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04

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 86/121

10:00 a.m., July 25, 1986

J. de Larosière, Chairman
R. D. Erb, Deputy Managing Director

Executive Directors	Alternate Executive Directors
	J.-C. Obame, Temporary
	M. K. Bush
	K. Celebican, Temporary
M. Finaish	
	M. Sugita
G. Grosche	A. Bertuch-Samuels, Temporary
Huang F.	
J. E. Ismael	
	J. Hospedales, Temporary
T. P. Lankester	
	H. Fugmann
M. Massé	L. Leonard
	A. Abdallah
	W. K. Parmena, Temporary
	M. A. Weitz, Temporary
	J. E. Suraisry
P. Pérez	
H. Ploix	S. de Forges
J. J. Polak	J. de Beaufort Wijnholds
	A. V. Romuáldez
	A. A. Agah, Temporary
A. K. Sengupta	A. S. Jayawardena
S. Zecchini	N. Kyriazidis

L. Van Houtven, Secretary
L. Collier, Assistant

Also Present

Bank of Jamaica: H. Brown, Governor; A. Ally, Deputy Governor. IBRD: G. T. Nankani, Latin America and the Caribbean Regional Office. Asian Department: S. Kohsaka. European Department: L. A. Whittome, Counsellor and Director; A. L. Bovenberg, G. S. Tavlas, H. Ungerer, H. Vittas. Exchange and Trade Relations Department: W. A. Beveridge, Deputy Director; J. T. Boorman. External Relations Department: A. F. Mohammed, Director. Fiscal Affairs Department: G. Blöndal, A. Cheasty. Legal Department: H. Elizalde, R. H. Munzberg, J. K. Oh. Secretary's Department: P. D. Péroz. Treasurer's Department: D. Williams, Deputy Treasurer; J. P. Caskey, J. C. Corr. Western Hemisphere Department: S. T. Beza, Associate Director; L. A. Cardemil, A. P. De La Torre, J. Fajgenbaum, F. Ferrán, M. E. Hardy, S. C. de Sosa, S. J. Stephens. Personal Assistant to the Managign Director: R. M. G. Brown. Advisors to Executive Directors: M. B. Chatah, L. P. Ebrill, G. D. Hodgson, A. Ouanes, I. Puro, D. C. Templeman, R. Valladares, A. Vasudevan. Assistants to Executive Directors: O. S.-M. Bethel, B. Bogdanovic, W. N. Engert, V. Govindarajan, S. King, M. Lundsager, T. Morita, J. E. Rodríguez, G. Schurr, H. van der Burg.

1. MEXICO - REPORT BY MANAGING DIRECTOR AND DEPUTY MANAGING DIRECTOR

The Managing Director reported that on July 23, 1986 he had participated in a large meeting in New York attended by representatives from the 13 banks of the Advisory Committee and from the banking community in general, not only from banks in the United States but in Asia and Europe as well. The meeting had begun with a description of Mexico's economic policies by the Mexican Under-Secretaries for Finance, Taxation, and Public Spending, followed by a well-received presentation by the Secretary for Finance. The Executive Vice President of the Inter-American Development Bank had spoken about the IDB's role in Mexico, and the President and Senior Vice President of the World Bank had discussed fully the loans and operations that the Bank had in the pipeline over the program period. He himself had described Mexico's achievements--and slippages--under the 1982-85 program and the serious impact of developments with respect to oil prices on the country's economic and financial situation. In that historical context, he had outlined the policies that the Mexican authorities planned to follow in 1986/87.

He had then explained that a minimum commitment of $6 billion for 1986/87 was required on the part of the commercial banks, the Managing Director continued. Indeed, the $6 million to be provided from official sources had been based on optimistic assumptions regarding commitments by multilateral agencies and bilateral parties, including the Paris Club and the World Bank, and on the assumption also that Mexico took the necessary policy steps to unlock World Bank operations. From the table that had been prepared for the meetings in New York and that had been circulated to Executive Directors on the previous day, it was clear that in net terms, after deducting repayments by the Mexican private sector to commercial banks of about $1 billion, the contribution of the commercial banks to the overall package was not that large.

In terms of the Baker initiative, which had made no allowance for the oil shock experienced by Mexico, the increase in bank exposure resulting from the combination of public and commercial support was slightly more than 3 percent a year over the two years, the Managing Director observed. The $6 billion package from the commercial banks could be augmented if the price of oil fell below the reference figure of $9 a barrel, thereby triggering the application of the Fund's oil contingency mechanism. He had reiterated the Fund's readiness to participate in that additional contingency financing, noting that the two parties with the flexibility to adjust the financing they provided, based on quarterly data on oil prices, were the Fund and the commercial banks. He had suggested a ratio of Fund/commercial bank support of 1:2. He had also stressed that with respect to the growth contingency provision, the World Bank would have an instrumental role to play in agreeing with the Mexican authorities on the projects to be selected as the vehicle for those possible increased outlays as well as in collaborating with the banks, possibly in the form of the cofinancing of those projects. Such financing might attract more interest on the part of the banks than financing that was more balance of payments oriented.

He had reported to the meeting that negotiations with the Mexican authorities on a proposed stand-by arrangement had been concluded and that the staff was writing its report to the Board, which could take the matter up in early September, the Managing Director said. However, the Board could do so only if there was reasonable assurance that the program was financeable and if the banks gave an indication by that time--within about six weeks--that the critical mass had been obtained.

The general presentation of Mexico's case seemed to have been well received, the Managing Director considered. The bankers had appreciated the frankness with which it had been made. His immediate concern was that the Advisory Committee of 13 banks should begin its work as soon as possible so as not to lose the momentum that had been achieved. He and the Deputy Managing Director had met the Advisory Committee on July 24 and had impressed that sense of urgency on its members. In response to their inquiries about possible interim arrangements to facilitate the cash flow position of the Mexican central bank over the coming weeks, he had explained that even if agreement on a program was reached in early September, large amounts of money would become available only toward the end of the year. However, he had been able to inform the Committee that he had already received replies to telexes that he had sent to a number of central banks, drawing their attention to the need to ease the cash flow position of Mexico in the interim period and to avoid arrears at the outset of the program. Those central banks had agreed in principle to participate in such an interim financing operation, provided that the commercial banks, who were of course aware of the situation, did so too. The technical modalities of that interim operation had been discussed with the Advisory Committee. And owing to the legal complexity of the operation, he had advised the Committee to form a working group in liaison with the Bank for International Settlements and the U.S. Federal Reserve Bank in New York in order to iron out the details.

The Deputy Managing Director commented that before the negotiations with the commercial banks could begin, it was of primary importance for the Mexican authorities to formulate a set of proposals. To meet the tight time schedule outlined by the Managing Director, those negotiations would have to start within the following few days. It might take 2-3 weeks for the Committee to agree on a package after which the Committee would have to make its presentation to a worldwide group of banks, who would then state whether or not they supported the package. At that point, the existence of a critical mass would be determined.

The Managing Director observed that the package could not be successfully negotiated without a Paris Club agreement; but it was also clear that without the maintenance or resumption of export credit cover, the gains from a Paris Club rescheduling arrangement would be lost. He asked Executive Directors to convey that message to their authorities.

Finally, the Managing Director stated that Mexico, confronted by extremely difficult conditions with a massive change in its terms of trade, had chosen the path of adjustment and had taken courageous structural measures and was seeking to negotiate a solution to its external payments problems with its creditors. Mexico deserved timely international support for those commendable decisions, and the international financial community had to bear in mind that its response in the following four to six weeks would shape the future of the international monetary system. He urged those who might have doubts about the program to study it carefully; it had been drawn up conservatively and was in line with the Baker initiative. It should be possible to reach an agreement in principle without allowing the technical issues to stand in the way; the Deputy Managing Director would urge the Advisory Committee, when he met its Chairman later that day, to utilize the four to six weeks ahead to muster the necessary support.

2. JAMAICA - OVERDUE FINANCIAL OBLIGATIONS - REPORT AND COMPLAINTS UNDER RULE K-1 AND RULE S-1

The Executive Directors gave substantive consideration to the Managing Director's report and complaint under Rule K-1 and Rule S-1 with respect to Jamaica's overdue obligations in the General Department and the SDR Department (EBS/86/157, 7/18/86). They also had before them an outline of Jamaica's medium-term economic program prepared by the Jamaican authorities (EBS/86/165, 7/24/86).

