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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 87/165

10:00 a.m., December 4, 1987

R. D. Erb, Acting Chairman

Executive Directors	Alternate Executive Directors
	A. G. A. Faria, Temporary
	Yang W., Temporary
	D. C. Templeman, Temporary
	A. Rieffel, Temporary
	H. S. Binay, Temporary
	M. Hepp, Temporary
	A. M. Othman, Temporary
G. Grosche	
J. E. Ismael	J. Reddy
	J. E. Zeas, Temporary
	C. Enoch
	D. McCormack
	G. D. Hodgson, Temporary
	D. Saha, Temporary
	P. D. Péroz, Temporary
	C. Noriega, Temporary
	M. Fogelholm
	D. Marcel
	G. P. J. Hogeweg
	I. Sliper, Temporary
	S. Rouai, Temporary
	L. E. N. Fernando
	T. Morita, Temporary
	S. Rebecchini, Temporary

L. Van Houtven, Secretary and Counsellor
S. Woolls, Assistant

Also Present

Asian Department: H. Neiss, Deputy Director; R. C. Baban, R. Hemming, R. J. Niebuhr, S. M. Schadler, D. A. Scott, W. M. Tilakaratna. Central Banking Department: R. B. Johnston. Exchange and Trade Relations Department: H. B. Junz, S. Kanesa-Thasan, L. F. Weniger. Fiscal Affairs Department: A. Cheasty. Legal Department: J. K. Oh. Secretary's Department: M. J. Miller. Western Hemisphere Department: S. T. Beza, Director; J. Ferrán, Deputy Director; J.-P. Amselle, M. A. Da Costa, R. Pearson, S. J. Stephens, M. A. Tareen, K. Thugge, G. Yadav. Personal Assistant to the Managing Director: H. G. O. Simpson. Advisor to Executive Director: Khong K. N. Assistants to Executive Directors: S. Guribye, A. Iljas, S. King, C. L. Haynes, V. Rousset, C. C. A. van den Berg, R. Wenzel.

1. THAILAND - 1987 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1987 Article IV consultation with Thailand (SM/87/259, 11/9/87). They also had before them a background paper on recent economic developments in Thailand (SM/87/274, 11/20/87; and Cor. 1, 12/2/87).

Mr. Reddy made the following statement:

The strong adjustment measures implemented by the authorities and a favorable external environment have resulted in a very positive outcome for the Thai economy over the last two years. The expected outcome for 1987 now looks even more favorable than it did during the staff's visit to Thailand in September 1987. The authorities have taken strong adjustment measures in the fiscal, monetary, and exchange rate areas. A number of structural reforms have been introduced, and some are in the process of being implemented. My authorities have maintained a prudent policy stance and made adequate responses to the challenges facing them. However, Thailand is a relatively open economy, and its economic success depends not only on its own policies but also, to a large extent, on developments in the world economy. Unfavorable developments with regard to protectionism in industrial countries, commodity prices, oil prices, exchange rates, and interest rates are a subject of constant anxiety to my authorities. In view of the recent stock market crash and the associated uncertainties regarding the prospects for growth in industrial countries, my authorities would like to see a more effective coordination of economic policies in the major industrial countries so that economic prospects for the world economy, including countries like Thailand, could be improved.

Real GDP growth, which had slowed to 3.2 percent in 1985, reached 3.5 percent in 1986, and is expected to reach about 6.6 percent in 1987. As in 1986, the main engine of growth continues to be the manufacturing sector, which grew by 8.5 percent, and the services sector. Meanwhile, the agricultural sector has expanded little because of unfavorable weather conditions. Prices have remained stable, with the consumer price index expected to increase by 2.7 percent in 1987, marginally higher than the 1.9 percent in 1986.

Domestic bank credit to the private sector is expected to increase sharply by 19 percent in 1987, compared with 4.9 percent in 1986. However, bank deposits are estimated to increase by 18 percent, compared with 12.5 percent during the previous year. Consequently, the banking system remains highly liquid and market interest rates have softened substantially from previous years.

After weak performances over the past five years, the fiscal balance has improved sharply. Revenues rose in the wake of the economic revival, while expenditures were restrained. The Government's cash deficit narrowed to 2.4 percent of GDP in 1987, from 4.6 percent in 1986.

The economic revival provided a strong stimulus to imports, which are estimated to increase across the board by 32 percent in 1987 after the decline of 3 percent in 1986. Exports are estimated to have increased by 23 percent, compared with 21 percent during the previous year. The current account, which had registered a surplus in 1986 for the first time in two decades, is expected to reverse itself, and the deficit in 1987 will remain under 1 percent of GDP. There were significant gains in services receipts, especially from tourism; the number of tourists is expected to increase by over 20 percent in 1987. Capital inflows remain strong in 1987, and the overall balance should be in surplus. As of October 1987, official reserves amounted to over $4.9 billion or the equivalent of about four and one half months of imports.

With the restoration of internal and external stability around 1986, the focus of economic management has shifted toward stimulation of growth and the pursuit of long-term development goals, particularly further improvements in allocative and distributive aspects of the development process. At the same time, policy measures will be implemented in a cautious and flexible manner to enable the country to cope with uncertainties in the world economic environment. To achieve sustained growth over the long term, the Government will continue to conduct a proper combination of stabilization and structural adjustment policies.

The budget for 1987/88, which came into effect in October, has been set rather cautiously with somewhat greater orientation toward development expenditures. The aim of fiscal management is to achieve further improvements in the efficiency of budget allocation and the utilization and further consolidation of government revenue through restructuring of the tax system, both for efficiency and equity reasons. Some rationalization of income taxes has already been made. Plans for further improvement in the tax system will include a gradual restructuring of business tax and import tariffs and introduction of a value-added tax (VAT). These reforms are intended to facilitate a more efficient resource allocation and a more elastic revenue system. My authorities expect that the VAT together with a rationalized system of excise duties could be put in place as early as the first quarter of 1989. Expenditures will continue to be monitored closely. The Government now has more effective control over public enterprises through its close supervision of investment, borrowing, and strategic planning. The authorities intend to pursue the privatization of public enterprises as rapidly as possible, and have already established

a committee to deal with different categories of enterprises. As a result of these measures, it is expected that the Government's cash deficit as a percentage of GDP will be further reduced.

Taking advantage of the relatively stable price situation, the authorities have, since early 1986, pursued a relatively accommodative monetary policy. As a result, interest rates in Thailand have declined by almost 6 percentage points between 1985 and 1987. This has provided an important stimulus to economic recovery. In the area of credit policy, the authorities have increased their emphasis on the pattern of credit allocation since the mid-1980s. The rural credit policy, requiring commercial banks to allocate a minimum percentage of their deposits as credit to the rural sector, was broadened in early 1987 to support current rural development strategy.

Exchange rate policy has been an important instrument in correcting the external disequilibrium problems in Thailand. The main objective of the current exchange rate policy is to support competitiveness of exports while maintaining the confidence of market participants in the stability of the exchange rate regime.

Even though the balance of payments position has improved and the debt service ratio has declined to about 17 percent of GDP, the Government has set an annual ceiling for external borrowing by the public sector at the same restrictive level as in 1986. Further improvements in the debt service ratios and the maturity structure of external debt are expected in 1988.

The authorities continue to monitor their energy pricing policy closely. It is now clear that their cautious approach has paid off, because the authorities did not have to raise domestic oil prices in the latter half of 1986--an action that could have had a negative impact on the recovery process. In the future, the authorities intend to make energy pricing policy more flexible by using a floating price regime and reducing the role of the Oil Fund.

Since Thailand has long been pursuing a growth strategy that relies heavily on the success of the export sector, the Government has always included export promotion as a key measure of its economic package. Thailand's export performance in recent years has been quite satisfactory, with the nominal annual growth averaging close to 20 percent during the period 1984-87.

Investment promotion policies have emphasized activities which are export oriented, labor intensive, resource based, or located in provincial areas. While investment promotion efforts have played a significant role in promoting modern industries in Thailand, other measures to support the industrialization process will need to be implemented on a more comprehensive scale. The

industrialization process in Thailand will continue to rely mainly on private sector initiatives responding to economic opportunities rather than being induced by government actions.

Considerable progress has been made in maintaining public confidence in the financial system, and a number of measures have been introduced to strengthen the financial institutions. For example, many commercial banks and financial companies have been required to increase their capital base, two government-owned commercial banks have been merged, many finance company mergers have been encouraged, and new activities are being explored to increase the fee-based incomes of financial institutions. Further amendments of relevant laws will be made where necessary, and the introduction of a deposit insurance scheme is under active consideration.

It is particularly difficult to forecast future trends in the world economy at this time, because of uncertainties regarding the effect of the stock market crash. However, if the indications of a slowdown in world economic growth and world trade eventuate, my authorities would expect a decline of 2.4 percent in Thai real exports to follow from a 1 percentage point decline in output in industrial countries. On the assumption that industrial countries' growth will continue at the 1987 rate, my authorities expect GDP to grow at an annual average rate of about 6 percent, compared with the rate of 5 percent targeted under the Sixth National Economic and Social Development Plan (1987-91), assuming normal growth in the agricultural sector. Increases in import prices are expected to be passed along and the consumer price index is expected to rise by 3.5-4.5 percent. The rate of growth for both exports and imports is expected to decelerate, and the current account deficit may widen slightly, but remain manageable at less than 2 percent of GDP.

I am happy to note that the rather optimistic outlook of the Thai authorities is shared by the staff, who conclude that "there are grounds for optimism, considering the recent Thai experience that has demonstrated a highly responsive and adaptable private sector as well as flexible and sound government policies." My authorities are in broad agreement with the staff report and I would like to join my authorities in thanking the staff for their excellent report.

