economic adjustment. It is my hope that the authorities will implement measures that ensure a smooth and orderly adjustment process. In the absence of such an appropriate policy stance, the authorities may eventually find themselves confronted with very harsh and costly adjustment scenarios.

I welcome the authorities' acceptance of the obligations of Article VIII.

Mr. Torres made the following statement:

After reading the staff's report on Greece, I was left with the impression that, given the magnitude of its macroeconomic disequilibria, there is no room for complacency. There is no need for anything but urgency--urgency in deciding upon and implementing a policy response appropriate enough to deal effectively with those disequilibria. Unfortunately, the medium-term program of fiscal adjustment and structural reform that was agreed with the EC in March 1991 and supported by an EC loan, remains clearly off track, particularly on the fiscal front. The concerns expressed in this Board during the previous Article IV discussion, about the inadequacy of the policies that were then in place to achieve the program objectives, seem to have proved correct.

It cannot be denied that there has been significant progress in reducing macroeconomic disequilibria and in the structural agenda over the last two years. But it cannot be denied that the progress has been clearly insufficient compared to what is needed, and that the previous fiscal slippages do not bode well for the success of the adjustment program.

A reduction in inflation to the level of the core EC countries and, hence, in the unsustainable level of the public debt/GDP ratio, remain central economic objectives to set the stage for improved economic performance on a sustained basis, and for Greece to be able to join in the future EMU at an early point. To this end, a considerably more ambitious up-front fiscal adjustment than that being considered by the Greek authorities is called for. It will undoubtedly be difficult to achieve, but it will also minimize the risk of having to make an even larger adjustment later.

Recent expenditure cuts, as confirmed in Mr. Papadakis's statement, go in the right direction and are welcome, but fall short of correcting previous fiscal slippages. To bring the fiscal situation in 1992 back on track would require additional measures.

I agree with the staff about the order of magnitude of the primary surplus, well above that envisaged by the Greek authorities, that is needed to disinflate the economy and put it on a convergence path. The emphasis of fiscal adjustment should be placed on expenditure restraint, together with new and permanent revenue-enhancing measures. In this regard, I fully endorse the staff recommendations.

In addition to a steady continuation of the structural reform process, the stabilization effort should hence emphasize a vigorous and up-front fiscal consolidation, supported by a tight stance of monetary policy. With tighter financial policies in place, an early entry into the ERM of the EMS would be helpful. Joining the ERM could be accompanied by a correction of the exchange rate to prevent Greece's persistent inflation differential from undermining the initial adjustment and enhance the credibility of parity at entry.

After all, Greece has already had considerable success with a similar package. In 1953, when Greece halved the drachma and entered the Bretton Woods system, inflation converged to the industrial countries' average within two years, and these measures set the stage for about two decades of impressive noninflationary growth. Economic and monetary union in Europe offers now a similar opportunity, and Greece should not miss it.

With these remarks, I welcome the Greek authorities' decision to move to Article VIII status.

The staff representative from the European I Department said that she wished to reassure Mr. Peretz that in its work on Greece the staff had enjoyed close coordination and cooperation with the EC staff.

Mr. Papadakis thanked Directors for their comments; his authorities greatly appreciated the views expressed by the Board. Since 1990, the staff reports and Board discussions had been very useful to the authorities in their continuous reassessment of medium-term policies and in increasing public awareness of the strong efforts required to place the economy back on the path of convergence required by the process of European unification.

During the previous Board discussion on Greece, some Directors had felt that the authorities were either not willing or not sufficiently prepared to stay the course in implementing a satisfactory program, Mr. Papadakis recalled. In his opening statement at the present meeting he had recounted the important and difficult steps that the authorities had taken in 1991 and in recent months. Still, the positive achievements apparently were not recognized by all Directors. Of course, he had not claimed that economic performance in 1991, especially on the fiscal front, had been as satisfactory as his authorities had desired. Nonetheless, any suggestion that there had been "large deviations" from the objectives of the program as a whole would not do justice to the important, difficult, and successful efforts that had been made in many areas, as a number of Directors had pointed out. The authorities fully recognized and had repeatedly stressed that fiscal adjustment was at the center of the required medium-term effort required. It was exactly for that reason that they had decided, in view of the fiscal results in 1991, to extend the planning horizon of their adjustment policies by preparing a Convergence Program--to be presented to the EC--that would be consistent with the adjustment path required to meet the Maastricht criteria.

Meanwhile, Mr. Papadakis continued, the 1992 budget, which was based on more realistic assumptions than the budget for 1991, envisaged significant improvements that the authorities were committed to achieving, as he had mentioned in his opening statement. The authorities were confident that expenditures did not pose a threat to fiscal discipline in 1992, and they did not anticipate any surprises through the end of 1993. At the same time, the new tax law had fundamentally changed the tax system, as it provided for lower marginal income tax rates both for individuals and companies, and for the use of an impressive array of instruments to attack with increasing success the insidious problem of tax evasion. The tax law had been designed to be tax neutral, but it would be naive to consider the fiscal situation as being totally free from uncertainties. For that reason, a cut in expenditure across the board, by Dr 100 billion, had already been decided. Developments continued to be closely monitored, and the situation would be thoroughly reviewed in September 1992. The authorities were determined to take additional measures, if needed.

He agreed that front-loading was an important element of any medium-term adjustment program, Mr. Papadakis said. For a number of reasons, that had not been achieved in Greece in 1990-91. As a consequence, a stronger adjustment effort, and for a longer period, seemed to be the only alternative. The authorities had accepted the challenge. If the 1992 fiscal targets were achieved, as was currently expected, the authorities estimated that a primary surplus of around 6 percentage points of GDP, on average for the period 1993-96, would be both necessary and sufficient to put the economy on the Maastricht convergence path. The authorities believed that, for the initial period--the coming 17 months--the attempted fiscal adjustment should, of course, take into account what was realistic as well as what was necessary for the required average trend to emerge. The scale and modalities of the operation would be based on what was required by the Maastricht trajectory, while avoiding stretching the limits of social cohesion to breaking point, which could render the whole effort unsuccessful. In his opening speech in Parliament on July 26, 1992, during the discussion on the ratification of the Maastricht Treaty, the Prime Minister had announced that a primary surplus of 8 percent of GDP was required for FY 1993. Obviously, that was by no means a small adjustment. To that end, primary expenditures would have to grow by no more than 6-8 percent in nominal terms, and revenue by no less than 22 percent. Preparations for the 1993 budget along those lines were currently under way.