Mr. Headley Brown, Governor of the Bank of Jamaica, represented Jamaica; Mr. Asgar Ally, Deputy Governor of the Bank of Jamaica, was also present.

The staff representative from the Western Hemisphere Department informed the Board that a staff team was currently in Jamaica conducting the Article IV consultation discussions. So far, the mission was still gathering data, but substantive discussions with the authorities should start in the following week.

The Deputy Treasurer noted that paragraph 2 of the proposed decision should be amended to reflect the increase in Jamaica's overdue obligations to SDR 74,729,824. Those obligations were equal to 52 percent of Jamaica's quota and to 12.4 percent of total outstanding Fund credit.

Mr. Massé made the following statement:

> Executive Directors scarcely need to be reminded of the extent of the contacts that have existed for some time between Jamaica and the Fund. They have been frequent and close and have been directed toward the goal shared by both sides of correcting imbalances in the Jamaican economy and restoring sound conditions for economic growth. Most recently we have had the new look mission and at present there are the ongoing Article IV consultations. It is to be hoped that as a result of this close examination of Jamaica's present economic circumstances it will be possible to establish a durable basis for the direction of Jamaican economic policy and for relations between Jamaica and the international financial community.

As part of a long period of good working relations we have had to solve together a number of problems; at present we are trying to deal with a particularly difficult financial period that has resulted in overdue obligations and the Managing Director's complaint to the Board. I believe that these difficulties will not be of long duration. It is true that there are differences of approach between Jamaica and the Fund on what needs to be done and how it should be done so that overdue obligations can be met and avoided in future, but the goodwill exists on both sides to overcome these problems.

Mr. Brown has been personally involved in the consultations with the Fund and is anxious that Board members should have as full an understanding as possible of the Jamaican authorities' point of view on the direction the policies in his country should take to promote balanced growth.

Mr. Brown made the following statement:

The Government of Jamaica deeply regrets its inability to meet payment obligations to the Fund that have fallen due since April 15, 1986. This development must be seen against the background of the fact that apart from occasional minor delays arising from exceptional circumstances, our record of payment in the past has been generally good.

The buildup of arrears to the Fund is due largely to the delay in the disbursement of a World Bank loan of US$40 million, the first tranche of the sector adjustment loan. This loan was programmed to be disbursed not later than March 31, 1986. If this had materialized, Jamaica would have met all the IMF performance criteria as at March 31, 1986. In those circumstances, the negotiations for the second year of the stand-by arrangement would almost certainly have been completed by now and the drawdown of Fund and Fund-related resources would have placed the cash flow of the Bank of Jamaica in a position to be current on obligations in respect of Fund payments. However, the World Bank tied the drawdown of these funds to our reaching agreement on the Tripartite Mission's report, a condition that did not exist when our agreement with the Fund and the World Bank was originally concluded.

The delay in the finalization of the Tripartite Mission's report has adversely affected the drawdown of the World Bank loan. We received the final report of the Tripartite Mission on May 9, 1986, and our response to the three agencies concerned--IMF, World Bank, and USAID--was dispatched on June 4, 1986.

The nonreceipt of the World Bank loan as well as of projected Fund and Fund-related disbursements has resulted in severe cash flow constraints and a consequential buildup of arrears to the Fund and other creditors. Had these resource flows materialized as projected, we would have been current in our payments to the Fund.

The prospects for clearing off all arrears to the Fund are critically dependent on the drawdown of the World Bank loan of US$40 million. The cash flow forecast of the Bank of Jamaica indicates that, provided the World Bank loan is received before the end of August, the Bank of Jamaica will be in a position to become current with the Fund by the end of that month. Arrangements have been made for the net outstanding SDR charges to date in the SDR Department to be cleared today.

In respect of future payments to the Fund, the cash flow forecast indicates that, provided a Fund program is in place and Fund drawings as well as Fund-related disbursements take place as programmed, Fund payments will be made as they fall due.

It is important to note that payments to the Fund in 1986/87 will be as follows:

Principal	SDR 123.7 million
Charges and interest	SDR 53.0 million
Total	SDR 176.7 million

(or)

US$203 million assuming SDR 1 = US$1.15

The debt servicing to the Fund will therefore account for approximately one third of total external debt servicing. The Fund payments tend to bunch, as the following examples indicate:

April 1986	-	SDR 24 million
July 1986	-	SDR 39 million
October 1986	-	SDR 19 million
January 1987	-	SDR 44 million

Given Jamaica's delicate cash flow situation and the need to sustain vital sectors of the economy, the programming of the cash flow to meet these payments depends heavily on policy-related cash flow loans such as those from the World Bank, USAID, and the IMF itself.

Without a Fund program, Jamaica's ability to meet its debt service obligations becomes extremely difficult; therefore, to maintain payments on a current basis, it is critical that a Fund program be in place at an early date so that the Fund-related resources can be drawn down as programmed.

There were breaches of certain selected criteria at March 31, 1986. None of these breaches would have occurred if the loan of US$40 million from the World Bank, programmed for disbursement during the last quarter of the fiscal year, had in fact been disbursed. The outturn for March 31, 1986 indicated that the following performance criteria were not met:

1. The net international reserve ceiling--adjusted for a higher than programmed level of external debt rescheduling--was exceeded by US$23.1 million.

2. The net domestic assets ceiling--adjusted as in paragraph 1 above--was exceeded by US$206.2 million.

3. Public debt payments arrears, which should have been eliminated by March 31, 1986, amounted to US$33.8 million at that date.

While accepting the link between these breaches and the World Bank loan, the Fund staff has argued that despite this shortfall, the performance of the capital account of the balance of payments was some US$39.0 million better than programmed. It argues further that the delay in the drawdown of the World Bank loan is not due to timing and is therefore not temporary and reversible.

The Government of Jamaica disagrees with the position of the Fund staff on the following grounds:

1. The policies pursued by the Government were to encourage private inflows to partially offset the decline in exports and sustain a higher level of imports in order to prevent disastrous consequences for the productive sectors arising from a further decline in imports during the year.

2. A susbstantial portion of the nonprogrammed inflows was in kind and not cash and hence could not be used as a substitute for the World Bank loan.

3. Given the nature of private capital inflows, it is difficult to make a clear-cut distinction between flows related to investment and flows related to borrowings. Furthermore, there are no ceilings on private capital inflows and it would be impossible and imprudent to seek to establish such ceilings.

It remains the case therefore that if the World Bank loan had been disbursed, all of the performance targets would have been met.

The medium-term economic program of the Government of Jamaica has been framed in the context of achieving the same objectives that underpin the work of the Tripartite Mission. The main objectives are:

1. To raise the rate of economic growth so that living conditions can begin to improve.

2. To reduce unemployment.

3. To restore viability to the balance of payments, measured by Jamaica's ability to service its external debt obligations in a sustainable way.

4. To achieve and maintain domestic price stability.

While there is concurrence between the Government of Jamaica and the Mission's recommendations with respect to the macroeconomic direction in the medium term, the policy mix proposed by the Mission for fiscal year 1986/87 would result in the second consecutive year of significant economic contraction. Furthermore, for the medium term, very moderate growth would be realized and as such the ability to realize the objectives would be limited.

The Mission's targets for a reduction in the balance of payments current account deficit/GDP ratio and the overall fiscal deficit/GDP ratio are almost identical with those of the Government of Jamaica. The main area of disagreement relates to the performance of GDP in 1986/87. The Mission's assumptions and proposals would lead to a contraction of 2.6 percent in GDP, while the program of the Government of Jamaica projects growth of 4.4 percent. The difference relates mainly to the fact that the assumed contraction of real consumption and exports completely neutralizes the Mission's projected growth in real investment during the year.

The macroeconomic framework of the Government of Jamaica's medium-term program recognizes the need for strong and sustainable growth in GDP as the only basis on which the stated medium-term objectives can be realized. It is recognized, however, that as a medium-term strategy, sustainable growth is possible only in the context of significant structural and macroeconomic policy shifts.

The necessary structural shifts were initiated in 1981, and there has been significant progress arising out of specific agricultural, fiscal, trade, and exchange rate policies. Further adjustments are envisaged in the area of trade policy, and a financial sector reform program is now under way, all under the auspices of successive structural adjustment programs with the World Bank.

With the objective of reducing inflation, removing distortions in the financial system, and eliminating interest rate discrimination against the private sector, the liquid assets ratio for both commercial banks and nonbank institutions were significantly reduced in May 1986 and will be further reduced by March 1987. These ratios will be completely phased out over a further two-year period.