Mr. Sliper made the following statement:

In Fund staff reporting of economic matters in both developed and developing countries, the Board is often confronted with an emphasis on problems. However, in the case of Thailand, the successes are very much in evidence, and a reform-minded government is starting to reap rich rewards from the adjustment and sensible

demand-management policies it has undertaken and is undertaking. A real growth rate of 6 percent in 1987 and an expected growth rate of 7 percent for 1988 is impressive and attests to the soundness of economic policies pursued in recent years.

With success stories, it is always tempting to search for lessons. A key ingredient in Thailand's recent economic success has been the Government's commitment to controlling public finances. In the early 1980s and in 1983/84 there were signs that the public sector deficit was starting to burgeon out at about 5 or 6 percent of GDP, and in both instances, the Government moved to curtail those deficits through strict expenditure control.

The commitment and fortitude the Government has demonstrated in controlling public sector growth has given it credibility, which is a fundamental element in the process of economic growth. It is not easily won and requires consistency of policy action over considerable time. It means not trying to go for quick-fix solutions, but instead, implementing sound economic principles in a medium-term framework. Thailand has followed such a growth path in recent years and is now receiving the benefits, particularly in strong growth in private investment and significant inflows of foreign capital.

Another feature of the Thai experience is the pattern of investment and the export diversification. The recent strong growth of nontraditional exports, particularly in manufacturing, has enabled Thailand to weather economic storms, including significant declines in some key agricultural commodity prices.

It is noteworthy that much of the investment in export diversification has been undertaken by the private sector, rather than led or directed by the Government. A strategy of getting the fundamentals right, rather than engaging in sponsoring investments in particular areas or sectors is commendable. The Government is also to be congratulated on not embarking on a series of large-scale, capital-intensive, publicly sponsored investment projects. The risk of such a strategy going awry is well documented, and Thailand is fortunate in not being saddled with providing large fiscal subsidies to prop up ailing public investments. The one very large-scale project that the Government is sponsoring is the program to develop the Eastern seaboard, and I agree with the staff that the authorities should check and recheck the economics of the subprojects within this development to make sure they continue to be viable.

The Government has sensibly committed itself to the introduction of a value-added tax in early 1989. During their discussion of the 1986 Article IV consultation with Thailand, Directors were generally critical of the existing tax system, which they considered a priority area for improvement; the authorities have reacted

quickly, and are proposing to introduce a single value-added tax rate, which is the most efficient way to administer it, rather than having a lot of different rates. However, the authorities are thinking of excluding a range of expenditures from the value-added tax, namely, on food, health care, education, and transportation, which account for about 40 percent of domestic expenditure. I seriously question the exclusion of so large a group of expenditures, and hope that if the decisions have not been made final, the authorities would reconsider these exclusions. The Fund's analysis of country experience of value-added taxes supports the theory that such a tax should be as all encompassing as possible, owing to the subsidies involved in the nontaxed areas and the distorting effects on expenditures.

The authorities consider the issue of tariff reform to be an area of lower priority, which is understandable, given the tight timetable that has been agreed to for the introduction of the value-added tax. However, the authorities should not lose the momentum of tariff reform, and I hope they will begin to work on the medium-term principles and objectives involved.

In conclusion, my authorities remain impressed with the economic management pursued in Thailand, and welcome the indications that the current outward-looking strategy will continue.

Mr. Templeman made the following statement:

During the last Article IV consultation with Thailand in June 1986, this chair expressed concern about economic developments in Thailand in a number of areas, including: fiscal slippages, inadequate domestic savings, growing debt, and structural weaknesses in the tax and tariff systems and in the financial sector. In most of these areas, the situation has improved substantially: there has been an impressive recovery in economic growth, inflation remains low, and the balance of payments situation has strengthened considerably.

In addition, progress is being made in some areas of structural reform. I agree with the staff that a good opportunity now exists for moving forward more rapidly toward structural reforms designed to help assure the sustainability of economic recovery, low inflation, and external balance.

The fiscal deficits of both the Central Government and the overall public sector have been reduced, with positive effects on the public savings ratio, and progress is being made in the reform of other areas of the public sector. However, there are still some elements of public enterprise activity which need continued attention, including the pass-through of world oil price changes, the continued losses in the transport sector, the opening of some

activities to private participation, greater dependence of the enterprises on financing from the markets, and privatization or liquidation of some enterprises. Also, some shift in expenditure priorities appears desirable, both in the public enterprises and in the Central Government.

An important step in creating a firmer and more elastic revenue base is the planned introduction of a value-added tax and the rationalization of excise taxes contemplated for January 1989, a deadline that I hope will be met.

The recent rapid growth of reserve money and other money aggregates bears close monitoring, as does the impact on monetary control of emergency assistance to weak financial institutions. Temporary help for these institutions from the Bank of Thailand and from commercial banks in the form of soft loans, equity participations, and lines of credit may be necessary, and a more permanent solution to this problem is called for; the staff report and Mr. Reddy's statement have mentioned deposit insurance, increases in capital mergers, strengthening of the supervisory system, interest rate liberalization, and opening the system to foreign participation as potentially useful steps.

There has been an impressive strengthening of the balance of payments since 1985, resulting from the rapid growth of exports and an increase in the surplus on net services, which has permitted a similarly rapid growth of imports to support the economic recovery. A cumulative real effective depreciation of the baht in excess of 25 percent between the peak reached in mid-1984 and mid-1987 has apparently played an important role in this respect. While exchange rate flexibility will continue to be needed to maintain Thailand's competitive position, the good record in domestic inflation should limit the need for nominal exchange rate movements.

In the capital account, foreign direct and portfolio investment and unrecorded capital inflows have helped to strengthen the overall payments position, while permitting a buildup of reserves equivalent to nearly five months of imports and an impressive drop of more than 7 percentage points in the debt and debt service ratios. A further relative decline in dependence on foreign debt capital and a further tapping of foreign equity capital might be facilitated by a relaxation of limits on foreign equity participation in Thai industries, which are seriously circumscribed by the Alien Business Law of 1972.

Not much progress seems to have been made in customs tariff reform. An average tariff rate of about 23 percent, following the tariff increase in 1985, constitutes a high level of protection. Also, there seems to be a decreasing justification for such a tariff level in light of the strengthened balance of payments

position, the desirability of increased competition in the economy, and the need to combat protectionism in all Fund members. Therefore, the authorities should move more rapidly in reducing tariffs.

Impressive progress has been made since the last Article IV consultation in strengthening the current economic environment and in beginning structural reforms in a number of areas. Furthermore, the favorable medium-term scenario described in the staff report supports the case for more rapid progress in adopting structural reforms to help assure the sustainability of growth, financial stability, and external balance in coming years.

Mr. Yang made the following statement:

The steady improvement in the economy has become more evident in 1987. The export-led economic recovery appears to have extended to the domestic sector, leading to a significant upturn in investor confidence. Consequently, investment has picked up sharply, and exports have continued to be buoyant. Although the rise in economic activity has resulted in a widening of the current account deficit, the increase in foreign investment will keep the overall balance of payments in a sustainable position. With higher revenue and lower expenditure, fiscal performance has improved markedly, and the rise in consumer prices has been moderate. In short, the performance of the economy has been impressive, and the authorities' highly responsive and adaptable skill in pursuing economic management is commendable.

While overall investment rose sharply in 1986/87, public capital outlays fell by 5 percent in nominal terms, largely as a result of the inelasticity of the tax system, which means that the reduction in the fiscal deficit was brought about primarily by expenditure restraint. However, because deficiencies in the country's infrastructure seem to be one of the main constraints to further development, increasing public investment in new infrastructure projects seems to be imperative. Therefore, further consolidation of the fiscal position will need to place particular emphasis on the revenue side. For this reason, I endorse the staff's view that revenue reform aimed at creating a more elastic revenue system is an important structural measure to raise public sector savings so as to sustain the current economic expansion. An increase in the savings ratio is also a critical factor in the realization of the medium-term objective. The private savings ratio, which is currently 18.4 percent of GDP needs to increase to about 20 percent of GDP by 1992, although it has essentially not changed for the past three years. While an increase in private savings along the lines suggested by the staff is achievable, the staff should make specific policy recommendations on how such a goal could be attained.

The most significant development in the export sector is perhaps further diversification, not only in terms of products, but also in terms of trading partners, as reflected in the sizable increase in overall trade with such regions as South America and Eastern Europe. In light of recent events in the world economy, it might be advisable for the authorities to strengthen the momentum of diversification to counteract any possible external shocks. In addition, I endorse the authorities' efforts to diversify and decentralize the country's industrial base, and I attach great importance to the implementation of the Eastern Seaboard Development Project.

Mr. Fernando made the following statement:

There are many reasons to be satisfied with the recent economic performance and policies of Thailand--another Asian country managing to combine strong growth with both external and internal financial stability. Despite domestic adjustment to relieve structural weaknesses and to meet external developments, Thailand has maintained essentially stable prices for six years. It is not only Thailand's recent growth record that gives cause for satisfaction; the medium-term prospects also suggest that the authorities are in control of the situation.

The authorities are to be commended for their strong adjustment effort, based on a bold exchange rate policy and expenditure restraint. Some element of luck was certainly involved in Thailand's success in that international conditions, such as oil prices, were conducive to domestic stabilization. However, without a strong private sector to grasp the opportunities presented by external and internal developments, the economic policies might have been less effective. Therefore, the Government deserves credit for earning and sustaining private sector confidence in its policies.