In response to a question posed by Mr. Goos, he wished to assure Directors that there were no "hidden motives" behind the treatment of capitalized interest in the official budget accounts, Mr. Papadakis said. The law on public accounting procedures required that only expenditures and revenues realized during each year should appear in that year's budget. There were constitutional matters involved in trying to change that procedure, which implied in essence that not the capitalized interest, but only the "interest on capitalized interest" should be included in the budget. In any event, the authorities were fully aware of the true magnitude of fiscal adjustment required to achieve the medium-term goals. As to the government guarantees to public enterprises, his authorities intended to eliminate them to the extent possible, Mr. Papadakis remarked. They had already been eliminated in a number of cases after the introduction of the system of monthly monitoring of public enterprises. Of course, the state continued to guarantee international loans whenever that was required by established practice.

The exchange rate policy had been extensively discussed from various viewpoints during the previous consultation with Greece, Mr. Papadakis recalled. There was no need to repeat the theoretical arguments in favor of a nonaccommodating exchange rate policy in certain situations, like the present one in Greece. He agreed with the comments of Mr. Peretz and other Directors on that issue at the present meeting. In any event, the relevant EC bodies had agreed on the nonaccommodating stance as the appropriate policy for the drachma. And, indeed, in practice that policy had proved to be the correct one in the circumstances of Greece thus far, as it had helped contain wages, suppressed imported inflation, allowed for a sharp decrease in unit labor costs, greatly contributed to financial discipline in both the government and the private sectors, and strengthened confidence in the drachma, leading to increased capital and quasi-capital inflows.

The ratification of the Maastricht Treaty was currently under discussion in the Greek Parliament, Mr. Papadakis noted. He had just received from Greece recent press clippings, one of which was entitled "But, Nonetheless, There WILL be a Devaluation" and stated in part that "besides, the International Monetary Fund openly proposes the devaluation of the drachma as the only measure that can contribute to achieving the Maastricht targets." A second article, in another newspaper, was entitled "Are We Heading Towards a New Devaluation?" and stated that "information about a probable devaluation has had a corresponding impact in the market, where tendencies emerged to hide stocks of imported goods." Therefore, he urged Directors and the Chairman to avoid including in the summing up any suggestion that could fuel expectations of a devaluation either at present or at the time Greece joined the ERM. Any such hint would jeopardize the monetary authorities' further efforts to reinforce financial restraint, liberalize foreign exchange transactions, and deregulate the banking and credit sector. Of course, he agreed with Directors who had stressed that fiscal and monetary policies were the most important factors behind any kind of exchange rate policy--and that conclusion would be especially applicable at the time Greece joined the ERM.

As to monitoring of the program, the authorities were well aware of the Fund's role, Mr. Papadakis continued. The authorities had greatly appreciated the staff's involvement and, since 1990, had always held frank, thorough, and constructive discussions with the staff. The recent technical assistance mission to Greece to examine the social security system had been successful. Such fruitful cooperation was always beneficial. At the same time, however, the authorities had chosen to make their own decisions about the international context in which they placed their economic program. The very close consultations between the Greek authorities and the Commission continued, and the Convergence Program would be within the framework of multilateral surveillance procedures agreed in the EC. Greece had always fully accepted the modalities, criteria, and procedures envisaged for each stage toward EMU. He saw no need for any additional monitoring beyond that which the Community decided was necessary for the Community's aims and goals and, in that context, what the Greek authorities decided was appropriate for their own purposes. Of course, in the forthcoming Board seminar discussion on the Maastricht agreement, Directors would have an opportunity to discuss extensively EMU issues relating to Fund surveillance, and perhaps some desirable solutions could be found for his authorities, too.

He wished to comment on the medium-term growth prospects, in response to Mrs. Martel's fear that the gap with the EC would widen in the future, Mr. Papadakis said. That issue was important for the debt, GDP, and interest rate dynamics in the staff's scenarios. While the thrust of macroeconomic policy was aimed at disinflation, flanking policies were aimed at precipitating the return to growth rates that, judging from past Greek experience, were attainable. Despite the fiscal consolidation, public investment had been increasing and would continue to increase as a share of the total budget. All small projects of dubious quality or with insignificant contributions to growth had been eliminated from the investment budget, which currently concentrated on much-needed major projects of high-quality investment in infrastructure. That approach had also increased the flow of financing from the EC's Structural Funds. In addition, large-scale projects (like the Athens Metro and the new International Airport) were being financed by contracting out to private concerns. The system of regional incentives had been switched from grants to increased tax-deductible allowances. The privatization process was releasing productive resources, thus exerting downward pressure on factor prices. The increasing competition, as a result of the liberalization of prices and markets, and the increased confidence in the drachma, had also contributed to the improved growth prospects. Economic developments thus far in 1992 were encouraging. A recovery in private investment and in net exports was expected to strengthen growth, with real GDP being projected to rise by 2-2.5 percent. The authorities were confident that, as the process of disinflation and restructuring continued, those factors would soon enable the economy to achieve growth rates similar to those achieved in the 1970s.

He agreed with the staff and Directors that including capitalized interest in the data on the budget had the important advantages of showing exactly what the fiscal situation was and of clarifying the extent of the adjustment needed, Mr. Papadakis commented. Hitherto, there had been some technical question in Greece whether the whole amount of capitalized interest should be included in the data. To some extent, the question concerned the legal basis of the public accounting procedures; it had not been clear whether the capitalization would require a difficult change in the constitution. He considered that conceptually the staff procedure was the correct one, and he was sure that the authorities, even if they did not officially include the capitalized interest in the published budget, nontheless in practice took it seriously into account as a parallel indicator.

Mr. Posthumus remarked that, with respect to the role of the Fund in Greece, it was important to bear in mind that, as long as EC countries were members of the Fund, they should agree that Fund policies applied to them in the same way as they applied to other Fund members. The need for that equal treatment was in his view one of the most important reasons why he had strongly protested one year earlier the introduction of interim and bicyclic consultations. It was not satisfactory to say that the European countries had a European Commission where relevant policy issues were reviewed.