The minimum savings deposits rate has been reduced from 20 percent to 16 percent with a further reduction to 15 percent targeted for August 1, 1986.

In the fiscal area, significant progress has been made toward reducing the scope of the public sector. The overall public sector deficit has been reduced from 19.4 percent of GDP in 1983/84 to 12.5 percent in 1985/86.

In the current fiscal year, further progress toward achieving the necessary structural shifts is proposed in the area of trade and fiscal policies. An interim adjustment of the existing tariff structure is to be implemented by March 1, 1987. The next phase, that of restructuring tariffs in collaboration with Jamaica's partners in the Caribbean Community will be addressed in 1987. In the fiscal area, the next phase of the ongoing tax reform program dealing with corporate tax reform and the general consumption tax will be implemented by March 1, 1987. The existing rebate system for exporters is to be revised shortly so as to enhance export profitability.

The Government of Jamaica's medium-term strategy is underpinned by a structural adjustment program supported by a consistent and flexible policy mix including the following:

1. A reduction in the scope of the Central Government in economic activity by reducing the public sector deficit/GDP ratio to 2 percent by 1988/89.

2. Money and credit policies consistent with objectives of self-sustaining growth and moderate inflation.

3. A flexible exchange rate policy aimed at maintaining the real exchange rate in 1986/87.

The direction outlined above is wholly compatible with the parameters presented by the Tripartite Mission. The main differences emanate from divergent assessments of 1986/87, which has relevance for the current discussions with Fund staff on the issue of overdue financial obligations and eventually with a view to concluding the 1986/87 program parameters. The difference arises also from the Mission's underassessment of some structural changes that have already been effected within the economy.

The ground that remains to be covered in order to reach agreement on a stand-by arrangement may be judged on the basis of the main areas of differences at present between the Government of Jamaica and Fund staff: exchange rate policy, aspects of the balance of payments, and the fiscal program.

On the issue of exchange rate policy, the Jamaican authorities, the Tripartite Mission, and the Fund agree on the need for a flexible exchange rate policy that will preserve the competitiveness of the country's exports. This is seen as necessary for the viability of the balance of payments. The present areas of disagreement relate to the implementation of exchange rate policy during the second half of 1986/87. The Fund advocates an up-front depreciation of the Jamaican dollar and maintenance of the real exchange rate thereafter. The Jamaican authorities have proposed that the present nominal exchange rate, given the policy mix that is in place, should be maintained until March 1987 with adjustments thereafter to maintain the real exchange rate. This is based on the view that given the excessive depreciation in the past, the maintenance of the present nominal rate together wtih complementary policies--such as the revised tax rebate scheme for exporters--will enable them to maintain their competitiveness up to March 1987. The dialogue is proceeding together with technical work to establish the extent of appreciation that took place during 1985/86 and whether in the context of other relevant factors there is need for any changes in the nominal rate prior to March 1987.

The Government of Jamaica contends that there is no financing gap in the balance of payments accounts for 1986/87 provided certain flows are firmly anchored. This conclusion derives from the assumptions that underpin the various elements of the balance of payments at this time. These assumptions are based on the Jamaican authorities' assessment of the economic program and strategies to be pursued during the current fiscal year. The Fund's technical staff is of the view that there is a financing gap in the balance of payments of about US$100 million after taking into account the Government of Jamaica's position on bauxite and oil.

A major area of difference between the two sides in relation to those estimates is the estimated level of private capital inflows during the year. Special programs have been identified by the Government of Jamaica, coupled with some balance of payments adjustment, that support private capital inflows of about US$100 million for the year. The Fund's judgment is that these inflows will not amount to more than US$50 million since they are directly related to the monetary and exchange rate policies being pursued. But based upon past trends and the Government's supporting evidence, it is expected that the agreed estimate will be closer to the Government's position.

Another area of difference is the projected improvement in the Bank of Jamaica's net foreign exchange resources. The Government's position is that US$131 million is a reasonable target while the Fund's target is US$165 million. Since the net reduction in gross liabilities of the Bank has been agreed, the difference relates to the buildup of gross assets. The Government's position implies negligible growth in these assets. The dialogue is continuing on this issue and it is expected that agreement will soon be reached.

Discussions with the IMF team on the fiscal accounts are continuing. The outstanding areas are

1. Some of the official capital inflows programmed by the Government, in relation to which reservations have been expressed by the staff.

2. The domestic financing available from the banking system. This point of discussion can be resolved only after agreement on exchange rate strategy has been reached and there is a determination of money supply growth during the fiscal year.

An overall assessment therefore suggests that the main obstacle to early agreement on a program is the exchange rate issue. The Government of Jamaica is of the view that a viable program can be built on the basis of its proposals on this issue. Such other difficulties as now exist can be speedily resolved. The Government has been implementing the program outlined, based on a nominal rate of exchange coming out of the current mix of policies of J$5.50 = US$1. The general economic climate has improved vastly since the beginning of the year. This is evidenced by the improved balance of payments position between January and June 1986. Improvements in other key economic indicators would suggest that the economy is responding positively to the policy initiatives. This response provides further vindication for the position of the Government.

It is hoped that these remarks, along with the program outline circulated to Executive Directors (EBS/86/165), will serve to make clear Jamaica's concern regarding the basic issue of overdue financial obligations to the Fund and the Government of Jamaica's position relating to its immediate and medium-term economic program.

Mr. Lankester commented that the situation, including the latest information on arrears, was disturbing, and the need for the present discussion was a great disappointment although not a surprise. In March (EBM/86/40, 3/3/86) the Executive Board had modified the stand-by arrangement with Jamaica on an ad hoc basis. He had expressed considerable reservations about the decision at that time but had been willing to go along with it because of the authorities' request and their promise that they would review their policies carefully in the light of the "new look" mission.

Unfortunately, the revised program had collapsed almost at once, and Jamaica had been in arrears since April 15, Mr. Lankester continued. Furthermore, Jamaica seemed to have decided to give particularly low priority to its obligations to the Fund. As of March 1986, the staff estimated that Jamaica's overdue obligations to the Fund comprised 55 percent of total external arrears. Unless there had been a dramatic change, that figure seemed to indicate that the authorities were far from giving the appropriate priority to repaying the Fund. The situation was particularly disappointing because the Board had made considerable efforts to help the authorities in their difficult political situation. He therefore urged them to make every effort to clear the arrears and to put in place more appropriate policies for sustainable growth as recommended by the new look mission.

Although he had read the program outline circulated by Mr. Brown with interest, he had not been entirely convinced by the arguments put forward, Mr. Lankester stated. In addition, he did not fully understand the figures presented in his statement, and in particular the assertion that if the World Bank loan had been made available, Jamaica would have been able to settle its arrears. He understood that the World Bank loan would be equivalent to less than US$50 million and that the first tranche would be considerably less than that figure, whereas the arrears to the Fund amounted to SDR 75 million. He asked the staff for clarification.

It was difficult to assess fully the authorities' policies in the absence of a detailed appraisal by the staff, Mr. Lankester remarked. In particular, he was not completely persuaded by their argument that more action on the exchange rate was not a prerequisite for achieving renewed growth. That question had been carefully considered by the new look mission, whose conclusions should form the basis for any future Fund programs. The Jamaican authorities were prepared to adjust the nominal exchange rate so as to maintain the current real rate of exchange; he did not consider that sufficient. A depreciation of the real exchange rate in Jamaica was required and would need to be a prerequisite for the stand-by arrangement to be rehabilitated.

He had two reservations about the draft decision, Mr. Lankester said. First, the Board should convey more forcefully its concern about the current situation, although he understood that the Chairman could do that in his communication to the authorities. Second, he had some reservations about allowing three months to elapse before the Board returned to the subject, particularly given the magnitude of the overdue obligations. Instead, he suggested that the subject be considered as soon as possible on the basis of a full report by the Article IV consultation mission, which should also cover the authorities' plans for clearing the arrears. He realized that there might be logistical problems and he was reluctant to add to the burden on the staff, but he asked the staff whether it would be possible to schedule the Article IV discussion within two months, or just before the Annual Meetings.

Mr. Suraisry noted that Mr. Brown had stated that the reason behind the buildup of arrears to the Fund was the delay in disbursement of the first tranche under the World Bank's structural adjustment loan because of understandings reached between the Jamaican authorities and the World Bank with respect to the Tripartite Mission. As that Mission consisted of the IMF, the World Bank, and the USAID, it seemed logical that those institutions would support the recommendations of the Mission. He asked Mr. Brown to comment.