The authorities have skillfully implemented exchange rate policy. The 29 percent real effective depreciation of the baht over the past three years provided an impetus to the diversification of exports, especially manufactured goods, and to the diversification of export markets. The United States has been an important destination for exports, but there has been an appreciation of the U.S. dollar-baht nominal exchange rate, and this raises questions about maintaining competitiveness in the U.S. market. Even though maintaining competitiveness, especially in relation to other exporting countries, is an important aspect of external policy, a great deal of prudence is called for in avoiding competitive depreciation. Therefore, the use of the exchange rate as a policy tool should be complemented by other instruments for maintaining competitiveness. The record of continuing price stability supports the exchange policy, and policies to improve

efficiency and contain costs should help in that regard. The surplus labor situation and the authorities' policy on wages, which has been one of restraint, is another factor that should dampen costs.

In regard to fiscal policy, my authorities agree with the staff recommendation that the contemplated measures on the revenue front should be implemented, and that further benefits are likely if the process is speeded up. The flexibility provided by greater elasticity in fiscal revenue would help make expenditure policy more efficient, and this would be an important improvement over previous policies under which fiscal objectives were achieved through expenditure restraint, involving arbitrary cuts in maintenance and capital expenditures.

As to private foreign investment, both direct and portfolio, Thailand's resource endowment, outward-looking policies, and strong private sector will increasingly attract foreign direct investment. The authorities should review the regulatory environment on a continuing basis to remove any remaining impediments. In this context, progress in tariff reform is important, as it will guide foreign investment into those areas that are most efficient from the point of view of production, whether for export or the domestic market. The growing and important role of foreign portfolio capital is a logical development in the context of the policy environment that has contributed to the development of the capital market. However, portfolio investment is very sensitive to financial policies and prospects, and the authorities should aim for a higher international reserves target than the current target, equivalent to three months of imports.

There is clearly room for increasing efficiency in the financial markets. Impediments to competition in this sector have caused excess liquidity in some institutions at a time when business investments are rising fast. The stagnation of interest rates is a feature which reflects some underlying problems, and the authorities should move quickly to strengthen the financial system by improving the supervisory and regulatory role of the Central Bank through appropriate legislative changes. At the same time, the rehabilitation plans for the financial houses that have suffered from bad management should include restructuring of both capital and management. In this context, and in the context of the sharp fall in deposit interest rates, the authorities should implement the deposit insurance scheme quickly.

In his opening statement, Mr. Reddy mentioned that a rural credit policy that requires commercial banks to allocate a minimum percentage of their deposits as credit to the rural sector is to be broadened. I wonder about the previous recovery rates for such credit, because recovery rates for rural credit generally do not exceed 70 percent. Are there government guarantees for these types of legislated credit delivery?

The balance of payments sensitivity analysis to exogenous developments clearly demonstrates the critical importance of market growth and market access for exports, especially for manufactures, and is the key to economic growth, both in terms of foreign demand for output growth and sustaining a level of imports conducive to higher growth. The Board has emphasized liberalization, deregulation, and outward-oriented policies as the key to sustained growth with balance of payments viability. Thailand's efforts at stabilization and structural reform, like those of other developed countries, can succeed only to the extent that the international economy permits. Mr. Reddy has correctly underlined the expectations and requirements for improved international policy coordination in the major industrial countries, which is vital for structural adjustment efforts elsewhere.

Mr. Enoch said that the economy had made substantial progress in recent years. Restrained fiscal and monetary policies and the maintenance of a competitive exchange rate had played an important role in that success. The revival of investment in 1987, especially private investment, after declines in the two previous years was especially welcome.

The overall outlook for the economy was good, and impressive levels of growth appeared to be achievable, Mr. Enoch commented. The level of liquidity in the economy needed continued monitoring, and the prospective rise in imports, even on the basis of the low elasticity assumed in the staff report, seemed a little worrying. Moreover, as the staff's sensitivity analysis had shown, much of Thailand's success would depend on developments in the world economy.

The authorities had significantly reduced the fiscal deficit in recent years, and a further reduction was envisaged for 1987, Mr. Enoch continued. That reduction was encouraging, and it helped to improve the external position. However, he agreed with the staff on the importance of the continued effort to improve the elasticity of the revenue system, and on ensuring that the large Eastern Seaboard Development Project was good value for money. In that connection, the fact that part of that scheme was no longer regarded as economically viable was cause for concern.

That the authorities had continued with their efforts to strengthen the financial system was encouraging, Mr. Enoch remarked. The poor performance of the financial system had been of concern to his authorities during the 1986 Article IV consultation with Thailand; they were grateful for the fairly full discussion of that topic in the staff report for the 1987 consultation. Competition within the financial system still seemed to be fairly weak; there appeared to be a need to promote greater competition through continued deregulation and possibly by encouraging foreign firms to enter the market. The staff should comment on the authorities' attitude about foreign investment in the financial system. In addition, the emphasis which the staff report had placed on the increasing importance of the capital markets in Thailand was noteworthy. Given the magnitude

of recent declines in those markets, he wondered whether any significant update was available on capital market developments, beyond what had been included in the footnote on page 11 of SM/87/259.

Although his authorities were grateful for the section on financial sector policies included in the staff report, the discussion of Thailand's tariff policies was disappointing in that it had been limited to a few qualitative points, Mr. Enoch commented. More quantitative material in that area might have been helpful. In addition, it would have been useful to have some estimates on the effects of recent protectionist measures in major export markets.

As to the substantive issues in the trade sector, the authorities felt that further progress on the tariff side was unlikely until after the introduction of the value-added tax, Mr. Enoch noted. The administrative difficulties involved in moving on several fronts simultaneously were substantial. However, Thailand's present external performance seemed to be relatively secure, and further tariff reform might have been initiated more promptly.

Thailand's debt service ratio was expected to fall dramatically by the end of 1987, from over 26 percent of GDP in 1985 to below 20 percent of GDP in 1987, Mr. Enoch remarked. In addition, the ratio was expected to decline significantly over the next three years to only 14 percent. If that target were achieved, it would put Thailand in an extremely strong position to meet the challenges of the next decade--a position to be envied by many other countries--and the authorities should maintain the thrust of their present policies, particularly the policy of maintaining ceilings on foreign borrowing, to bring that success about.

Thailand seemed to exemplify the importance of regional surveillance in understanding current situations, Mr. Enoch observed. There had been an impressive improvement in manufacturing performance, and Thailand was concerned with maintaining a competitive real exchange rate. The staff report had included some information on those developments on page 2 of SM/87/259, where it noted that Thailand had been benefiting increasingly from the relocation of industry from other parts of East Asia. However, to put that information into context, it would have been helpful to have some explicit references to developments in other ASEAN countries, particularly since all of those countries had been seeking to improve their real exchange rates. The staff paper on the second review under the stand-by arrangement with the Philippines (EBS/87/207, Sup. 1) had included real effective exchange rate indices for the period 1982-87, comparing Philippine rates with those of its trading partners and major competitors; similar information would have been useful for the Article IV consultation with Thailand. He wondered whether the crucial point in the current discussion was that Thailand had improved its position vis-à-vis other East Asian countries, or that Thailand was participating with the other countries in a wider improvement in performance.

The authorities enjoyed a relatively healthy external outlook which was largely a consequence of their prudent policies, Mr. Enoch observed. They should stay on their current path and continue the structural reform efforts that could help lay the basis for continued growth.

Mr. Noriega made the following statement:

During the past two years the economy has performed satisfactorily, taking advantage of a supportive external environment and prudent domestic policies. After a period of monetary tightening and fiscal stringency, the large internal and external imbalances were reduced to sustainable levels, and growth resumed along with a healthy balance of payments and financial stability. Even more important, prospects for the medium term appear to be reassuring. The staff report provides a balanced view of the major issues facing policymakers and in general, my authorities agree with it.

Looking at preliminary figures for 1987, an acceleration in the rate of growth of monetary aggregates and a significant accumulation of international reserves at the Central Bank are noticeable. These developments are consistent with a reactivation of the economy, which undoubtedly has spurred demand for money holdings. Another factor stimulating money demand is the transition from a rural economy to an industrial one, or more precisely, a service economy. However, it is unlikely that the expansion of monetary aggregates observed during the first semester of 1987 will be compatible with long-term exchange and price stability. Despite the reduction of the fiscal deficit, which lowered demand in the credit market, domestic credit is expanding rapidly.

Although these developments are currently not exerting pressure on prices and the balance of payments, they could do so if a shift in money demand took place. As nominal and real interest rates have been declining and the margin over rates in the international market has been reduced, the financial system has become more liquid with M1 growing at a faster rate than M3. The high level of liquidity in the financial sector could lead to a crisis, given the weaknesses of the financial system described in the staff report. Therefore, the authorities need to monitor monetary policy closely and be prepared to tighten credit, if they perceive symptoms of excess liquidity. However, the implementation of financial reform should be given the highest priority.

According to the staff, the medium-term scenario was designed, "to illustrate the consistency of relatively high growth with a manageable balance of payments in the Thai economy." The staff's optimism is based in part on a very dynamic export sector, but that dynamism also implies a higher ratio of imports to GDP. The staff should comment on the probability of the elasticity used in impinge on the balance of payments forecast. The staff report

indicates that the medium-term scenario is very sensitive to the growth of international markets, and it is sensitive to a higher import content of exports. In that case, a more cautious interpretation of the scenarios would seem pertinent, and he would exhort the authorities to hasten the implementation of structural adjustment.

My authorities welcome the recent developments in the economy, and broadly support the economic program being pursued.

Mr. Grosche said that the economy was now set firmly on a path of recovery, and progress was impressive. Although Thailand's problems had been alleviated and supported by favorable external developments, the authorities deserved commendation. In a way, Thailand demonstrated the effectiveness of timely and comprehensive adjustment measures taken in cooperation with the Fund, although the positive external environment may have offered scope for even stronger efforts in a number of areas.