Mr. Papadakis said that he had taken for granted that the same surveillance procedures that were applied to all Fund members were also applied to Greece and any other EC member country. His previous remarks were meant to suggest only that Greece had taken the steps that it believed were correct in the context of the cooperation among the membership of the EC.

The Acting Chairman made the following summing up:

> Directors expressed their deep concern at the continued weakness of Greece's economic performance. Although there had been some improvement in 1991-92--including a reduction of inflation from the 1990 peak, a return to positive output growth, and a narrowing of the external current account deficit--this fell far short of what was needed. Inflation was still running at over three times the EC average, public debt had risen well above 110 percent of GDP, and convincing measures were not yet in place to stabilize the public finances and lay the basis for sustained domestic economic growth and the eventual convergence with EC

partners. Directors noted in particular the considerable slippage in fiscal policy from the targets that the Government had set out a year ago, and Directors stressed the need for immediate action to bring the adjustment on track. In their statements, Directors endorsed the thrust of the staff appraisal and a number of speakers reiterated the concerns and views they had expressed on the occasion of last year's Article IV consultation.

As in the past, Directors emphasized the importance of a front-loaded approach. The dynamics of deficits and debt meant that a vigorous attack on the deficit was needed in 1992-93 in order to make credible the authorities' longer-term objectives. In this light, Directors viewed the budgeted adjustment for 1992 as inadequate and were concerned that even these targets might not be achieved. They saw the criteria for convergence with the rest of the EC laid out in the Maastricht treaty as providing a clear and concrete framework for the objectives of fiscal policy. Directors encouraged the authorities to advance, from 1994, the target date for the elimination of monetary financing of the public sector borrowing requirement and to eliminate the practice of capitalizing of interest on public debt. In addition to immediate actions to meet the fiscal objectives, there should also be effective measures of structural reform, particularly the swift implementation of pension reform, improvement in the performance of public sector enterprises, increased privatization, financial sector reform, and encouragement of more competitive markets. The fiscal and monetary policy requirements, and these structural reforms, were seen not only as facilitating the convergence within the context of the European Community but also as being needed in any case to address Greece's financial imbalances and re-establish the basis for sustainable growth.

Directors considered that fiscal restraint should be focused on the expenditure side. They supported the authorities' intention to restrict the public sector wage bill, but they considered that a lasting reduction would require cuts in public sector employment. Social security reform was viewed as another critical area, and immediate action to reform the system should be taken. Speakers generally also believed that revenue-enhancing measures would be needed; several expressed concern about the possible revenue losses from the 1992 tax reform. The authorities were commended for their plans to limit subsidies and to speed up privatization--or liquidation where necessary--of public sector enterprises. It would be important in this area to keep to an ambitious timetable.

Substantial liberalization of the financial system occurred during 1990-92, which Directors welcomed. Directors noted also that financial liberalization had tended to raise the cost of servicing government debt, making fiscal adjustment all the more urgent.

Directors noted that while administrative allocation of bank deposits had been significantly reduced, monetary policy continued to be hampered by the accumulated debt burden and large financing needs of the public sector. Higher real interest rates on government paper had facilitated large sales of debt to the nonbank private sector in 1991, when monetary growth had been below target. Many Directors considered that it would be important to maintain interest rate flexibility given the size of the public sector borrowing requirement, and to avoid any loosening of monetary policy that could endanger the disinflation process and external stability.

Directors welcomed the improvement in the external current account and overall balance of payments in 1991-92. They noted that high interest rates and rising EC transfers had contributed to this. However, despite some improvement in relative costs in 1991, the underlying competitiveness of the economy remains a concern, and it was noted that the current account deficit is expected to increase over the medium term unless appropriate policies are put in place. Many Directors pointed out that it would be important that profitability and competitiveness in the traded goods sector be improved to encourage investment and exports, and permit a revival in growth without running into a balance of payments financing constraint. Doubt was expressed by some Directors whether the needed improvement in competitiveness could be achieved by domestic policies alone. But there was a consensus among speakers that strong and credible monetary and fiscal restraint would need to be in place--and be supported by a broad array of structural reforms--for exchange rate policy to be able to contribute to Greece's adjustment strategy. In that context, some Directors encouraged early movement to the ERM. It was, however, stressed that the starting position of the economy when joining the ERM should be credible and sustainable, from a competitive standpoint and in terms of the strength and consistency of domestic policies.

The authorities' liberalization of the exchange rate system in 1991-92 and the acceptance earlier this month of the obligations of Article VIII were welcomed by Directors. They considered that these steps provided a further impetus to the implementation of sound economic policies as well as to a strengthening of collaboration between Greece and the Fund. A number of speakers emphasized in that context that it was in the interests of Greece that the Government implement adjustment policies that the Fund would be able to endorse.

It is expected that the next Article IV consultation with Greece will return to the standard 12-month cycle.

2. JOINT VIENNA INSTITUTE - RECENT DEVELOPMENTS, AND REQUEST FOR BUDGET APPROPRIATION

The Executive Directors considered a staff paper on recent developments with respect to the Joint Vienna Institute and a request for an appropriation for the Institute (EBAP/92/128, 7/21/92).

The Director of the IMF Institute made the following statement:

It might help the discussion if the decision to set up a training institute in Vienna was placed in the context of the overall strategy of the IMF Institute to meet the massive training needs of Eastern Europe and the former Soviet Union, and some other former centrally planned economies.

The IMF Institute has moved in several directions: it has increased the size and the number of courses in Washington to accommodate participants from new member countries without evicting participants from other countries; and it has organized short (three-day) seminars for high-level officials and two-week courses for middle-level officials in the various countries of the former Soviet Union and in some Eastern European countries. The main effort was in setting up the Joint Vienna Institute, which tries to accomplish the following:

1. It expands the training capacity of the IMF Institute, which is limited in Washington. The courses given in Vienna will be roughly the same as those given in Washington. The main differences are the somewhat shorter duration, the availability of interpretation into Russian, and a new basic economics course which will precede the courses on macroeconomic and financial policies.