Mr. Bertuch-Samuels said that he appreciated Mr. Brown's remarks regarding the importance his authorities attached to restoring and maintaining normal financial relations with the Fund, and he welcomed his announcement that arrangements had been made to clear the overdue obligations in the SDR Department. Nonetheless, it was regrettable that the present meeting had become necessary, particularly as only a few months following Board approval of the modified stand-by arrangement Jamaica had accumulated new arrears to the Fund, a number of performance criteria had been breached, and the program appeared to have again gone off track. It had been only with considerable reluctance that many Directors had agreed to the modification of the stand-by arrangement and that retroactive drawings had been approved with the expectation that by the end of March the program would be back on track. Moreover, it was the clear understanding of his chair that the situation had then been in a transitional stage and that the authorities had been committed to take a fresh look at the situation on the basis of the Tripartite Mission report.

He was therefore deeply concerned about the negative response of the Jamaican authorities to the comments in that report on the required scope and pace of adjustment, Mr. Bertuch-Samuels continued. Time had not allowed an in-depth evaluation of the authorities' quantified economic program, and he asked the staff for some preliminary assessment of these policies. It appeared, however, that the stipulated measures fell short of what was needed to correct the serious economic and financial imbalances in Jamaica's economy. For example, he was concerned about the proposed large spending increases in the budget for 1986/87. While the authorities expected to keep the deficit under control and still achieve the target of a 2-3 percent deficit/GDP ratio by 1988/89, he had serious doubts about the underlying optimistic assumption that the expected boost to economic growth would generate sufficient revenues to finance those increased outlays. Experience in other countries seemed to point in a different direction.

As pointed out by the Executive Board in March 1986, the maintenance of a highly overvalued exchange rate would seriously hamper the process of export diversification and structural change, and thus would have a negative effect on Jamaica's future growth prospects, Mr. Bertuch-Samuels noted.

In sum, while he did not question the intentions of the authorities, he continued to believe that the only solid basis on which Jamaica could embark on a sustainable growth path would be a comprehensive adjustment program that would rapidly eliminate the substantial macroeconomic imbalances while addressing the deep-seated structural problems, Mr. Bertuch-Samuels stated. The report and recommendations of the Tripartite Mission would constitute an appropriate framework for such a program, and he urged the authorities to come to an early agreement with the staffs of the Fund and the World Bank. To do so would restore the confidence on the part of the international community that was needed to provide Jamaica with the necessary financial assistance in the coming years.

With respect to the proposed decision, he supported the amendment put forward by Mr. Lankester, to convey more forcefully the Board's concern about the current situation--which could also be included in the Managing Director's communication to the member--and the suggestion to meet sooner than the three months stated--perhaps in two months--for a substantive further discussion of the matter, Mr. Bertuch-Samuels concluded.

Mr. Hospedales made the following statement:

I appreciate Mr. Brown's description in precise terms of the structural impediments to growth associated with the economic transformation process in one of the Fund's member countries.

The situation in Jamaica continues to pose major challenges for the authorities as they grapple with the severe external shocks that have had substantial adverse consequences for that country in recent years. It is imperative, therefore, in these circumstances, that Jamaica's overdue financial obligations to the Fund do not in any way interfere with the re-establishment of the conditions for sustained growth in Jamaica. I agree with the Jamaican authorities that a necessary prerequisite in this respect is a Fund program, the main elements of which are already contained in a brief for Executive Directors circulated by the Jamaican authorities (EBS/86/165). The Fund should facilitate the structuring of such a program, which would not only meet the legitimate requirements of Jamaica but could also command the support of international donors and creditors and lead ultimately to a resumption of normal financial relations with the international financial community. For these reasons, I support the proposed decision, which is in line with existing procedures for similarly placed countries at this stage of substantial consideration of overdue financial obligations.

Ms. Bush made the following statement:

We note the Jamaican authorities' deep regret over the emergence of arrears to the Fund; nonetheless, we believe that Jamaica has the capability, with some policy modifications, to remain current to the Fund. Jamaica's worsening arrears position is a matter of gravest concern to my authorities and to this Board. Jamaica has the highest level of Fund credit outstanding, in relation to its quota, and has been the most extreme example of prolonged use of Fund resources. These facts indicate the exceptional efforts that the Fund has made over the years to provide financial support and policy advice to the Jamaican authorities. It is in light of this support that we find the emergence and growth of Jamaica's arrears to be particularly disturbing, since it gives the impression that the Jamaican authorities do not place a high value on maintaining good relations with this institution.

To be more specific, in March 1986 the Board approved a review of Jamaica's stand-by arrangement that released two drawings on the basis of a policy program that the Board considered as temporary, given its reliance on an inappropriate fixed exchange rate and a rather austere fiscal and monetary policy stance. The clear conclusion that came out of that Board meeting was that we would agree to this temporary approach on the ground that a Tripartite Mission--composed of Fund, World Bank, and USAID officials--was preparing a report on the medium-term outlook for Jamaica, with the emphasis on restoring sustainable economic growth. That report was to form the basis of the policy program for the fiscal year beginning April 1986. Our understanding, from comments at this meeting, is that the Jamaican policy package now in place does not bear a substantial resemblance to that recommended by the Tripartite Mission. Medium-term goals may be the same, but it is clear that in the short run, there are many differences of view.

We therefore find it difficult to believe that these medium-term goals will be attained in the next few years if the policy package currently in place continues to be followed without implementation of the policy recommendations of the Tripartite Mission. In fact, the combination of a fixed exchange rate and an expansionary fiscal policy, as practiced in the present fiscal year, can only lead to the conclusion that the payments position probably will not improve as projected and domestic inflationary pressures could easily rise. This is clearly not a sustainable policy path, and, in fact, it will most likely lead to severe economic contraction in the future.

We can only conclude that it is incumbent upon the authorities to begin to implement the policies recommended by the recent Tripartite Mission. These policies place the emphasis on generating stronger export growth, which, along with basic structural change, could lead to stronger economic growth. In fact, we believe that had the Jamaican authorities been following a more realistic policy path, it would have been within Jamaica's capabilities to remain current with the Fund.

There are stark indications of the seriousness of this problem. The Board met in early March to conclude a review that received only marginal support. Just a few weeks later, end-March performance criteria were breached. Like Mr. Lankester, we have some difficulty with the view put forward that if the World Bank loan had materialized, arrears would not have emerged. Furthermore, arrears emerged on April 15, or shortly after the Board discussion, and no payments have been made since then. Finally, the authorities have implemented a policy package that gives little hope for a turnaround in the economic situation and for support of the package from the international community.

I can therefore readily support the suggestion that the Board return to this matter at an early date; perhaps a shortening of the review period is warranted. I hope that Mr. Brown will convey to his authorities our grave concern about both the arrears problem and the domestic policy package, which we do not believe will lead to the sustainable growth that his authorities are seeking.

Mr. Pérez observed that Mr. Brown had given a compelling description of the difficult economic situation of Jamaica and the factors that had contributed to the country's falling in arrears. For many years the Fund had been aware of the economic problems of Jamaica and had provided the country with continuous support, both through one of the highest levels of financing given to a member country in relation to its quota and through help in the catalytic effort to obtain additional funding from other sources, external aid, and debt relief.

It was unfortunate that in a country where the help of the Fund had been extraordinary, the result of that effort had been the emergence of an arrears problem, Mr. Pérez commented. He was encouraged by the Government's intention to cancel outstanding obligations in the SDR Department that day, although it would have been preferable to clear the arrears before that meeting. Also, the existence of arrears to the Fund would not be helpful in regaining the confidence of the institution and, above all, the support of the international community.

Member countries in arrears to the Fund were causing the institution serious financial difficulties that were reflected in the rate of charge for users of Fund resources, implying an additional burden for those countries that were already facing a difficult economic situation. Hence, he urged the authorities to clear arrears to the Fund as a matter of first priority and to put in place the policies recommended by the staff in order to lay the basis for external viability and growth.