Given the risks and uncertainties in the world economy, the authorities should strengthen policies, particularly in the structural area, Mr. Grosche remarked. It was somewhat disappointing that only a small improvement in the fiscal position was to be expected in 1988, although the authorities planned to strengthen revenues through a restructuring of the tax system and the introduction of a value-added tax. Given the prevailing favorable conditions, he wondered whether the authorities should set an earlier date for the implementation of those measures. In addition, supplementary measures on the expenditure side seemed warranted. Stronger efforts should be directed particularly toward the financial position and the role of the public enterprises. The Public Investment Program should be implemented with prudence, with particular emphasis on improving the efficiency of resource allocation in the public sector. Given its dependence on the export sector for growth and the uncertainties resulting from recent events in the currency and stock markets, the authorities would have to speed up their structural reform measures and continue the flexible exchange rate policy. Furthermore, it would be important to continue efforts to put the financial sector back on a sound footing. Among the measures under consideration, adequate supervisory relations would make a useful contribution to strengthening domestic resource mobilization and to improving confidence and credibility.

Although the authorities' performance had been excellent, even more could be done to support a sustained recovery, and the authorities should continue their adjustment policy, Mr. Grosche continued. The firm commitment of the authorities was convincing, but they should be cautioned against relaxing adjustment efforts in favor of achieving growth targets, even if developments turned out to be less favorable than expected. The Thai experience of the early 1980s clearly demonstrated that too much relaxation could quickly lead to wide imbalances and eventually to frustration and disillusionment. Therefore, a prudent and sustained medium-term approach leading to steady growth rates was clearly preferable to stop-and-go

policies aimed at achieving high growth rates for a short time. Such efforts had to be paid for with prolonged adjustment, and were coupled with sluggish growth for some time.

Mr. Hodgson made the following statement:

The impressive economic performance during the past two years was partially due to favorable external factors, but it also stemmed from strengthened demand management and a restoration of external competitiveness. The continuation of these policies, with perhaps greater focus on the structural issues raised in the staff report, could propel Thailand into a new stage of development. Although recent events in international financial markets may have some impact on Thailand's favorable medium-term outlook, the current situation presents an ideal opportunity for undertaking significant structural reforms.

There is a clear need for a more elastic revenue system, if public finances are to remain sound. In this context, the planned introduction of a value-added tax, along with a restructuring of personal and corporate income taxes is welcome, although I share Mr. Sliper's questions about the coverage of a value-added tax. For the 1988 fiscal year, the targeted slight reduction in the public sector deficit could be more ambitious. I agree with the authorities' desire to reorient expenditures toward investment and maintenance, but it should be done in close coordination with the planned revenue measures to ensure that the overall fiscal balance continues to strengthen. The elimination of the energy price subsidy provided by the Oil Fund deserves prompt attention, the process of withdrawing budget subsidies to public enterprises could be accelerated, and those enterprises should be encouraged to become more self-sufficient and commercially oriented. Privatization seems to be a reasonable course to follow in an economy with a relatively well-developed private sector, such as Thailand's.

The restructuring of the financial sector deserves the high priority the authorities have given it. The current support arrangements between the Bank of Thailand and financial institutions are a burden on fiscal performance, and efforts to consider a broader approach, including appropriate legal and institutional changes, such as the deposit insurance scheme or greater foreign participation, are welcome. Greater attention could also be given to the tariff structure, with reforms directed at lowering import duty levels and narrowing their range to promote a more efficient and competitive structure of production. I support Mr. Enoch's request for stronger regional surveillance--a subject his chair has raised on previous occasions.

Mr. Faria made the following statement:

The authorities are to be commended for putting in place, starting in 1985, an apropriate set of corrective policies to cut excessive domestic absorption and restore external competitiveness, thus enabling the economy to profit impressively from the subsequent sharp improvement in the external environment. As a result, at end-1986, the economy was well on the road to recovery, enabling the authorities to cancel the stand-by arrangement with the Fund which only six months previously had been extended through end 1987.

As the staff report makes clear, there are areas in which further structural policy adjustments are needed and, indeed, are being contemplated by the authorities, notably, consolidating the revenue system and raising its income responsiveness, thus reducing the need to restrain residual growth in investment expenditures; reducing effective protection to domestic industry through a rationalization of the tariff structure, and strengthening the financial sector to facilitate the deepening of the private capital market. I wholeheartedly support the staff's view that the prevailing favorable economic and financial situation provides an excellent opportunity for the authorities to implement these far-reaching structural policies which would establish a sustained recovery into the medium term.

On the other hand, I find the staff recommendations on prospective monetary policies somewhat ambiguous. Against the background of continuing increased net foreign assets from enhanced export receipts and a net capital inflow particularly of foreign portfolio investment, I wonder how the staff suggests that the recommended sterilization of resulting excess liquidity should be carried out. In this connection, I note that the Bank of Thailand's intervention in the repurchase market to absorb excess liquidity earlier this year was only partially successful.

However, the staff was correct in pointing out--through its quantitatively well articulated medium-term forecasts, including a sensitivity analysis--some possible clouds on the horizon. On page 21 of SM/87/259 the staff asserted that if a shortfall amounting to 1 percent of GDP occurred in domestic savings, the balance of payments situation would become unsustainable. That assertion leads me to wonder whether the authorities' failure to maintain the historically high savings ratio of 23 1/2 percent of GDP achieved in the 1970s into the 1980s is attributable exclusively to the inappropriate demand-management policies that were pursued earlier in this decade, or whether it also reflects subsequent structural shifts that would militate against a reachievement of that high savings rate. Like Mr. Yang, I would like the staff to recommend policies to secure this objective.

On the external side, the sensitivity analysis suggests that the greatest downside risk is likely to emanate from the sensitivity of the manufacturing sector as a leading growth sector to market growth and market share retention. Since one third of the increase in exports went to Japan and the United States and one fourth to other Asian countries, the staff should elaborate further on the extent to which recent events necessitate a downward revision of medium-term forecasts, if possible by making reference to the prospects for principal manufactured exports.

Mr. Morita said that he joined previous speakers in welcoming the remarkable economic developments in Thailand's economy during the past year. Although those improvements were partly due to the favorable economic environment, they were brought about primarily by the authorities' commendable implementation of economic policy.

The medium-term prospects were expected to be positive, provided the sound macroeconomic policies and favorable economic environment continued, Mr. Morita observed. However, as the staff had pointed out, if those two conditions were not met, there would be a downside risk involved. Therefore, the authorities' intention to continue their cautious and prudent policy stance was welcome, and special attention should be paid to exchange rate and monetary indicators.

The authorities should take advantage of their recent good economic performance to implement structural reforms rapidly, Mr. Morita commented. It was necessary to ensure efficient domestic resource mobilization to achieve relatively high growth with a sustainable balance of payments. In that connection, revenue reform was important. To avoid an undue shortfall in domestic savings arising from an increase in the public deficit, the revenue structure needed to become more elastic, and the recent revenue recovery should not mask that need. The authorities clearly recognized the need for revenue reform, and some measures, including the introduction of a value-added tax, were scheduled to be introduced in the near future; he hoped that such measures would be undertaken as scheduled.

Intensified efforts were called for to strengthen the financial sector, Mr. Morita remarked. The authorities had already made some direct support arrangements and had achieved a degree of success. However, continuous efforts were clearly needed, preferably through strengthening supervisory measures, rather than through direct support at that stage. Moreover, some oligopolistic aspects seemed to remain in the financial sector, and the relaxation of restrictions on foreign ownership and financial institutions associated with the amendment of the merger law also deserved consideration.

The recent rapid growth of the manufacturing sector was welcome and would contribute to export diversification, Mr. Morita commented. However, some 70 percent of the labor force was still engaged in the agricultural sector. Thus, the promotion of labor-intensive, employment-generating

industry, rural development, and agricultural reforms were necessary. From that viewpoint, he supported the thrust of the Sixth Development Plan. However, that Plan should be implemented efficiently and monitored closely to ensure a sustainable public sector financial position.

Mr. Fogelholm said that he supported Mr. Enoch's request for regional surveillance data in staff reports for Article IV consultations; that issue had been taken up on several previous occasions, and interregional comparisons had still not been included in the staff reports. They would make helpful additions to the reports and would facilitate the Executive Directors' reading. Even though the staff was strained, it should at least consider finding ways to carry out such interregional comparisons.

Mr. Reddy asked for further clarification of Mr. Enoch's request for strong interregional surveillance in Article IV consultations. The idea of placing regional surveillance in the context of exchange rates carried with it the implication that somehow Thailand's exchange rate policy was giving it an undue advantage vis-à-vis other countries in the region, and there was no evidence that that had happened. In fact, a few other countries in the same region had undertaken much greater devaluations, but were not doing as well as Thailand. Foreign investment depended not only on the exchange rate, but also on many other factors, such as social and political stability, macroeconomic policies, structural policies, the availability of skilled manpower, and natural resources. To put the discussion of strong regional surveillance in the context of the exchange rate discussion was not appropriate.

Mr. Grosche said that he fully agreed with Mr. Reddy. It was extremely difficult to say that the exchange rate was the major factor in the success of a particular country, because so many factors had to be taken into account in evaluating economic success or failure. However, it certainly was important in the Article IV consultations and surveillance process to pay close attention to the effects that one country had on neighboring countries and the interlinkages that existed between countries. For example, in Europe it had become increasingly important to pay attention to such interlinkages. Restricting such analysis to exchange rates would be too limiting.