2. It acts as a catalyst by attracting to Vienna other international institutions that are offering courses for officials from economic and finance ministries and central banks (and, in the case of the EBRD, enterprise managers) from Eastern Europe and the former Soviet Union. "Additionality" was an important principle guiding the project.

3. It benefited from economies of scale by spreading overheads over a larger number of courses than what the IMF Institute alone could give.

4. In Phase II, it will allow participants the unique opportunity of benefiting from the knowledge and practical experience of all six sponsoring institutions in a single place.

In short, the Joint Vienna Institute should be seen as a cost-effective way for the IMF Institute to undertake the training and retraining of economic and financial policy makers, advisors, and implementers in Eastern Europe, the former Soviet Union, and some other former centrally planned economies.

Mr. Prader made the following statement:

My Austrian authorities support the proposed decisions relating to the participation of the Fund in the Joint Vienna Institute (JVI).

From the outset, my authorities have supported the Managing Director's idea of establishing a training institute for Eastern Europe and the former Soviet Union for a number of reasons, including Austria's traditional policy of bringing international organizations to Vienna as well as its position as a neighbor, creditor, and trading partner of Central and Eastern Europe. Having such an immediate and direct stake in the Institute, Austria considers that the announced intentions of a number of other JVI donors, who are less directly involved in Eastern Europe and the former Soviet Union, are to be commended and appreciated all the more strongly. We are not only grateful to these donors but would also welcome any contributions from other potential donors who see the need for such an institution and the need to share the costs of the activities of the international community in aid of new Fund members from the former centrally planned economies.

We believe that training and the transmission of expertise will be among the most enduring contributions we can make to the transformation and adjustment process now under way in Eastern Europe and the CIS states, and we can imagine no better avenue toward this objective than a special institute in which international organizations with special expertise work together. In this connection, I should emphasize that my Austrian authorities' appreciation of the excellent work of the IMF Institute, and the prospect of integrating the Fund's operational experience with macroeconomic adjustment and market reform into the work of the Vienna-based Institute were important considerations underlying their endorsement of training facilities for officials and managers of formerly centrally planned economies. Their support for the Fund's idea of a regional training center is also a response to their recognition of the early and leading role of the Fund in helping the adjustment and reform process in Eastern Europe by designing and financing programs at a stage when no other institution wanted to go ahead.

During the process of preparing and negotiating the establishment of the JVI, my authorities have greatly appreciated the initiative and efforts of the IMF staff and management, in particular Mr. de Fontenay and Mr. Evans, as well as the invaluable assistance of the Legal Department.

As an observer of the negotiations, I can say that the task of establishing the JVI in collaboration and coordination with five other international organizations was subject to complications, and that without the heroic and patient efforts of the Fund staff, and the strong support and drive of the Managing Director, which brought about, inter alia, the timely appointment of an Institute Manager and the acceleration of the preparations for Phase II, it would not have been possible to overcome all of the critical situations and potential deadlocks, especially within the brief time available. In the end, however, we think this joint venture by the major international organizations into the domain of international training assistance has greatly benefited the Institute and was therefore well worth the effort.

Provided the Board approves the proposed decision, Phase I of the Institute can start in September and the Institute can officially open its doors on October 5, 1992 as planned. My authorities are happy that it will be possible to accomplish the objectives of Phase I on schedule. Of course, it would have been preferable to have completed the program preparations for Phase II within the original ambitious schedule, but we can accept that the difficult negotiations with the other organizations will require further work.

Finally, on the scope of the contributions of the Austrian Government and central bank in terms of furnishing the building and equipment and extending to the Institute the same privileges and immunities as to other international organizations, I do not need to be specific, since these contributions are already discussed in sufficient detail in the staff document.

Mr. Fridriksson made the following statement:

It is quite clear that one of the major difficulties handicapping the countries emerging from decades of centralized economic decision making and aspiring to develop market economies is the lack of the various skills and institutions necessary to initiate and implement the adjustment effort. Over the years, the Fund has provided invaluable services to its members through the operations of the IMF Institute, but much more is obviously needed to deal with the immense tasks associated with the reform challenges facing Central and Eastern Europe.

In my view the Vienna Institute is an appropriate and impressive response. The Austrian authorities are to be warmly commended for their generous contribution to the Institute, and also the Fund management and staff for the leadership role they have played. I am also pleased to note the cooperation that has been established between the Fund, the World Bank, the BIS, the European Bank for Reconstruction and Development, the OECD and the Commission of the European Community. The Institute has the potential to become crucially important in the badly needed training of officials from the economies in transition.

The paper mentions that the Netherlands will make a significant financial contribution to the Institute, and that Japan is likely to contribute substantially. I also note that contributions are likely from Belgium, Switzerland, and Canada. It is my pleasure to inform the Board that Finland, Norway, and Sweden have also decided to make direct contributions to the Institute, Finland some $55,000 this year, Norway some $73,000 this year, and Sweden about $74,000 in each of the years 1992 and 1993, altogether a total of around $275,000. In this context, could the staff elaborate on possible contributions from others, both from which countries and for what amounts? How will such possible contributions affect the cost to the Fund?

Having said this, I have a few comments on the more technical matters relating to today's appropriations request, as well as some general reflections on the training planned for Vienna. After all, this is the first time the Board has discussed this project.

On the financing side, the Fund has sought cofinancing from individual donor countries both for expenses related to the Fund courses during Phase I and for the running costs of the training center, some of which will continue in Phase II.

At the same time, it seems--particularly with reference to the Progress Report distributed in early June (EBAP/92/112)--that financing arrangements may not have been settled, and that many of the sponsoring organizations appear to be facing financial constraints.

In EBAP/92/112 (6/4/92), reference was made to a third organizational meeting to be held at the end of June 1992, for the purpose of discussing alternative arrangements in the event of shortfalls in financing contributions from outside, and the possibility of financial commitments related to Phase II by the six sponsors. Were these matters discussed at the meeting, and, if so, what were the results? In any case, the relative share to be borne by the Fund appears to be rather large.

As far as the training program in Vienna is concerned, I wonder whether the staff could elaborate on the reason for the change the Institute is making in its orientation between Phase I and Phase II. During Phase I, the Institute will offer 50 courses to an estimated 33 participants per course. During Phase II, the focus will be on a single, integrated course of several months' duration--six to nine months--for 66 participants.