With respect to the proposed decision, Mr. Pérez remarked that Jamaica had not made any payment before the substantive consideration by the Board, and the Government was giving neither a positive assurance of future payments nor a precise date for the clearance of arrears. In the circumstances, and taking into account the principle of equal treatment that governed the Board's decisions, he would prefer to shorten the period until the next review to two months and to include a clause that, unless Jamaica was current with the Fund on that date, a declaration of ineligibility was expected. Nevertheless, he could go along with the staff proposal, as amended by Mr Lankester, with the hope that Jamaica would take advantage of that period to agree with the staff on a program in order to clear arrears to the Fund.

Mr. Romuáldez noted that other speakers had indicated doubts about the comprehensiveness and durability of the adjustment efforts that Jamaica had been undertaking with the support of Fund resources. The policies that Jamaica had attempted to pursue had been characterized as ad hoc. Against that background, it was not surprising, although regrettable, that Jamaica had run into the present difficulties. Apart from the problem of arrears, those difficulties included the fact that a number of performance criteria under the arrangement with the Fund--pertaining to reserves, arrears, net domestic assets, and monetary base indicative limits--had been breached. It also appeared that Jamaica had not been able to embrace the recommendations of the Tripartite Mission, the staff having indicated that Jamaica had questioned the pace of adjustment recommended by that Mission. Recent measures included in the 1986/87 budget--a doubling of central government capital outlays and a rollback of domestic electricity tariffs and food prices--appeared to have gone in the opposite direction from that recommended, although the staff had also noted that there would be a significant windfall to the budget as a result of petroleum and commercial electricity tariffs being maintained notwithstanding the fall in oil prices.

He strongly urged the authorities to undertake adjustment in less gradualist fashion, Mr. Romuáldez stated. In particular, he stressed the importance of exchange rate action as proposed by the Tripartite Mission and as advocated by his chair during the discussion of March 1986.

Some Executive Directors considered that a more effective way of coping with the problem of arrears would be to make a declaration of ineligibility virtually automatic when a member's arrears were considered substantively for the first time--at the three-month point, Mr. Romuáldez said. Although the case of Jamaica was not the occasion to consider that issue, it should be discussed when a review of the Fund's existing practices was undertaken.

While he supported the proposed decision, he could go along with the amendments suggested by Mr. Lankester, Mr. Romuáldez concluded.

Mr. Parmena stated that in view of the ongoing exchange of views between all parties involved, including the Fund mission, and in line with existing review procedures, he supported the proposed decision to review the case of Jamaica in three months' time.

Mr. Hospedales asked the staff what the experience had been in other cases at the present stage of substantive consideration with respect to the time given for the review.

The staff representative from the Western Hemisphere Department commented that Mr. Brown had made the point that the Tripartite Mission's projections for 1986/87 would lead to a reduction in GDP of 2.6 percent. That conclusion depended very much on the mix chosen between public and private expenditure and between investment and consumption. The staff had a number of difficulties with the specifications of the model used by the Bank of Jamaica to reach that conclusion, and he pointed out that the Tripartite Mission, based on its own assumptions, had projected a growth of between 1 percent and 2 percent in real GDP.

With respect to arrears, the staff mission had not received the latest actual figures from the Government, but the staff estimated that total arrears currently amounted to about US$120 million, of which about US$90 million was to the Fund, the staff representative said.

The World Bank loan that had been mentioned was actually two related structural adjustment loans that would total between US$50 million and US$60 million and would be disbursed in two tranches--both, it was hoped, during the current Jamaican fiscal year, the staff representative reported. The first tranche would amount to about US$30 million and would not be disbursed by August. The conclusion of the arrangements with the Bank depended upon both an agreement on the macroeconomic framework, on which discussions were continuing, and on the resolution of a number of issues related to the loans and their conditionality. Some problems seemed to have arisen--particularly in the area of tariff reform--that might take time to resolve.

The staff would do its best to meet the short timetable called for by scheduling an Article IV consultation discussion in the Board within two months, or before the Annual Meetings, the staff representative remarked. The scheduling would depend to some extent on the duration of the discussions under way.

While the staff's views on the Jamaican program were still preliminary, its main concerns related to the feasibility of the Government's balance of payments targets for 1986/87 and subsequent years and the consistency of exchange rate and demand management policies in the short and medium term, the staff representative commented. In particular, the staff's review of the balance of payments suggested a weaker current account position than estimated by the authorities. Major questions existed on both official capital flows and private short-term capital flows; an important element of short-term capital flows was trade credits of the state oil company. With the fall in oil prices, the value of the stock of oil credits was likely also to decline. There was no assurance that official capital inflows could be kept at the level of the preceding year. A further round of consultations with donors might be necessary to ascertain that point; otherwise, the gaps could be large. At present, even if official assistance were maintained, the gap could be about US$150 million, with similar gaps foreseen for the following fiscal year, implying that the adjustment of the current account would need to be faster than targeted at present. In particular, a lower level of imports than the 17 percent increase currently envisaged by the authorities would have to be targeted.

With respect to macroeconomic policies, the staff's main concerns were related to exchange rate policy and its consistency with other policies, and to the size of the necessary reduction in the fiscal deficit, the staff representative continued. Since the shift in exchange rate policy in October 1985, the real exchange rate of the Jamaica dollar had appreciated by about 15 percent from the low point in October and by about 7-10 percent compared with the average of the period April-October 1985 under the floating rate system; thus, some of the gains in competitiveness during the previous two years under earlier adjustment programs had been reversed. The current policy of maintaining the exchange rate of J$5.50 = US$1 through the end of the fiscal year would involve a further real appreciation of the exchange rate. Unfortunately, not only would competitiveness be lost but the progress of adjustment efforts made earlier would tend to be undermined. Meanwhile, the Government's program called for an expansion of the money supply by 19 percent, and wages continued to rise at a rate of 15 percent a year or more; even with a fixed exchange rate policy, inflationary pressures were likely to increase, while fiscal policy would need to be tighter than currently envisaged by the authorities.

Although the impact of the decline in international oil prices was substantial--about 4 percent of GDP--and would permit some reduction in the overall public sector deficit and the requirement for official capital inflows, the need to improve reserves and to avoid crowding out the private sector seemed to indicate that the overall public sector deficit would need to be about 6-7 percent of GDP compared with 9-10 percent of GDP projected by the authorities, the staff representative stated.

The planned structural reform covered a number of areas, including exchange controls, deregulation of the financial system, and tax and tariff reforms, the staff representative said, and the discussions were taking place with World Bank participation in many of those areas. He was particularly concerned that the reform of the tariff system as currently envisaged might not go far enough to remove existing distortions and that the timetable for implementation of those reforms might slip.

The postponement of the World Bank's disbursement of US$40 million, resulting from delays in reaching agreement on the loan's policy content, had affected Jamaica's cash flow, the staff representative from the

Western Hemisphere Department remarked. It was clear that the shortfall as a result of the World Bank's delay in disbursement had complicated the task of cash management; technically, there would have been a sufficient margin in the ceilings on foreign borrowing to allow the performance criteria under the stand-by arrangement to have been observed, if the loan had been disbursed. Nevertheless, even if the World Bank has disbursed in March, no drawings could have taken place under the program because of the absence of agreement on performance criteria for the remainder of the program period. Agreement on those parameters before March 31, 1986 was also a requirement of the arrangement.

The Deputy Treasurer commented that in terms of precedents and standardization of the decisions on overdue obligations, it would be preferable for the Board's concern about the current situation to be conveyed to the Jamaican authorities in a communication from the Managing Director. As to the reduction of the review period, there was no precedent for a shortening from three months to two months; the decision, in both its structure and timing, was identical with all decisions taken at the present stage of consideration of a complaint under Rule K-1. In reply to a question, he added that there had been cases where there had been no payment made by the country before the first substantive examination. However, on May 20 Jamaica had paid SDR 700,000 with respect to a repurchase due April 15.

Mr. Sengupta observed that in light of the staff's explanations and of the anxieties shared by members of the Board, perhaps the timing need not be reduced from three to two months and the decision could be retained as proposed.

Mr. Lankester considered that the situation was sufficiently serious and urgent from the Fund's point of view for the review to be scheduled earlier than three months ahead, especially as the staff had said that that might be possible.

Mr. Suraisry commented that he regretted the buildup in arrears to the Fund and the lack of understanding between the Jamaican authorities and the Fund, which had been supportive of the economic adjustment in Jamaica. Maintaining good relations with the Fund was of paramount importance, particularly at a time when the country was facing mounting economic and financial problems.