Mr. Enoch said that he had not been suggesting that the need for stronger interregional surveillance was just an East Asian issue; he had only used that region as an example. The same need also applied to Europe, Southern Africa, and Latin America. He did not think the Board could adequately discuss economic prospects for Uruguay, for example, without also knowing the growth prospects for Argentina and Brazil. Likewise, he had used the exchange rate as an example, because it had been given quite a prominent role in the staff report, and there had been some suggestion that the exchange rate had been a major factor behind growth in Thailand. However, he would not dispute Mr. Reddy's suggestion that many factors were involved in gaining investor confidence and in achieving economic success. When the Board examined exchange rates, it would be helpful to have not only a picture of global development, but also comparisons

between the country being discussed and other countries in the same region. The staff report had referred specifically to industries moving to Thailand from other countries in that region, and had implied that there was a great deal of interaction between the economies of the various countries. Therefore, examining only one country would not give a complete picture of the current economic situation. The Board was trying to determine whether the manufacturing growth was coming primarily from corporations choosing to locate their plants in Thailand exclusively, or in other countries such as Malaysia as well. If Thailand were the only ASEAN country experiencing high growth rates, it would be in a significantly different position than if all of those countries were growing simultaneously. Those differing positions had different implications for the overall growth potential of manufacturing, in light of the constraints arising from market shares and protectionism. It would be interesting to have answers to such questions to gain a more complete picture of the current economic situation.

Mr. Templeman said that recent economic development in East Asia was an interesting subject, and he wondered whether that topic could be addressed in a seminar at some time. Even though the Board and the staff's time and capabilities were limited, the Board had recently held an interesting seminar on the failure of some programs to deal adequately with inflation. It would be interesting to examine some successes and the reasons for their occurrence.

Mr. Hodgson said that when the Board had discussed regional surveillance in the past, it had been in a more general context. That issue had certainly been raised in the context of discussions concerning South Africa and regional implications relating to the South African economy and the surrounding states. Perhaps that topic could be raised during the Board's forthcoming discussion on surveillance.

The Acting Chairman said that the issue of stronger regional surveillance could be examined at the Board's upcoming surveillance review. It was not always easy, when concluding an Article IV consultation with a single country, to try to place that country in a regional context. But it would be useful for the Exchange and Trade Relations Department and the area departments to consider ways in which interregional information could be systematically analyzed and compiled for inclusion in individual country discussions.

The staff representative from the Exchange and Trade Relations Department said that the staff had taken note of the current discussion and the need to incorporate something on regional surveillance in the forthcoming surveillance review. She agreed with Directors that the economic linkages between neighboring countries should be brought to the Board in the context of Article IV consultations. Although it was difficult to systematize such an analysis, some work was being carried out, and for particularly relevant countries it had already been completed, both in terms of comparing effective exchange rates, and of compiling competitor-effective exchange rate indices to determine what was happening

between competing countries. That sort of analysis was of immediate importance to the success of competition for the tourist dollar--or perhaps the tourist yen, since the impact in that area was more immediate. The exchange rate relationships were not the only relationships to be considered; the surrounding environment, investment climate, financial policies, and other factors should also be taken into account. Some of the other possible interregional comparisons might be much harder to conduct, but where it was necessary some such analysis should be incorporated into the staff report as a matter of course. In that respect, it was not only important to focus on the regional comparisons, but where countries were commodity-dominated, comparisons should also be made regarding trade. For example, a coffee-producing country should not be examined in isolation, but should be viewed in the context of other coffee producers; therefore, the Board should take a somewhat broader view of such comparisons, rather than just concentrating on regional aspects.

The staff representative from the Asian Department said that many speakers had pointed out the importance of introducing the value-added tax in making the revenue system more elastic and enabling a further consolidation of public sector finances. The issue of exemption from coverage had also been raised. The design of the value-added tax was almost complete, and it exempted from coverage various necessities, such as unprocessed foods, health and education, domestic transportation, primary production, and professional services, all of which amounted to about 40 percent of domestic expenditure. The staff shared the Directors' concern about the impact of those exemptions on revenue. However, although those exemptions were higher than in industrial countries, they were roughly in line with those in countries at a similar stage of development that had also adopted a value-added tax.

The importance of tackling tariff reform at an early stage had been emphasized by many speakers, the staff representative noted. The urgency of such reform was based on some preliminary findings that tariff rates were relatively high in Thailand, nominally averaging about 33 percent. They were also widely dispersed, ranging up to 200 percent. In addition, there was a complicated system of exemptions that made the drawback provision for exporters cumbersome and ineffective. As a result, the existing tariff system was biased in favor of finished goods and against primary production and exports.

The ongoing relocation of foreign direct investment from Asian economies to Thailand had been referred to by several speakers in the context of the restoration of competitiveness, the staff representative continued. There had been substantive gains in the competitiveness of the baht vis-à-vis the Korean won, the Singapore dollar, and the new Taiwan dollar. A rough comparison would show that Thailand had extremely low labor costs compared with other countries in the region. Investment applications to the Board of Investments during the first three quarters of 1987 were about 2.5 times higher than during the corresponding period in previous years and for the whole of 1987, applications were expected to be three times higher than in 1986. About 47 percent of the investment applications so

far in 1987 had come from foreign investors. Of this share, about 30 percent came from Japan, 7 percent from the United States, 8.5 percent from Taiwan, 5 percent from the United Kingdom, and 7.5 percent from smaller European countries. A continuation of the relocation of foreign investment to Thailand was one of the key assumptions in the staff's relatively optimistic investment and export projections.

A question had also been raised concerning the impact of recent stock market developments on Thailand, the staff representative recalled. The most recent data showed that the Thai stock exchange index had dropped substantially--by about 40 percent--from its peak value, but had subsequently recovered. It was now about one third lower than its peak value; but it was still nearly 50 percent higher than it had been at the beginning of 1987. According to the Bank of Thailand, the impact on investment in Thailand would be mild. Internationally, of course, there would be an impact on Thai exports in that the recent stock market developments would lead to a slowdown in output growth in industrial countries which would result in lower market growth rates than were assumed in the medium-term scenario. However, a purely mechanical calculation of effects on foreign growth--taking into account the wealth effect on consumption, and then the consumption effect on investment and growth--suggested that the overall impact would be manageable for Thailand. If the market growth for exports would be half a percentage point lower than previously assumed, Thai manufactured exports would grow by about 2 percentage points less than projected, given an assumed elasticity of 4.0. According to Mr. Reddy, the authorities had used a less optimistic elasticity assumption of 2.4; under that assumption the growth of manufactured exports would fall by just over 1 percentage point. However, that purely mechanical calculations did not take into account any adverse effects arising from possible changes in investor confidence, and those effects were difficult to project.

Intensive discussions on all aspects of the Eastern Seaboard Development Project had been continuing since the project's beginning, and they had led to some agreed conclusions, namely, that a planned fertilizer project would be in doubt unless project costs could be lowered and that a planned second port might not be necessary, the staff representative stated. The exact project content of the Eastern Seaboard Project would be decided on a case-by-case basis.

In the staff's relatively optimistic scenario, the ratios of both investment and savings to GDP were projected to continue rising from their historical lows in the early 1980s, the staff representative said. The projected savings effort was predicated on an increase in public savings, resulting from a further consolidation of public sector finances, as well as an increase in private savings. If the present recovery was sustained, the projected level of savings was likely to be realized. If the savings ratio remained low, however, the authorities could consider fiscal incentives to increase savings, particularly after the introduction of the value-added tax made the tax system more elastic.

In regard to the broadening of agricultural credit, which Mr. Reddy had mentioned, future directed lending was to include the agroprocessing industry in the agricultural production sector, the staff representative observed. The recovery rate on those credits would be better than that on agricultural production credits. In Thailand, no government guarantees were provided for agricultural credit.

The expansion of M2 had reached the upper range of the authorities' target, and the staff urged continuous monitoring of the growth of reserve money stemming from the improved current balance of payments. The authorities were aware of the difficulties in controlling monetary aggregates, given the relative openness of the monetary system, and were prepared to act quickly if necessary.

In regard to the elasticity assumption used in the staff's medium-term scenario for imports, there had been a presentational error in Table 7 of SM/87/259, the staff representative explained. The elasticity of non-oil imports in relation to GDP, which had been stated as 0.8, should have been 1.3. The 0.8 figure referred to the elasticity of oil imports and was low because a growing part of Thailand's energy demand would be met in the future by domestic sources, mostly natural gas. The assumed elasticity for non-oil imports of 1.3, which corresponded roughly to the average elasticity experienced in previous periods, might be somewhat low if new investments turned out to be more import intensive.

The 1987 forecast for exports, which had been based on data for the first half of the year, was on the low side in the staff report, the staff representative from the Asian Department concluded. The staff had estimated that exports would increase in value by 16 percent in 1987, but the annual increase during the January-September period had already reached 27 percent. Similarly, imports had picked up. The staff forecast for 1987 as a whole had been 26 percent; however, in the period January-September the increase had been 36 percent. Because both exports and imports had been underestimated, the staff found that the trade account would be about on track, and the originally envisaged current account deficit might roughly hold.

Mr. Reddy said that most of the Board's comments on the policies undertaken by the authorities had been very positive. As for the words of caution about the growth of liquidity in the economy, his authorities were monitoring the situation very closely, but they felt that the rate of inflation was under control; there was no evidence of overheating, and the balance of payments position was reasonably good. There were tremendous amounts of underemployed and unemployed resources which could be better utilized if the momentum of growth were supported by accommodating financial policies. However, if any evidence of overheating or inflation became apparent, the authorities would not hesitate to act to control it.

The authorities' intended fiscal reforms were in accordance with the advice that had been given by the Fund staff, and there was an expectation that, once those reforms were implemented, the elasticity of the tax system

would improve considerably, Mr. Reddy remarked. The authorities agreed with Directors that the reforms should be implemented quickly. The timetable for implementing the value-added tax and the excise reform, namely, by January 1989, was a very ambitious one, and expediting that schedule further would be difficult.