Can the staff also comment on the satellite program planned during Phase II, where short courses on specialized subjects will be "coordinated" as far as feasible with the core program?

I think it will be important for the Institute to closely monitor the effectiveness of its instruction, and to carefully listen to the views of the benefiting countries--through a running dialogue--on course availability and orientation as well as practical aspects.

As much as I appreciate the importance of the Vienna Institute, I would like to emphasize that candidates from the Baltic countries and the CIS should continue to have the opportunity also to attend the IMF Institute courses in Washington.

I support the first decision as proposed. With regard to the second decision, I would like to ask whether the amount to be authorized should not be reduced also by the size of financial contributions by countries other than Japan.

As far as the third decision is concerned, I can understand that the medium-term commitment of sponsoring institutions is important to the Austrian authorities, and I can, in principle, endorse it. However, we must take care to contain the share of costs borne by the Fund, and I would be interested in hearing about the commitment of the other institutions to the operation of the Institute over the medium term.

In conclusion, I wish to emphasize again my expectation that the Vienna Institute will be the most important institution providing training to officials from the economies in transition in Central and Eastern Europe. I hope that more countries will demonstrate their appreciation of this effort by contributing to the financing of the Institute.

Mr. Posthumus made the following statement:

In my view, the Joint Vienna Institute initiative is very important and very welcome basically for two reasons. First, the task of helping the former republics of the Soviet Union and, to some extent also, a number of Eastern European countries is very large; and it is in fact, I think, even larger than we expected. It is very large because the countries are large and contain many people. But it is larger than we expected because the lack of knowledge is much larger than we had expected when the Iron Curtain was lifted and the decisions were being taken that those countries wanted to move into market economies. The technical infrastructure in the former Soviet Union was, of course, quite large. It was perhaps directed to some wrong purposes, but it was very large. But the managerial infrastructure is almost absent--at least that which is needed to manage a market economy. Therefore, the experience, which has grown over the past year, made the initiative to set up this Joint Vienna Institute all the more important as time went by.

The second reason why it is so important is linked, of course, to the first: by having this institution in Vienna we prevent the IMF Institute in Washington from being forced to cut much of its training. It would definitely have been forced to do that, because the large number of people who can now come to Vienna could not have been accommodated in Washington without our having been forced to ask some of our existing members to give up some of their training needs here. I also said that the initiative is welcome because it joins six institutions in Vienna in one institute that cooperates on training issues.

The Austrian authorities have supported this initiative in a really grand way. That has been the basis for the progress that the Fund and the other institutions have been able to make in setting up this institution, and we should be very grateful to the Austrian authorities. I am glad that my authorities contributed funds to the support of the new Institute. I tried to alert them to this issue at a rather early stage, and I think it has helped.

Mr. Fukui made the following statement:

The smooth and quick transformation of the former centrally planned economies to market-oriented ones is one of the most urgent tasks facing the international financial community. It is well recognized that the provision of technical assistance to the countries in transformation and the retraining of officials will play an important role in this process. This cannot be overemphasized. From this perspective, it is very timely that six prominent international organizations, which are the major providers of technical assistance, have jointly established an institute in Vienna to train officials from former centrally planned economies.

I am very grateful for the Austrian Government's quite significant and generous contribution to this Vienna Institute. Also, I would like to express my appreciation to management and staff for their efforts that have brought us up to the current stage of this difficult and important task.

My authorities have been assisting the Fund's technical assistance activities through the Japan Technical Assistance Fund, and in light of the importance of the Vienna Institute, which I mentioned, I am glad to announce today that my authorities are prepared to contribute $1 million to the Fund for its activities in Vienna during Phase I, through the Japan Technical Assistance Fund, as is suggested in the paper. This may be taken as an official commitment to Phase I. Japan's contribution reflects my authorities' recognition of the importance of technical assistance, which is why they have supported the Fund's technical assistance over the years. This contribution is also based upon our understanding that officials from Asian countries in transformation will be invited to the Vienna Institute along with those from Eastern Europe and the former U.S.S.R.

Let me now turn to some specific points. Regarding the curriculum, there is a big difference in the arrangement of courses between Phase I and Phase II. During Phase I, each sponsoring organization offers many short courses, whereas during Phase II there are basically two long, core programs and satellite courses. Why are the two phases so different? Is there any fundamental difference in philosophy between the two phases? I would appreciate hearing the staff's comments on this point. In addition, I would like to know the pros and cons of having many short courses as in Phase I, and a small number of long courses as in Phase II.

With respect to the participants, what level of officials is expected or targeted for the Fund's course? Is there any difference in the level of officials targeted by the various sponsoring organizations, or between Phase I and Phase II? The staff's elaboration would be welcome.

There will be far fewer participants in Phase II than in Phase I. How is the staff assessing the demand for training from countries in transformation and the supply of assistance by the Fund? Can we say the Institute will be able to cover a significant part of the demand for training? In other words, I would like to know the possible impact of this new initiative on the training needs in these areas.

Now let me turn to the budget. This chair clearly understands the increased work load of the Fund and the staff owing to the work related to the states of the former U.S.S.R., but the importance of streamlining the work and the deployment of the staff cannot be overlooked in this area also. In this regard, while I welcome the fact that among 19 positions necessary for the Vienna Institute, 9 are supposed to come from the allotments of the financial year (FY) 1993 budget, I wonder whether more positions will come from the initial FY 1993 budget, in light of the fact that in the 1993 Institute budget there are 15 additional staff.

In this connection, I would like to know whether the establishment of the Vienna Institute and the start of Fund courses there would reduce the number of participants in courses in Washington by diverting the demand for courses at headquarters to Vienna, and thus reducing the work load of the IMF Institute. If the answer is yes, I would also like to know how this effect is taken into account in the budget request.

In conclusion, the Vienna Institute will surely be an important vehicle in helping the transformation of the formerly centrally planned economies by training their officials. I hope the purpose of the Vienna Institute will be realized to the full extent through strong leadership by the Fund. In this connection, I welcome the fact that the Fund is expected to provide the director of the Institute. In this context, I would like to have some comments from the staff on how the interests of six different institutions will be coordinated through this administrative mechanism.