During the discussion in March 1986, many Executive Directors had supported the proposed decision with great reluctance, Mr. Suraisry recalled. Indeed, the decision had been supported with the hope that the authorities would be able to implement the recommendations of the Tripartite Mission. He therefore regretted the authorities' reluctance to implement those recommendations.

Reaching an understanding between the authorities and the Fund and World Bank was essential if Jamaica was to regain the confidence of the international community and, consequently, to put its economy on a sustainable growth path, Mr. Suraisry observed. For that purpose, the authorities should settle their arrears to the Fund promptly; if not those arrears would reach SDR 179 million by 1987. The experience of other countries in arrears to the Fund provided a valuable lesson in that regard. As the authorities were aware, the Board attached great importance to the prompt settlement of overdue obligations. The authorities should act to avoid the complications that would arise from the need to take further action on Jamaica's overdue financial obligations to the Fund.

Mr. Fugmann said that he shared the views of other Directors, in particular those put forward by Mr. Pérez. He supported the proposed decision as amended by Mr. Lankester.

Mr. Massé, speaking on behalf of his constituency, said that there was insufficient justification for constraining the time schedule for a review and for setting a precedent in the case under discussion. The staff had expressed the view that if the World Bank loan had been disbursed by the end of March, the Jamaican authorities would probably have been able to observe the quantitative performance criteria included in the stand-by arrangement. In addition, Mr. Brown had stated that a number of differences of view existed between the Jamaican authorities and the staff that, in a number of cases, were extremely difficult to resolve. They related, in particular, to the import and export elasticities, which were acceptable areas of disagreement. To solve those questions, and to permit full consideration of the program submitted by the Jamaican authorities, the staff had stated that it might need more than two months. From the point of view of the Jamaican authorities the period should not be less than three months.

From a pragmatic point of view, a longer time frame might be needed, Mr. Massé remarked. His first preference was to have the decision stand as drafted, referring to a three-month period; otherwise the decision should refer to a period of "three months or less." Proper negotiations between the Jamaican authorities and the staff might well take more than two months and should not be rushed.

Mr. Wijnholds remarked that his chair had always taken the position that a certain amount of flexibility should be applied to the review procedures. Previous suggestions to stipulate a two-month, rather than three-month, period for the first review had never been accepted although the case of Peru showed that the procedure could be tailored to the individual country. In the light of comments by other speakers and the disappointment of his chair about the Jamaican situation, he supported the proposed decision as amended by Mr. Lankester.

The Deputy Treasurer, replying to questions raised by Mr. Pérez and Ms. Bush, explained that the first substantive discussion in the case of Peru had not resulted in a timing precedent but had resulted in a change of procedure by eliminating the second review altogether and including a decision citing a possible declaration of ineligiblity after two months.

Mr. Pérez observed that the decision adopted following the substantive consideration of Peru's overdue obligations had provided for a shortening of the period of consideration and for an expectation of a declaration of ineligibility. Therefore two precedents had been set: He believed that the majority of the Board preferred to shorten the period for review with the expectation that Jamaica would reach an agreement with the Fund and the World Bank that would allow it to clear arrears as soon as possible. The question of precedent was important because, while he did not oppose the shortening of the time period, the principle of equal treatment should be retained.

The Chairman recalled that in the case of Peru, the Board had considered that there was sufficient indication that it should reconsider the situation at an early stage. The Board would have to decide whether it wanted to apply that precedent to the present case.

Mrs. Ploix remarked that she shared the views expressed by other Executive Directors but, in light of Mr. Massé's comments and the fact that the Article IV consultation might not be scheduled for Board discussion within two months, she supported the three-month time period for review of the decision.

Mr. Sugita said that he supported Mr. Lankester's proposal to shorten the period to two months. Flexibility was necessary in dealing with the problem of arrears; in the present case the amount involved was serious, and an early resolution of the matter was imperative. In addition, the differences in views between the staff and the Jamaican authorities were clear and could be dealt with during the consultation discussions.

Ms. Bush stated that on balance, she could support Mr. Lankester's suggestion of shortening the period for review to two months. She understood that the Article IV consultation process had begun. In addition, the payments that would fall due during the remainder of the year were cause for worry. It would be in the interests of the authorities and the Fund and World Bank if the momentum provided by the present frank and informative discussion were to lead to an early agreement and clearing of the arrears.

Mr. Ismael said that he supported Mr. Massé's position.

Mr. Fugmann remarked that it was important that the next review should coincide with the Article IV consultation discussion.

The Chairman observed that the scheduling would depend not only on the staff's work load but on the pace of the ongoing negotiations with the Jamaican authorities.

Mr. Brown commented that the procedures relating to the US$40 million disbursement from the World Bank would not be completed by the end of August 1986. However, the understandings agreed with the Bank had been that at a certain stage, interim arrangements could be put in place; the

Jamaican authorities were proceeding on that basis. Another element was critical at the present stage: the use of Fund resources, including a drawing under the compensatory financing facility that was currently being discussed. The authorities were quite certain that, provided discussions with the World Bank proceeded according to expectations and that the other flows expected through the end of August materialized, Jamaica would be in a position to become current with the Fund at that time.

With respect to the difference beween the Fund staff mission and the authorities on the critical question of growth in the short term, the authorities had confidence in their assessment inasmuch as they considered that the mission had forecast a contraction--significant in some cases--of all the elements of aggregate demand in 1986/87, including exports, consumption, and investment in real terms, Mr. Brown continued. In that situation, whatever model was used, growth could only be negative.

There were no indications at present of any disagreement between the Tripartite Mission's basic recommendations and conclusions and the three agencies involved, Mr. Brown noted. The Government of Jamaica was fairly close to the Mission's position, certainly for the medium-term macroeconomic parameters and even for the majority of the parameters for fiscal year 1986/87. The differences mentioned by the staff would be settled during the course of the consultations. At present, their respective assessments of certain critical numbers differed. Two basic yardsticks could be used to measure the viability of the program. First, the current account of the balance of payments had turned around significantly. Second, there was no longer a parallel foreign exchange market, and the exchange rate was a viable one.

The proposed program and its implementation had been tested on a normal basis, Mr. Brown stated. The consistency of any program could be judged according to the monetary accounts, and the Jamaican Government's budget for 1986/87 was consistent with the bottom line numbers within those accounts. Therefore, it was premature to draw any conclusion about the inconsistency of the 1986/87 program, as further discussions with the staff mission would show.

The Chairman said that a majority of Executive Directors was clearly in favor of a review in two months' time, but it was still unclear whether Board consideration should be linked to the discussion of the Article IV consultation even if it could not be scheduled within two months.

Mr. Lankester commented that it was important to have the Article IV consultation discussion at the same time as the review, although if for some reason there were delays, the review, which he hoped would take place in two months, could be put back by one or two weeks.

Mr. Obame said that he would prefer the decision as drafted.

The Chairman stated that the decision would be formulated to indicate that the majority of Executive Directors favored a review at the same time as the 1986 Article IV consultation, within a period of two months if possible. In his communication to the authorities, he would make it clear that there had been expressions of dissatisfaction and regret about the buildup of arrears by Jamaica. The Fund had been very supportive of Jamaica's adjustment efforts over a long period of time, and concern had been expressed that perhaps the authorities were not giving the high priority to Jamaica's relations with the Fund that the institution had given to supporting Jamaica. If that were the case, it would indicate the emergence of a grave situation in respect of Jamaica's relationship with the institution. The priority that must be accorded to clearing and regularizing Jamaica's position vis-à-vis the Fund should be demonstrated not only in words but in immediate action; further delays would only compound a difficult situation. Jamaica, with its large use of Fund resources in terms of its quota, confronted large monthly repurchase obligations. Delays that would allow further arrears to accumulate must be avoided. Early action that would eventually lead to agreement on a program would require some flexibility on the part of the Jamaican authorities, who had developed a medium-term program that they were convinced was workable; they must now convince the staff and the Board.

Executive Directors had stated that greater flexibility on matters pertaining to the exchange rate was called for, but without taking a dogmatic view, the Chairman continued. The staff mission would discuss that matter, as well as other elements of the program, with the authorities. Agreement would have to be reached on fiscal action to close impending gaps.

Understandings could be reached if an openness of minds existed on both sides, the Chairman concluded, and he urged the authorities to be flexible with respect to their program. The Article IV consultation discussions would be instrumental in paving the way to agreement on policies that could be supported by the Fund at a later stage and could consequently unlock other necessary financing elements.