The authorities had taken a number of measures in the area of financial sector reform, including strengthening the supervisory role of the Central Bank, which was currently restructuring the management of some of the financial institutions, Mr. Reddy added. Additional capital had been requested to cover for bad debt provisions in many financial institutions, but the authorities now believed that the worst was over, and further consolidation would take place in the coming months. Overall, there was much more confidence in the financial system than there had been in the previous two years.

The Directors had recognized the authorities' successful achievement of their stabilization objectives through the adoption of sound macroeconomic and flexible exchange rate policies; some had cautioned the authorities not to relax those policies, Mr. Reddy observed. In addition, the Directors had noted the progress that had been made on structural reforms, particularly in the financial and state enterprise sectors.

Major tax reforms were soon to be implemented, and the focus was currently shifting toward public policy, particularly toward development and distributional issues, Mr. Reddy went on. The per capita income in Thailand was still very low, at only $800 a year, or roughly 1/20 of that in the United States. Therefore, the concentration of public policy on developmental and distributional issues was understandable. The tremendous amount of existing rural poverty would be one of the major challenges in coming years.

The Acting Chairman made the following summing up:

> Directors noted with satisfaction that the recent improvement in Thailand's balance of payments had been associated with the resumption of rapid growth, continuing price stability, and an improved external debt position. Directors remarked that the adjustment efforts undertaken by the Thai authorities in recent years, particularly their commitment to keeping control over the public finances and to restoring external competitiveness, had laid a foundation that had enabled the economy to fully exploit opportune external developments. The Government's policy which was focused on export diversification and the strengthening of private sector activity was well conceived.
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> To consolidate the gains made thus far, Directors stressed, there was a need to continue to exercise prudent financial policies, to raise the domestic savings ratio further, and to maintain external competitiveness. In that context, monetary policy should be conducted with a view to preventing the recent substantial

expansion in reserve money--and the associated comfortable liquidity position of banks and declining interest rates--from leading to an overly rapid increase in monetary aggregates.

Directors noted that, since November 1984, the depreciation of the exchange rate in real effective terms had essentially reversed the real effective appreciation of the baht that occurred during the preceding six-year period. Continued flexibility in exchange rate management was urged to support Thailand's external competitive position; at the same time, caution was expressed about too much reliance on the role of the exchange rate in further strengthening competitiveness. In that connection, importance was attached to the role of structural policies to increase efficiency of the export sector.

Directors concurred that the present economic environment in Thailand provided a timely opportunity to strengthen structural efforts in several areas. The further strengthening of public sector finances through revenue reform and improved expenditure control would be a vital component of appropriate demand management. In that context, Directors noted that Thailand was moving toward the adoption of a value-added tax, which would increase the elasticity of the revenue system, particularly if the VAT would be sufficiently broad based. The need to carefully review the economic viability of major investment projects, such as those within the Eastern Seaboard Project, was noted by several Directors. Weaknesses in several public enterprises continued to pose a financial burden on the public sector, and Directors agreed with the authorities' broad-based approach to remedy the situation, which would include price increases, managerial improvements, and privatization. The need for greater flexibility in energy pricing was also noted. While recognizing the high priority that the authorities were placing on tax reform, Directors felt that customs tariff reform should be initiated without delay to reduce the level and number of tariff rates in the medium term and, thereby, contribute to the rationalization of investment incentives. It was also observed that further measures to facilitate foreign direct investment would be beneficial to Thailand.

In discussing the financial sector, Directors noted that a number of arrangements had been implemented to assist weak financial institutions. Constant review of the cost, duration, and impact on monetary control of those arrangements would be essential, and the need to explore alternative means of assistance, and ways to strengthen supervisory arrangements, were underscored. With respect to the authorities' desire to strengthen the financial sector as a whole, Directors called for a greater degree of competition, which could be fostered partly through a further liberalization of interest rates.

Directors stressed that prospects for rapid growth with external stability over the medium term depended crucially on a favorable external environment and on continued progress in implementing structural measures. While it was too early to determine the impact of the recent events in international financial markets on overall investment, Directors indicated that the anticipated large increase in foreign investment augured well for the Thai economy and underscored the international community's confidence in economic management in Thailand.

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

2. ANTIGUA AND BARBUDA - 1987 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1987 Article IV consultation with Antigua and Barbuda (SM/87/264, 11/16/87). They also had before them a background paper on recent economic developments in Antigua and Barbuda (SM/87/271, 11/20/87).

Mr. McCormack made the following statement:

The economy of Antigua and Barbuda has grown very rapidly in recent years. Real annual GDP growth in the years 1983-87 has averaged more than 7 1/2 percent. The main engines of growth have been tourism and construction, as modern hotels have been built and supporting infrastructures put in place. Growth has taken place in an environment of relative price stability, and unemployment has been brought to low levels. Indeed, labor shortages are being reported in a number of sectors.

The very rapidity of the growth experienced in recent years--amounting to a virtual transformation of Antigua and Barbuda's economy--has put strains on the balance of payments and the public finances. These are analyzed perceptively in the staff report, and my authorities are in general agreement with the staff's conclusions and recommendations, particularly that the key to the establishment of a viable balance of payments over the medium term is strengthening the public finances.

The basic difficulties now facing the economy of Antigua and Barbuda arise from implementing, over a very short time, a number of large projects required to stimulate and support tourist development. These projects include construction of a luxury hotel complex, a desalination and electricity generating project, and other projects aimed at road and airport improvement. These projects should be of a one-time-only nature, and therefore, the related financing difficulties should be largely self-limiting. This is explained clearly in the staff's medium-term projections. On the basis of relatively conservative assumptions, the overall

public sector deficit was expected to be about 27 percent of GDP in 1987; it was expected to move to virtual balance in 1988 and to record a surplus of some 2 1/2 percent of GDP by 1992. Because of a bunching of amortization obligations, the financing gap is expected to reach 9 percent of GDP in 1988, before declining to 2 1/2 percent in 1992. The medium-term balance of payments projections are essentially the mirror image of the fiscal projections. Thus, by 1992 the current account balance of payments is projected to decline to some 2 percent of GDP. The overall conclusion to be drawn from these projections is that the country's financing difficulties can be expected to fall to more easily manageable levels in the coming years. The policy agenda for the authorities will be demanding but not unattainable.

In the short run, the main priority is to deal with the debt service obligations and reverse the process of arrears accumulation in an orderly way. At the time of the last consultations, the authorities had engaged a British investment bank to act as intermediary in negotiations with the country's four major creditors. These negotiations have not been finalized, but the authorities hope to achieve a successful conclusion in the near future. The authorities, as noted in the staff report, are taking a number of other measures to reduce the scale of their debt-servicing commitments, notably the sale of a number of assets, such as factory shells and a major government-owned hotel, for which preparatory work is well under way. In addition, the authorities are seeking to refinance the relatively short-term debt associated with the Deep Bay Hotel and the tourist complex in St. John's by entering into long-term mortgage arrangements. It is also their intention to sell the Deep Bay Hotel as soon as it is feasible to do so; it would not be financially prudent to put two hotels on the market at the same time. These measures should reduce the scale of the financing problem to more manageable dimensions, particularly if rescheduling arrangements can be negotiated satisfactorily.

Over the longer term, the authorities recognize that durable improvements in the structure of the public finances are required. The authorities accept that the present tax system is not sufficiently elastic, and that its base has been eroded over the years by generous exemptions and concessions. They have already introduced a number of tax measures, and are envisaging major increases in property and consumption taxes, for which they have requested technical assistance from the Fund. In addition, the authorities are continuing their efforts to improve tax administration, including computerization.

On the public expenditure side, the scope for reductions is extremely limited, though the need for expenditure restraint over the medium term is well appreciated. In this connection, the

recently negotiated increase in public sector wages exceeded the authorities' initial expectations. To put this award in perspective, it should be borne in mind that the average pay level in the public sector was very substantially lower than in the private sector, particularly in the buoyant tourist industry. The disparity in pay and conditions had resulted in a severe drain from the public sector of technically qualified personnel, such as teachers and nurses. Suitably qualified entrants to the public sector were also proving difficult to attract. In the short run, a virtual hemorrhage of personnel from key social services could not be accepted. In principle, this problem might have been better addressed by granting selective increases to key personnel. However, this solution could not be accommodated within the prevailing system of bargaining in Antigua and Barbuda. There was, finally, the threat of industrial action by a key group of workers in the sanitation services which could have threatened the peak summer tourist period. The lessons of this recent experience have not been lost on the authorities, and they are determined to improve the system of expenditure control as a priority.

As for capital expenditure, the authorities note and accept the essential validity of the staff's criticism of existing project appraisal methods. The Government's recent White Paper on development objectives and strategy for the period 1988-92 is equally frank in its observations on this issue. The authorities have, with technical assistance from the Commonwealth Fund for Technical Cooperation, recently revamped the project unit in the Ministry of Economic Development, Tourism and Energy, and this can be expected to bring about an improvement in investment appraisal systems and to promote the early elaboration of a comprehensive public sector investment program, as recommended by the staff.

Finally, my authorities wish to thank the staff for its customarily constructive--at times critical, but always fair--report.

Mr. Woodward made the following statement:

At first sight, the economy might appear to be performing well; growth has been sustained at annual rates of between 7 percent and 9 percent for the past five years, and is expected to be 7 percent in 1988. The rate of inflation has remained low. However, this masks some potentially serious future problems.