I support the proposed decisions.

Mrs. Martel made the following statement:

Today, we are called upon to make decisions on the request for appropriations for the Fund to participate in Phase I of the Joint Vienna Institute and on the passage, in principle, to Phase II. Before referring to the budgetary issues, I would like to make a few general comments on the creation of the Joint Vienna Institute.

First, my authorities are of the view that the establishment of such a regional training center serves well the huge training needs in Central and Eastern Europe, as well as in the former U.S.S.R. In this regard, I would like to express our appreciation for all the work done and efforts made by Austria to facilitate the setting in place of this training center.

Indeed, the costs implied by the establishment and the functioning of this Institute may appear high, but the urgent need for technical and training assistance for young generations of officials to help achieve the difficult transition from formerly centrally planned economies to market-oriented ones is, per se, a rationale for the JVI.

In this context, the Fund is playing a significant role as initiator and catalyst. Coordination and cooperation among the six financing institutions will certainly provide efficient training, by bringing together the expertise of these institutions and by developing a combined, not independent, strategy of training.

Besides the example of international cooperation that this Institute represents, it allows for economies of scale, offering a large range of courses for more than 1,000 trainees as well as an opportunity for the participants to mix with officials from other countries and to share views and experiences.

For all these reasons, my authorities have considered very positively a contribution to the functioning of the JVI. I am pleased to announce today that they have taken a decision, in principle, to participate in the cofinancing of this Institute.

It would be desirable to include in the programs courses in French.

On the budgetary issues, I would like to pose two questions. First, the staff report is clear in indicating that the estimated cost of Fund participation in the JVI during Phase I is \$3.4 million, and that budgetary authorization is sought for \$2.5 million, of which \$1.7 million will apply to FY 1993. I understand the catalytic role played by the Fund, but I would like to know the estimated costs for the five other institutions. Second, I noticed the increase in the common costs for Phase II, which is attributable in part to the expenses related to travels and allowances. I would like to know the estimated cost for the Fund in Phase II, at least for the first year of phase II?

This chair especially appreciates the role that the Fund is playing in the establishment of the JVI and approves the strong involvement and participation of the Fund in this matter.

Mr. Végh considered that the Austrian Government was to be commended for its pragmatic offer for dealing with the urgent training needs in Central and Eastern Europe and the states of the former Soviet Union. In view of the reputation of the sponsoring institutions, and the particularly well-suited expertise of the IMF Institute in providing such technical training, he was pleased to support the proposed budgetary decisions, and he congratulated management and staff on their work. The fact that the cost per Fund participant-day in Vienna was considerably less than the comparable cost of courses in Washington and that donors and other participating institutions were sharing common costs pointed to the efficiency of the approach that had been used in organizing the new Institute.

He welcomed the staff's clarification that the regionally targeted courses offered in Vienna would be roughly the same as those offered in Washington, thereby representing a significant expansion in the training capacity of the IMF Institute, Mr. Végh commented. In that regard, he wondered what degree of participation from those new member countries was envisaged in the courses regularly conducted in Washington. While he continued to attach importance to the objective of promoting the widest possible geographical participation in Fund-sponsored courses to enhance the exchange of views on the topics covered, a future review of the experience of the JVI with decentralized training activities should serve as a useful basis not only for determining the extent of the Fund's future involvement but also to induce additional donor contributions, which might lessen the Fund's budgetary burden in the medium term.

Mr. Wright made the following statement:

> I should like to join others in welcoming the Fund's central contribution to getting the Vienna Institute up and running and to commend the progress made thus far in reaching agreement with the other five institutions involved, which has been a considerable effort. I would also like to express my appreciation of the Austrian authorities for providing facilities in Vienna, which, I think it can be fairly said, has provided the initial impetus to this important project.
>
> Looking at the 1992/93 program, it is clear that the courses that are being offered will form a core part of the technical assistance necessary to strengthen administrative capacity in the states of the former Soviet Union and Eastern Europe. The importance of this work and of the Institute's catalytic role cannot be understated, and, therefore, I strongly support the principle of providing such training and the setting up of the new Institute. It will of course be important to coordinate closely with bilateral agencies (including central banks) involved in the provision of similar training to ensure that there is no duplication of effort. Some of the courses provided by the BIS, for example, look very similar to some offered by the Centre for Central Banking Studies at the Bank of England.
>
> My main concern is that given the nature of the new Institute--which is a joint venture involving six international institutions--the Fund should avoid taking on an undue proportion of the financial burden. I wondered, for example, why there appeared to be no staff provided by the EBRD or the IBRD. It

seems, on the face of it, that the Fund is effectively subsidizing the other institutions by providing the majority of staff and the majority of the common costs in Phase I. This is due in large measure to the fact that the Fund will be the most active participant in the Institute in Phase I and thus bears a large share of the common costs. But the Fund's share of the costs seems to go some way beyond this, and I would be interested to hear more about the rationale for this.

My concerns about this are allayed to some extent by the fact that there appears to be a clear cost saving in training in Vienna. Table 3 shows a cost per participant-day of $316, i.e., around $1,600 per participant per week, while the comparable figure for courses in Washington is, I believe, something over $2,000 per participant per week. Such savings would, however, be even greater if financial burden sharing among participating institutions were more equitable.

I also thought that the financial implications of Phase II appeared rather loose. There are, of course, many uncertainties regarding the financing of Phase II, but it is not clear, for example, what would happen if bilateral contributions fall short of what is expected. I am thus somewhat wary of agreeing to the third proposed decision in its present form; this could, in my view, run the risk of the Fund providing effectively a blank check for its participation in the Institute.

I would therefore favor amending the third decision to specify a ceiling on the Fund's financial involvement without further consultation with the Board. This would permit us to monitor how burden sharing among the institutions is evolving. I would also favor reviewing progress before the FY 94 budget discussion; otherwise--as happened this year--the appropriation for the Institute will be subsumed within the wider picture. I hope other Directors might be able to support this.