Ms. Bush commented that in the circumstances, a two-month period that included some leeway for completing the Article IV consultation was appropriate. However, it should be made clear that the review would take place within three months, irrespective of the scheduling of the Article IV consultation discussion.

The Executive Board then took the following decision:

1. The Managing Director has reported to the Executive Board, under Rule K-1 and Rule S-1 of the Fund's Rules and Regulations, the facts on the basis of which it appeared to him at the dates of these reports that Jamaica was not fulfilling

its obligations under the Articles of Agreement, and submitted complaints on June 20, 1986 (EBS/86/134) in accordance with those Rules. The complaint under Rule K-1 was that as of June 20, 1986, Jamaica was not fulfilling its obligations relating to repurchases and the payment of charges in the General Department in the total amount of SDR 34,702,701. The complaint under Rule S-1 was that as of June 20, 1986, Jamaica was not fulfilling its obligations to pay charges in the SDR Department in the total amount of SDR 581,148. These facts and the complaints of the Managing Director were communicated to the authorities of Jamaica on June 25, 1986.

2. Taking into account that further obligations of Jamaica have become overdue since June 20, 1986, Jamaica's overdue obligations to the Fund now total SDR 74,729,824 in the General Department and SDR 581,148 in the SDR Department.

3. Having considered the report of the Managing Director, the complaint under Rule K-1, and the views of Jamaica, the Fund finds that Jamaica has failed to fulfill its obligations in the General Department under the Articles of Agreement as stated in paragraphs 1 and 2 above.

4. The Fund regrets the nonobservance by Jamaica of its obligations and urges Jamaica to resume their observance forthwith. The Fund decides:

(a) pursuant to Rule K-2 of the Fund's Rules and Regulations that Jamaica shall not make use of the general resources of the Fund until such time as Jamaica has become current in its obligations under the Articles of Agreement relating to repurchases and the payment of charges in the General Department, and

(b) pursuant to Article XXIII, Section 2(b) of the Articles of Agreement, to suspend the right of Jamaica to use SDRs it acquires after the suspension until such time as Jamaica has become current in its obligations to which that provision applies.

5. The Fund shall review this decision within a period of two months from the date of the decision or at the same time as the 1986 Article IV consultation but in any event not later than three months from the date of this decision.

Decision No. 8345-(86/121) G/S, adopted
July 25, 1986

3. IRELAND - 1986 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1986 Article IV consultation with Ireland (SM/86/163, 7/3/86; and Cor. 1, 7/11/86). They also had before them a report on recent economic developments in Ireland (SM/86/166, 7/9/86; and Cor. 1, 7/21/86).

The staff representative from the European Department noted that in Table 30 in the report on recent economic developments net capital flows should be plus 759.

Mr. Leonard made the following statement:

> Ireland's economic performance since the Article IV consultation in June 1985 continued to be constrained by significant external debt-servicing costs and further close containment of public spending. Bad weather lowered agricultural output, and, in face of the slowdown in world trade, both industrial output and exports in 1985 were less buoyant than in 1984. Despite the dampening effect of these factors, the underlying vigor of the economy was also in evidence. Manufacturing growth, after reaching a low point in the second half of 1985, has since recovered and the volume of manufacturing output is now expected to increase by 5 percent in 1986 as against 1985's 2 3/4 percent. Private sector services maintained a growth rate of 1 1/2 percent through 1985 and are expected to show a much stronger performance in 1986. Moreover, in spite of some loss of buoyancy, exports in 1985 continued to enlarge their market share, and present indications are that they will at least maintain their position this year. Overall, the growth of GDP in 1985 was a positive 2.1 percent and the forecast figure for 1986 is 3 1/2 percent.
>
> There was further progress on the external account; foreign trade moved from a negative to a positive balance (the first since 1944) and the deficit on current account fell to 3.6 percent of GDP.
>
> The average annual rate of increase in the consumer price index fell from 8.6 percent in 1984 to 5.4 percent in 1985; by May of this year the rate had fallen to 4.4 percent and the average for the year is expected to be 3 percent or so.
>
> As I indicated in the Executive Board discussion of September 1985, the Government in seeking a return to fiscal balance is endeavoring to avoid, on the one hand, deflationary effects that would weaken the vitality of the economy and lower employment and, on the other, failure to narrow the current budget deficit and reduce the Exchequer and total public sector borrowing requirements. Within the narrow compass of these limits, the Government, recognizing the necessarily deflationary overall stance of fiscal policy and the pressing need to promote

employment, is also endeavoring to enhance economic incentives through changes in direct taxation, to stimulate enterprise, raise economic efficiency, and safeguard social cohesion.

So far, fiscal performance, while moving toward the goals of the Government's National Plan, has fallen short of its specific targets. Thus, the current budget deficit envisaged for 1986 is 7.4 percent of GNP compared with the planned figure of 6 1/4 percent and those for the Exchequer borrowing requirement and the public sector borrowing requirement are 14 percent and 11.8 percent compared with 13 1/4 percent and 11 1/4 percent in the Plan. The wider deficit in the current budget has resulted mainly from higher unemployment and the consequent increase in welfare payments; to a lesser extent higher spending on pay has also been a factor.

The budgetary aggregates do not, of themselves, fully show the extent to which in recent years the fiscal stance has been tightened by discretionary action. Thus, while current revenue and expenditure have broadly maintained their shares of GNP since 1983, the share of expenditure on supply services has fallen from over 37 percent of GDP to 34 percent. In the same period capital expenditure fell by over 3 percentage points of GDP also, contributing to a severe contraction in investment in building and construction. On the taxation side, fiscal drag and direct taxation changes in 1983 and 1984 caused average nonagricultural earnings, which were roughly static in real terms, to fall, posttax, by about 5 1/2 percent, following a fall of the same order in 1982. Since then, the fall in real earnings has been alleviated by tax reliefs and the value of such earnings in 1985 is estimated as being about 1 percent higher than in the previous year and should be somewhat higher again in 1986.

The ratio of external public debt to GNP fell slightly in 1985 to 67 percent; the debt service ratio also fell from about 18 percent to 15 percent and is expected to fall further to 13 percent in 1986. The thrust of fiscal retrenchment as outlined in the National Plan remains an essential objective of government policy. In financing fiscal deficits arising in future, the authorities will continue to avail of Ireland's favorable access to international markets insofar as they consider that appropriate. The extent of such recourse is likely to lessen, however, as continued strengthening of the external account, which is now achievable, should allow greater use of domestic sources of funds.

Liquidity conditions were comfortable in 1985, apart from the pressures created by speculative outflows toward the end of the year, which continued into the first quarter of 1986 but which have since turned around. Private sector credit grew by less than half the indicative guideline for the year set by the Central Bank, and, in large measure as a result of a fall in nonmonetary financing of the Exchequer borrowing requirement, there was a marked slowing down in the rate of domestic credit expansion. Real interest rates showed a generally falling trend and came into closer convergence with rates in other industrial countries.

Monetary conditions remain comfortable this year. In pursuing their aims of maintaining the external value of the Irish pound and ensuring that external reserves are maintained at an adequate level, the monetary authorities have not found it necessary to issue a formal guideline for bank lending to the private sector. Banks are, however, being encouraged to give preference to lending for productive purposes in providing accommodation to the personal sector. Interest rates are tending further downward and an increase in official external reserves over the year as a whole is envisaged. Prior to the European Monetary System realignment, the authorities successfully contained speculative pressure on the Irish pound and in the realignment itself maintained the position of the Irish unit in the system.

Following deregulation measures in the banking area taken in May 1985, no major new initiatives have been put in train this year although the desirability of further deregulation of certain activities is being examined.

Cumulative trade figures to end-May 1986 show that the volume of imports has fallen by 3 3/4 percent compared with the corresponding period of 1985. The growth in imports for the year is now expected to be less than that of exports, contrary to earlier expectations. The balance of trade, already positive, will rise significantly and the current deficit is forecast to fall to a little more than 1 percent of GDP. The Irish authorities, while welcoming the improvement, remain vigilant as to the progress of the external account. In present circumstances, they see strengthening the current account balance, mainly through export expansion, as the key to better overall economic performance and, together with further narrowing of the fiscal deficit, as the means of reducing the burden of external debt and the consequent drain on domestic resources.