Labor shortages in some areas have given rise to considerable upward pressure on wage levels, and rising nominal wages have not yet fed through into higher inflation, owing to the high proportion of imports in consumer goods and the fixed exchange rate; therefore, competitiveness is being eroded rapidly. Table 1 of SM/87/264 suggests that private sector wages will have almost

doubled between 1982 and 1988, while the exchange rate vis-à-vis the U.S. dollar has not changed. This will presumably squeeze profit margins in tourism and reduce incentives to invest.

Fiscal policy appears to be weak, due largely to the exceptionally high level of capital expenditure, which is worrying. Investments are being financed by foreign commercial borrowing, which has resulted in a quadrupling of public external debt to nearly 100 percent of GDP over the past two years. The investments are also contributing to labor shortages and rising wage levels; and their appropriateness is questionable in light of the World Bank's serious reservations about project selection criteria. The fiscal policy problems are exacerbated by the major reduction in public sector savings from 7 percent of GDP in 1986 to 1.1 percent in 1987, presumably due in part to the large wage settlement that was concluded recently in the public sector. Aside from its fiscal impact, the wage settlement will exert a considerable additional upward pressure on wages in the private sector--a matter of particular concern, because the agreement also provides for large increases during the next two years.

Another area of concern is the external position. The large public investment expenditure over the past two years has given rise to a considerable current account deficit, which is expected to be reduced only slowly, as well as the very large increase in foreign commercial debt already noted. This deficit comes after a period of substantial accumulation of external arrears which continue to increase rapidly. The projected financing gap suggests that arrears will continue to increase until satisfactory rescheduling arrangements or new sources of finance can be found.

The financing problem could be still more difficult if the medium-term balance of payments falls short of the staff's projections. In particular, there is a danger that the rapid rate of growth projected for tourist receipts may prove to be optimistic in view of the continued erosion of competitiveness which now appears likely. If private sector wages follow the pattern of the recent public sector settlement, wage costs could rise by a further 60 percent over the next three years. In light of the ever-increasing competition from other Caribbean countries in tourism, it is doubtful whether the projected rate of growth can be sustained. This problem will be compounded if foreign investment in the tourism sector is discouraged by substantially higher labor costs.

The economy in general is heavily and increasingly dependent on tourist receipts. In 1983, tourism accounted for about two thirds of current foreign exchange receipts. In 1987, the proportion was estimated at about three quarters, and by 1992, it is expected to reach about 85 percent. Apparently, there are no plans to encourage other actual or potential exports, and these are likely to suffer substantially from declining competitiveness.

Despite its good record of promoting growth and controlling inflation in recent years, Antigua and Barbuda faces some major economic challenges in the next few years. The indications in Mr. McCormack's opening statement that those problems may be soluble in the medium term and that a more sustainable growth path can be regained are encouraging. However, that optimistic scenario will require substantial changes in economic policy. I support the staff's suggestion of liberalizing immigration procedures, so as to ease labor shortages and slow down the erosion of competitiveness. However, the effectiveness of such an approach in terms of competitiveness will be significantly hampered by the three-year public sector wage agreement, which will also make improvements in the fiscal position and public savings more difficult. Therefore, it is important that that obstacle be overcome. Reduced public sector employment, greater restraint in current expenditure, and an improved tax structure are needed. The authorities should discuss their current criteria for project selection in public investment with the World Bank. Mr. McCormack's assurance of the authorities' intention with respect to these policy issues is welcome.

Mr. Hogeweg said that the staff report and some of the economic problems it described reminded him of previous reports for other Caribbean islands, such as the Netherlands Antilles and Aruba. The Board discussion on Thailand had highlighted the importance of regional aspects in economic development. In the case under discussion, the regional similarities of some problems among countries was again clear and should have been made more prominent in the staff report. Tourism was the mainstay of the economy in many Caribbean countries, and the role of governments in promoting that industry and in bearing the financial burden of those risky investments was similar. The tourist market was risky because it was volatile and because of the heavy competition for market shares that existed among Caribbean islands.

The Government seemed to have overstretched itself, Mr. Hogeweg remarked. Although the extremely high government and external deficits related to the large investments in new tourist projects were expected to be temporary, they were cause for serious concern. On page 7 of SM/87/264, the staff had noted that the World Bank continued to harbor serious reservations about the criteria used for the selection of projects and had stressed the uncertainties about the likely economic and financial returns. The operating surpluses of the projects planned for the future did not appear to be sufficient to meet the debt service commitments. Meanwhile, the island had incurred external payments arrears, and the Government seemed to view continued borrowing as a permissible source of finance. If that impression was correct, he strongly disapproved. The staff had been correct in not taking revenues from the Government's sale of hotels into account in its medium-term projections. Although the intention to sell was laudable, its success remained to be seen.

The strain on the labor market and the emergence of labor shortages, especially in the skilled professions, were notable, Mr. Hogeweg commented. A lack of skilled labor was a common characteristic of many Caribbean islands. In Antigua's case, labor--and presumably not only skilled labor--seemed to be creating a real bottleneck in the operations of new projects; he wondered whether that indicated a certain overstretching of the island's resources. He also wondered whether it was wise to generate projects that could be operated only at the expense of either inflows of foreign labor, which gave rise to social and political sensitivities, or increases in real wages which could erode competitiveness. Competitiveness was largely dependent on domestic cost developments because of the monetary and exchange rate constraints associated with membership in the Eastern Caribbean Central Bank.

Under the current circumstances, the staff concerns regarding fiscal management; wage policy, especially in the public sector; the importance of obtaining a rescheduling agreement within the framework of a comprehensive set of adjustment measures; and containing the buildup of external arrears were justified, Mr. Hogeweg continued. In light of Table 2 of the staff report on the operations of the consolidated public sector, he wondered why the staff had projected the same levels of central government surpluses and external financing for 1991 and 1992. Had the staff meant to imply that the public sector would be able to generate sufficient domestic resources for debt servicing in those years? In addition, he wondered whether the figures given in the table indicated that a rescheduling was unavoidable to prevent further arrears.

Mr. Rieffel made the following statement:

> While GDP growth has continued and the annual increase in consumer prices has slowed to less than 1 percent, the current account deficit increased substantially and the Government continued to accumulate external arrears on debt servicing. The continued buildup of external arrears to finance substantial public sector investment is clearly not tenable, as my authorities noted during the 1986 Article IV consultation.
>
> The authorities must revise fiscal policy in an effort to correct the imbalances that are increasing. This effort should include a more realistic investment program with projects prioritized to match the economy's absorptive capacity and to conform to the amount of financing which can reasonably be obtained for the chosen projects. In this regard, it would be preferable to avoid further contracting of commercial debt. World Bank assistance would appear to be valuable in this area, and I share Mr. Hogeweg's concern about the quality of the public investment program. In addition to scaling down the public investment program, there is scope for selling assets to the private sector; the authorities' consideration of this possibility is welcome, and it should be pursued promptly.

Wage increases in the public sector have been high, and I agree with the staff that they may have inhibited efficient use of the labor force. To counter the effects of those wage increases on the fiscal position, the authorities may need to consider reducing the size of the civil service and reducing future wage increases to more reasonable levels. Future substantial wage increases could adversely affect the competitiveness of the economy. It would be helpful to find ways to encourage labor inflows from neighboring islands, and I would be interested in any ideas the staff might have in that regard. Mr. McCormack's assurance that the lessons of recent experience have not been lost on the authorities is encouraging, and I welcome their determination to improve the system of expenditure control.

The medium-term balance of payments scenario highlights the urgent need for action on the fiscal front. During the years ahead, financing gaps apparently will continue, unless action is taken immediately to curb the fiscal deficit. The continued buildup of arrears is clearly an inappropriate method of financing this deficit. The authorities should work to reschedule their arrears in a multilateral context and proceed with a more responsible debt service policy. A policy of accumulating arrears could undoubtedly have an adverse impact on foreign investment, which is critical to the further development of tourism.

Mr. Faria said that he fully agreed with the staff that, because of institutional arrangements which limited the scope for independent monetary and exchange rate policies, including reserve management, a viable external position was crucially dependent on the strengthening of public finances. However, he was less optimistic that the overall position of the public sector would move into near balance in 1988 and to a surplus of 2 1/2 percent of GDP by 1992. The projected sharp rise of revenue and grants to 32.5 percent of GDP for 1988, following an estimated decline of 4 percent in 1987, seemed ambitious in light of the fact that a major fiscal effort could not be contemplated owing to the likelihood of elections. Moreover, the implied average annual growth rate of just under 10 percent for revenue through 1992 would entail at least a unitary elasticity of the tax system.

The expected sharp cutback in capital expenditures to 7 percent of GDP for 1988 compared with those existing prior to the large increase to 60 percent of GDP in 1986, was noteworthy, although it was equal to the reduction in the level of real investment and could potentially have adverse effects on growth, Mr. Faria commented. However, the projections for the annual average growth of current expenditures, which assumed a deceleration to between 6 and 8 percent--or 10 percent if interest payments on debt were excluded--did not take sufficient account of the recurrent cost implications of the massive increase in capital expenditure that had taken place during the previous two years. He wondered how the repayment of existing debt service arrears, as reflected in Table 4 of the staff report, had been factored into the medium-term fiscal projections, and whether the

staff could clarify these revenue, expenditure, and financing aspects of the fiscal position. The increase of the debt service to public sector revenue ratio to a cyclically high 41 percent gave an indication of the pressure that would continue to be exerted on the budget by the growing burden of debt service obligations and argued for a closer review of prospective investment plans and associated financing.