Finally, let me emphasize that none of these comments is intended to detract in any way from the importance my authorities attach both to the work of the Institute and the contribution of the Fund in getting it up and running in a very short space of time. It is a valuable and important facility but not one which should be supported at any cost. The Fund's contribution needs to be realistic and, like other components of the budget, carefully monitored. The Institute seems at the moment to be cost effective from the Fund's point of view, but there is some risk that, as the work of the Institute develops momentum in an environment in which financing is uncertain, the Fund's room for maneuver could become rather limited, with serious financial implications. We need to take care to avoid this outcome.

Mr. Toé made the following statement:

The collective undertaking by six leading international institutions, including the Fund, to respond to the training needs of member countries in Central and Eastern Europe and in the states of the former Soviet Union should be viewed in the context of the exceptional and large-scale resource mobilization to assist these countries in the transformation process of their economies.

While we can go along with the proposed arrangements for the Fund's participation in the collective efforts for the setting up of the Joint Vienna Institute, we would like some clarifications from the staff on a couple of points.

One of the striking features of the arrangements for Phase I is the disproportionate share of the Fund in the operating expenses of the Institute, making the Fund the largest contributor in terms of organization, administration, and financing. Admittedly, Fund contribution of such a scale can be justified, it being the initiator of the project and also in view of the prospect for transferring Fund activities in the states of the former Soviet Union and Central and Eastern Europe to the Joint Institute in Vienna. But we wonder whether, given the resource constraints facing the Fund, this would not lead to a diversion of staff resources from the IMF Institute. It appears that one response by the IMF Institute to the recent increase in training needs has been a shift in the language composition of its courses in favor of English. In this connection, we note with concern that for 1993 the IMF Institute is reducing the number of courses it provides at headquarters to only two in French, as well as in Spanish and Arabic, despite the growing demand from member countries. Countries in our constituency value very much these courses and would like to see the level of service maintained, if not increased. We would hope that the creation of the Vienna Institute will not mean that the needs of other developing countries will now be given less attention.

Another question relates to the long-term relationship between the Joint Vienna Institute and the IMF Institute. Since the former was seen as a vehicle for extending the activities of the latter, the issue of their long-term relationship can be raised. In a long-term perspective, will there be a gradual transfer of the IMF Institute's activities to Vienna? In the paper, it is stated that the participants from other former centrally planned economies could also be invited to the Joint Vienna Institute. We take this to mean that, and we stand to be corrected, nationals of centrally planned economies in, say, Asia and Africa could be selected for the Vienna Institute. Staff elaboration on this will be appreciated. If, as suggested by Mrs. Martel, arrangements were made to dispense courses in French, this will broaden the geographical basis for participation in the Vienna Institute courses. It may also prove to be more cost effective to the Fund since participants will no longer have to travel all the way to Washington. We, therefore, hope that the Institute will give serious consideration to Mrs. Martel's suggestion.

Finally, on Phase II, while we have no difficulty in agreeing in principle to Fund participation in this phase of the project, we would reserve our position pending detailed information on the cost-sharing formula among all the sponsoring organizations.

With these remarks, we support the proposed decisions.

Mr. Fuleihan made the following statement:

The joint efforts of six multilateral bodies to establish a regional training center that provides training to officials from economies in transition constitutes an integral part of technical assistance to these countries. The generous offer of the Austrian authorities to house and equip the JVI has greatly facilitated its establishment and is warmly welcomed.

In addition, I agree fully with Mr. Posthumus that the establishment of the Vienna Institute should prevent the crowding out of the traditional recipients of Fund training at the Fund's Institute. The importance of preserving their access to the Fund's Institute cannot be overemphasized.

Regarding the specific details of the proposal before us, I welcome the two-stage approach envisaged in the paper, as it appears highly pragmatic and expedient. Nevertheless, like other speakers, I could not help but notice the Fund's disproportionate share in the functioning of the Institute. While this attests to the Fund's efficiency and the crucial role of the Fund's technical assistance in the overall provision of technical assistance to economies in transition, it does not necessarily follow that the Fund should bear fully the financial burden of the courses it offers.

In this context, the contributions of Japan, the Netherlands, as well as that of the Nordic countries, are highly appreciated. Nevertheless, the other five organizers of the Institute may be enticed to bear a more proportionate burden of the financial costs, even if their contribution to the provision of courses is less. The issue of burden sharing is particularly relevant in Phase II. In this context, I largely share Mr. Wright's concern regarding the third proposed decision. However, if we explicitly include a ceiling on the Fund's contributions in Phase II, we may undermine our negotiating position with other contributors.

With these remarks, I support the proposed decisions.

Mr. Mohammed made the following statement:

This chair joins other Directors in paying tribute to the Austrian authorities and to the IMF Institute and other staff members who have coordinated this very large enterprise of six international organizations. I note that Mr. Végh and Mr. Wright both mentioned the much lower cost per participant-day in Vienna, and I am a little bit apprehensive whether a cost of $316, which seems to be roughly half or even a third of the cost of running a similar program at headquarters, is not cutting it too fine. A reputation for parsimony is not something to be discouraged, but as the Fund does take a very large share in the direction of the Institute, I hope that it will not create an impression of miserliness on the part of the Fund that might result in senior people not being attracted to the JVI's courses. There is a danger that the "A-team," as it were, will not be attracted to Vienna, and that would be unfortunate. It is important that senior policymaking people take advantage of the Vienna Institute.

This leads to a question that was posed by some of the other speakers, particularly Mr. Fukui--namely, what is the core course in the second phase and what is the course's objective? If the core course is to be something like six or eight months long, then we will certainly not be able to encourage senior people to participate, in which event the JVI could become much like a kind of graduate program, which would be unfortunate. I know that the Institute will be in the same place as the Customs Institute of the Austrian Government, and I hope we are not creating a kind of training school and that it is very important that the core program also be of a sufficiently brief duration that it does attract fairly senior people to participate.

Like previous speakers, I would expect that the IMF Institute's substantial involvement in Vienna does not detract from the level of service to other parts of the world, and that the level of service for the Arabic program in particular, which is of great interest to this chair, continues to be maintained at current levels.

Mr. Goos made the following statement:

I certainly wish to welcome the Austrian authorities' generosity in providing facilities and equipment needed to set up the

Institute, and I commend the other countries that have pledged or indicated financial contributions to the operation of the Institute. I certainly should also include in my thanks my appreciation for the work of the management and the staff.

In general, I also have the feeling that the additional resources that are being requested for the Fund budget for the financing of the Institute would be put to a useful purpose, and I agree in this context that the Fund will achieve considerable savings relative to the alternative approach of inviting all the participants to the Institute in Washington.

Nonetheless, like Mr. Wright and others, I found the very high share of the cost to be borne by the Fund rather surprising. At first glance, it might appear reasonable to allocate the total common cost of the Institute according to the number of course weeks to be provided by each institution, but I do not know whether this is really the only reason or criterion one could think of. Could not one argue that all the institutions with their work contribute to the success of the other institutions in their work in the republics of the former Soviet Union?

It is, of course, clear that the Fund will be in charge, in the first place, of macroeconomic policy advice. The other institutions will be more in charge, in the first place, of microeconomic policies. But what the Fund teaches the participants in terms of macroeconomic policy should be valued as highly by the other institutions. So I would have thought that one could have tried also to allocate the costs among the institutions by dividing the total costs by six. My concern applies also to the fact that the Fund is supposed to finance the costs of the supervisory and administrative staff--the Director and the Head of Administration of the Institute. I think there can be no doubt that the services provided through these positions are essential for the operations of the Institution, and, therefore, that all the institutions equally share in those services, so why not then also add these costs to the common costs of the institution? Maybe the staff or the Chairman could indicate to what extent that approach was attempted.

The costs involved are significant, amounting to $2.5 million. One certainly has to include the almost $900,000 of personnel outlays for already existing positions. I was somewhat surprised that those positions could be freed up for the Vienna Institute from the budget, given the assurances we received at the budget discussion on the exceptional restrictiveness of the proposal and the continued tightness of the personnel situation. I must say I am somewhat concerned that these expenditures will show up again in the next budget with the explanation that the Institute needs to maintain its services to members outside the region. I would be glad to hear the views of management and the staff on this.

Ms. Creane said that she agreed with previous speakers that education was a very important early part of the Fund's effort in Eastern Europe and the former Soviet Union, and, therefore, she fully supported the establishment of the JVI. She understood the concerns of many Directors about the share of the Fund's cost in the total costs, but her viewpoint on that issue was somewhat different: she preferred to have the Fund take the lead, and paying salaries was a way to ensure that role and, therefore, did not cause her the kind of problem it did others. At the same time, she shared the concerns of Mr. Wright about the openness of the third proposed decision. She would support some kind of limit. The contributions of the Austrian Government in particular, but also those of the Netherlands, Japan, and others were very welcome. Unfortunately, at the present time it did not appear that her authorities would be able to contribute, at least to Phase I, but that did not detract from her chair's support overall for the Institute.

Mr. Evans said that he, too, wished to commend the Austrian authorities for their generous initiative that had made the JVI possible and the Fund staff for the speed and skill they had shown in giving full effect to the initiative. It was particularly pleasing that the new Institute was a joint operation of the six organizations concerned, as that was obviously the most efficient way of providing training. There would be many areas in which cooperation among all or some of the six organizations would be necessary, but the JVI apparently was the first example of such cooperation actually having been achieved. He hoped that the staff's experience in organizing the JVI could be used in other areas, notably in the coordination of technical assistance. He was pleased that the JVI had already invited participation from Mongolia.

The Executive Directors agreed to continue their discussion in the afternoon.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/92/95 (7/24/92) and EBM/92/96 (7/29/92).

3. ISLAMIC REPUBLIC OF IRAN - 1992 INTERIM ARTICLE IV CONSULTATION; AND DECISION CONCLUDING ARTICLE XIV CONSULTATION

1992 Interim Article IV Consultation

The Fund notes the staff report for the 1992 interim Article IV consultation with the Islamic Republic of Iran (SM/92/140) and declares the consultation completed.

Decision No. 10099-(92/96), adopted
July 24, 1992

Decision Concluding Article XIV Consultation

1. The Fund takes this decision relating to the Islamic Republic of Iran's exchange measures subject to Article VIII, Sections 2 and 3, and in concluding the 1992 Article XIV consultation with the Islamic Republic of Iran, in the light of the 1992 interim Article IV consultation with the Islamic Republic of Iran conducted under Decision No. 5392-(77/63), adopted April 29, 1977, as amended (Surveillance over Exchange Rate Policies).

2. The exchange restrictions and multiple currency practices described in Part A of Appendix IV of SM/92/140 are subject to approval under Article VIII, Sections 2(a) and 3. The Fund notes the authorities' intention to move expeditiously toward the elimination of these measures and, in light of the circumstances of the Islamic Republic of Iran, grants approval for the retention of the exchange restrictions and multiple currency practices described in Part A of Appendix IV of SM/92/140, until August 31, 1993 or the completion of the next Article IV consultation, whichever is earlier. The Islamic Republic of Iran also maintains bilateral payments agreements with Fund members as described in Part B of Appendix IV of SM/92/140. The Fund urges the Islamic Republic of Iran to eliminate the restrictive features of these agreements as soon as possible.

Decision No. 10100-(92/96), adopted
July 24, 1992

4. RUSSIAN FEDERATION - REPRESENTATIVE RATE FOR RUSSIAN RUBLE

The Fund finds, after consultation with the authorities of the Russian Federation, that the representative rate for the Russian ruble under Rule O-2(b)(i) is the midpoint between buying and selling rates against the U.S. dollar in the interbank market, as ascertained by the Central Bank of Russia. (EBD/92/159, 7/22/92)

Decision No. 10101-(92/96) G/S, adopted July 24, 1992

5. ANNUAL MEETINGS - GOVERNORS' PER DIEM ALLOWANCE

The Executive Board approves the recommendation contained in EBAP/92/125 regarding per diem allowances for Governors and Alternate Governors during attendance at meetings of the Board of Governors.

Adopted July 28, 1992

6. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 92/3 through 92/8 are approved.

7. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAM/92/52 (7/23/92) is approved.

8. TRAVEL BY ACTING MANAGING DIRECTOR

Travel by the Acting Managing Director as set forth in EBAP/92/130 (7/27/92) is approved.

APPROVED: March 22, 1993

LEO VAN HOUTVEN
Secretary