In the past, fiscal management had been characterized by the persistent accumulation of new external debt arrears, Mr. Faria noted. While there were indications that that tendency would persist beyond 1987, it had become equally apparent that sizable feedback effects on the budget from the elimination of existing external arrears were likely to emerge. Therefore, it would have been useful for the section on the external sector policies and outlook in the staff report to have contained an analysis--perhaps based on discussions with the authorities--on the scope for rescheduling, including the distribution of debt holders, the term structure of existing debt, and the minimum desirable rescheduling profile that would be consistent with the baseline fiscal scenario. The staff should offer some further qualitative insights along those lines, and on the reason for the authorities' apparent preference to engage in borrowing on commercial terms from private creditors, rather than on concessional terms from official creditors, including multilateral organizations, thus laying the basis for a prospectively serious external debt problem.

Mr. Zeas stated that the economy had achieved a satisfactory growth performance over the past six years; the estimated per capita GDP of US$3,100 for 1987 represented an impressive improvement in living standards. What was more important, it had been achieved in an environment of price stability, low unemployment, and a free trade system. However, that impressive growth performance had been dependent mainly on one sector of the economy--tourism. Therefore, more diversification is highly desirable.

Given the lack of statistics on important social variables, a complete picture of the overall social economic situation could not be obtained, Mr. Zeas said. Therefore, his chair believed the authorities could benefit from technical assistance from the Fund or any other multilateral organization in compiling key statistical information. He was in general agreement with the staff report.

His authorities agreed with the staff that the authorities should attach the highest priority to a prompt solution to the external debt arrears problem, Mr. Zeas went on. The authorities should give due consideration to a number of initiatives recommended by the staff, such as more prudent wage policies, sales of some of the less efficiently run hotels, and adjustments of public utility rates. His chair did not envisage much room for maneuver on the revenue side, as the revenue to GDP ratio already exceeded 27 percent. Furthermore, Antigua's external debt reached nearly 100 percent of GDP in 1987, and approximately 75 percent of that debt was owed to foreign commercial banks and suppliers. Given the rather short maturity of that debt and the high interest costs and commissions involved, it posed a difficult debt service problem for

which both the borrowers and the lenders must find a mutually agreed solution. If that problem was not solved promptly, it would introduce a higher degree of uncertainty in the staff's medium-term scenario.

His authorities agreed with the staff that while the real effective exchange rate had recently depreciated, additional high wage increases could undermine the competitiveness of labor, which might in turn jeopardize future export growth of goods and services, Mr. Zeas concluded. In that context, it was noteworthy that merchandise exports had declined continuously, dropping to US$31 million in 1987, compared with US$37 million in 1983.

The staff representative from the Western Hemisphere Department said that the staff's fiscal projections for 1988 included a large increase in current revenues, because some nontax revenues from the sale of government-owned condominium units had been included. Although these sales would have a one-time effect, they would account for a substantial increase in nontax revenue. After 1988, the growth in revenues would depend on the growth of tourist-related taxes, and would be concomitant with the expected growth in tourism.

In regard to the current and maintenance expenditures related to the public sector investment projects currently under way, some projects, such as the desalting plant, already included maintenance agreement contracts in their estimated costs, the staff representative explained. With respect to the expected financing, an overall government surplus had been projected, particularly for 1992, but the amortizations of foreign debt were much higher than the expected surpluses. Thus, a financing gap would continue to exist, and that would be reflected in the balance of payments.

The rescheduling that the authorities were trying to achieve would only cover current arrears, the staff representative continued. The staff had not elaborated on that point at length, because it had already been discussed during the 1986 Article IV consultation, and negotiations were still under way. The authorities hoped they would not need to reschedule any debts other than those already in arrears, because they expected to sell two government-owned hotels: one that was already built and operational, and one that had recently been built and would become operational by the end of 1987. If the authorities could complete the sale of those assets, the revenue would go a long way toward reducing the currently projected gap. The authorities had been financing projects on commercial terms rather than obtaining concessional financing from official sources, because of the nature of the tourist market. In such a competitive environment, the authorities considered that the process of obtaining standard financing on concessional terms was too lengthy.

It was important to note Antigua's particular success in tourism, the staff representative remarked. Tourism had been increasing since the recession in 1982 and it had increased in Antigua by close to 60 percent,

compared with an increase of 20 percent for the Caribbean as a whole. Although the Caribbean share of the world tourist market had increased fairly substantially, it was difficult to predict whether that increase would continue at its present rate; therefore, the staff had projected a lower rate of growth in the volume of tourist arrivals, and the projections given for the years following 1988 were for a growth rate of only 6 percent, compared with the much higher rates that had been achieved in the past three or four years.

The possibility of further immigration was a touchy issue within Antigua because of the sociopolitical implications involved and the burden on social services, the staff representative from the Western Hemisphere Department pointed out. However, the authorities would continue to favor a liberal policy and a substantial amount of immigration had been taking place. The considerable expansion expected in the tourism sector, might tax labor resources. In addition, if there was a substantial drop in the hotel occupancy rate, owing to fluctuations in the tourist market, it would be reflected in lower hotel rates, and the hotels would be forced to negotiate lower wage increases with their staffs.

The staff representative from the Exchange and Trade Relations Department said that the point made about the need to view economies in a regional perspective was valid, particularly with respect to the Caribbean countries because of their heavy dependence on tourism. The issue of regional surveillance would be discussed in general terms during the forthcoming surveillance review, when the Board would examine ways to approach and deal with that issue in general, including possible consultation with the World Bank staff on the issue of stronger interregional surveillance.

Mr. Faria, referring to the existing debt service arrears in the medium-term projections, wondered whether the interest arrears for 1987, amounting to about EC$26 million, had been taken into account in determining the overall budget surplus.

The staff representative from the Western Hemisphere Department replied that both the fiscal and the balance of payments in the medium-term projections had included all interest obligations. The staff had considered that if the authorities were unable to meet the necessary obligations, it would be reflected in the financing gap.

Mr. McCormack acknowledged that Antigua may have been somewhat impatient in its eagerness to develop. As a result, the development process had not always been as orderly as one might have liked, and some potentially serious problems had arisen. However, the authorities recognized those problems and in the Government White Paper, published in June 1986, had given a strikingly frank and in-depth analysis of the way in which the country had developed.

The next step would be to implement concrete policies to remedy current problems, Mr. McCormack observed. The authorities realized the crucial importance of improving the public finances, and were determined

to take the necessary measures to do so. In addition, they were seriously concerned about arrears, and certainly did not regard the accumulation of arrears as a permissible means of financing; instead, the authorities were currently trying to regularize their financial position. In that general connection, Directors' recommendations regarding the need to improve the entire planning process were noteworthy, and his authorities would be quite receptive to them.

As to the large wage awards that had recently been granted, it was important to note that wage levels in the public sector were considerably lower than those in the private sector, Mr. McCormack concluded. Therefore, an immediate impact on private sector wage formation was not expected. However, in principle, the implications of continuing such wage increases against the background of a tight labor market were serious; the authorities appreciated that fact and were determined to remedy the problem. In sum, the first phase of rapid growth had come to an end, and the authorities were trying to tackle the problems that had resulted from the rapidity of this growth and to foster a more orderly and coherent pattern of development in the future.

The Acting Chairman made the following summing up:

Directors were in general agreement with the thrust of the appraisal in the staff report for the 1987 Article IV consultation with Antigua and Barbuda.

They noted that economic growth in Antigua and Barbuda was among the highest in the Caribbean, and that inflation and unemployment were low. However, Directors expressed concern that labor shortages and high public and private sector wage increases could contribute to a future erosion of competitiveness, the overall fiscal deficit had widened in recent years because of sizable wage increases and large public sector investments financed by external commercial borrowing on relatively short terms, and that a large external deficit had emerged.

Directors urged the authorities to take prompt action to strengthen the public finances to stem the accumulation of overdue obligations. Current expenditures could be restrained, for example, through reductions in the size of the civil service and limits on future wage increases. Capital outlays should be scaled down substantially since most of the infrastructure needed to support private activity in tourism and other sectors had already been put in place. With regard to public investments, Directors saw a need to improve project selection criteria based on a stricter assessment of financial viability, and they saw a role for the World Bank in that context. Also, Directors strongly urged that new debt on commercial terms be avoided.

Directors noted that fiscal adjustment measures alone might be insufficient to close the medium-term financing gap. Thus, they stressed the importance of continuing negotiations to reschedule existing arrears and to refinance short-term loans. Moreover, they encouraged the authorities to expedite the sale of assets, such as government-owned hotels, to liquidate the related debts and reduce the debt service burden.

Directors were concerned that the authorities had overstretched themselves. The volatile nature of the tourist market, competition from neighboring areas, the institutional constraints on exchange rate policy, and a possible decline in the competitiveness of Antigua and Barbuda put the island's growth prospects at serious risk unless major efforts were undertaken to restrain wages and other costs, to eliminate the imbalance in the public finances, and to halt the buildup of foreign debt.

It is recommended that the next Article IV consultation with Antigua and Barbuda be held on the standard 12-month cycle.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/87/164 (12/2/87) and EBM/87/165 (12/4/87).

3. MADAGASCAR - STAND-BY ARRANGEMENT - AMENDMENT

Paragraph 4(b) of the stand-by arrangement for Madagascar (EBS/86/201, Supplement 1, 9/19/86), as amended, is further amended by substituting "December 16, 1987" for "October 30, 1987." (EBS/87/246, 11/30/87)

Decision No. 8741-(87/165), adopted
December 3, 1987

4. NEPAL - TECHNICAL ASSISTANCE

In response to a request from the Nepalese authorities for technical assistance in the central banking field, the Executive Board approves the proposal set forth in EBD/87/309 (12/1/87).

Adopted December 3, 1987

5. EXECUTIVE BOARD TRAVEL

Travel by Advisors to Executive Directors as set forth in EBAP/87/263 (12/2/87) is approved.

APPROVED: July 21, 1988

LEO VAN HOUTVEN
Secretary