Competitiveness is accepted as a primary consideration in the pursuit of the balance of payments objectives and is being sought through action on a broad front as described in the staff papers. The Irish authorities generally share the staff position on the competitiveness issue. Particular attention is accordingly being given to pay costs relative to those in competitor countries and considerable moderation has been achieved in both absolute and relative pay increases. There are also good grounds for believing that Ireland's position should improve further in 1987 on the basis of pay moderation and of trends in price rises, "normalized" productivity in manufacturing, and the working out in the economies of trading partners of recent exchange rate movements in their currencies.

The Irish authorities do not envisage using changes in the exchange rate for the purpose of promoting price competitiveness.

The Government has yet to indicate its medium-term intentions for the management of the economy in the years after 1987. At the official level, the staff's base illustrative scenario for medium-term external debt is regarded as useful in identifying issues that will have to be addressed, on the basis of the underlying assumptions, and the recommendations arising out of them are seen as to the point. As regards the alternative scenario, it is considered that the downside risks on the balance of payments are overstated.

The Irish authorities are happy to continue to work with the Fund in its surveillance activities. They would prefer, however, that the consultation cycle be extended, primarily to reduce the demands made by the consultations on limited staff resources on the Irish side. In that connection, I have mentioned to my authorities the suggestions recently circulated among Executive Directors that some member countries might be put on a cycle of full and limited consultations every second year. These ideas may, I understand, be brought forward shortly for informal discussion by Executive Directors. My authorities consider that the question of an extended consultation period for Ireland might suitably be looked at in the context of these discussions. I would ask, therefore, that the question of the timing of the next Article IV consultation with Ireland be left aside temporarily pending the discussions and any formal proposal that may be put to the Executive Board as a result.

Mr. Grosche made the following statement:

The staff report gives a sober and accurate account of the difficult economic problems Ireland continues to face. The authorities seemed not to have made full use of the improvement in internal and external economic conditions, marked by a reduction in inflation, interest rates, and energy prices. They have not achieved much progress in correcting Ireland's financial imbalances, which have been the subject of many of our previous discussions on Ireland. The Board's comments and recommendations offered during last year's Article IV consultation discussion (EBM/85/135, 9/10/85) have lost none of their validity.

The staff makes it very clear that the goals set forth in the Government's National Plan can only be considered the minimum of what is required and that every effort needs to be made to step up the pace of economic reform in the coming years. This is particularly important as a mere continuation of present policies is likely to fall short of achieving the fiscal objectives of the National Plan.

The need for bolder steps is illustrated dramatically by the alarming increase in public indebtedness, which is the highest among EC countries. The interest payments on external debt alone have doubled within just a few years to some 5 percent of GNP. I can therefore only repeat what was said by Directors last year, namely, that the authorities should give the highest priority to a rapid reduction of the large fiscal deficit. This view is apparently shared by the Central Bank of Ireland, which warns that the unexpectedly favorable external circumstances--stemming from the drop in oil prices and the decline of the U.S. dollar--cannot be taken for granted for a longer period of time. Therefore, I fully agree with the staff's assessment that by taking advantage of the present favorable conditions and stepping up the pace of fiscal adjustment the Government could minimize the longer-term costs in terms of output and employment. The Central Bank's recent Annual Report stated that "no strategy other than resolute corrective action has any validity."

The large imbalances in public finance can by and large be traced back to excessive spending, in particular on the wage bill and on social benefits. The expenditure overhang is so large that despite the increase in tax revenues, the deficit could not be brought under control. In fact, additional taxes offer no solution as the increase in personal taxation has already led to a weakening of incentives with negative effects for economic activity. The authorities rightly decided that a lowering of the tax burden was called for and that the brunt of the adjustment had to be borne by current expenditures.

Against this background, it is disappointing that the Government was unable to cut expenditures when it would have seemed possible. This is particularly the case with respect to the recent wage settlement. Given the fact that the wage bill takes up approximately 40 percent of total expenditures, it is even more important to show determination and restraint in future wage rounds.

Similar considerations also apply to private sector wages, especially as the unexpected sharp decline in the rate of inflation resulted in a substantial increase in real wages and rendered the settlements in the private sector more generous than intended. A moderation in wage increases would seem particularly important because of the openness of the Irish economy. A noticeable reduction of unemployment can only be secured if Ireland maintains an appropriate level of competitiveness vis-à-vis its major trading partners.

While the improvement in Ireland's balance of payments over the past years was welcome, I share the staff's view that the current account remains vulnerable. Therefore, the authorities need to place continued emphasis on strengthening the country's external competitiveness not only through wage moderation but also through improvement of supply-side conditions. I share the authorities' view that external competitiveness within the European Monetary System needs to be secured through domestic adjustment and stabilization rather than through an active exchange rate policy.

In this connection, the authorities' efforts to strengthen the domestic productive sectors through tax reform measures and a reorientation of industrial policy, including the promotion of foreign direct investment, are commendable. Nevertheless, I would urge them to seek more rapid progress in eliminating existing distortions in the economy, particularly in the labor markets. Such structural policies--which would of necessity have to include a thorough review of the very generous social welfare system--would also lay the basis for a significant reduction in the alarmingly high unemployment rate.

In sum, the Irish authorities are basically aiming in the right direction, but they should increase the number of steps they are taking. Since no fundamental changes in policies are to be expected, I can go along with Mr. Leonard's ideas on the consultation cycle.

Mr. Templeman made the following statement:

Since our last review of the Irish economy some progress has been made in areas such as the recovery of gross fixed investment, further declines in the inflation rate, and a drop in the current account deficit of the balance of payments. Also, the situation with regard to a number of policies about which the Board expressed some concern last year has improved, for example, the need for reductions in the ratios of spending and taxation to GNP, the maintenance of Ireland's international competitiveness, and a deceleration in the rate of growth of wages. However, progress in these policy areas has been quite modest, and, more important, the serious structural problems in the fiscal accounts and in labor markets have not been addressed in a very vigorous fashion.

With regard to real economic growth, there are some favorable developments worth mentioning. The growth of GNP in the three years 1984-86 appears to be fairly satisfactory. And this year, for the first time in the past five years, there would be a perceptible increase in total domestic demand, meaning that growth would be less export-dependent at a time when current account adjustment among industrial countries calls for such a shift in a number of countries' growth patterns. Real gross fixed investment rose last year after three years of decline, and investment in machinery and equipment of 8 percent last year and 6 percent this year would be encouraging signs. In fact, there has been an impressive strengthening of the gross national savings ratio, despite the continuation of negative savings by the Central Government in the 7-8 percent of GNP range over the past four years. The good performance of private savings and some strengthening of the fiscal position outside the Central Government have contributed to this outcome.

Regrettably, the employment situation has not shown much sign of improvement, although the worst may now be nearly over, with a possible rise of 3/4 percent in employment this year and a stabilization in the unemployment rate at a very high 17 1/2 percent level this year and next. We would welcome some comment by the staff on labor market rigidities. The recent fiscal incentives to research and new product development, the use of industrial policy--including grants for employment, technology, and marketing--and the creation this year of the new National Development Corporation may make some contribution to employment growth. But we continue to believe that productivity growth and across-the-board restraint of wages and social benefits offer the best prospects for maintaining Ireland's international competitive position.

In assessing the country's international competitiveness, the staff report points out the contrast between the recent decline in relative unit labor costs adjusted for exchange rate changes and the flat pattern of relative hourly earnings in manufacturing. Given the importance in reducing relative unit labor costs of one-time labor shedding, some question about Ireland's competitive position seems merited. Still, export performance has been good and the unusual appearance of a trade surplus last year and the sharp drop in the ratio of the current account deficit to GNP between 1981 and 1985 are encouraging evidence of an improved external position. However, continued domestic price and cost restraint is still called for, taking into account the fortuitous improvement this year in the terms of trade, and bearing in mind the 67 percent external public debt ratio at the end of 1985. Also, we would caution against a complete set-aside of the exchange rate tool.

Furthermore, both the baseline and alternative medium-term debt scenarios continue to show a rather high debt ratio. The less favorable alternative scenario, which assumes no gain in export market shares and a higher import elasticity, also flags a potential problem with regard to the ratio of the current account deficit to GNP by 1991, when the ratio could rise to about 6 percent of GNP. We note, however, Mr. Leonard's belief that the risks concerning the balance of payments may be overstated. We commend the recent prudent efforts of the authorities to restructure the maturity of foreign debt and their intended caution in future foreign borrowing for deficit financing.

Maintenance of a sustainable external position in coming years will depend importantly on both wage and price moderation and on a stronger fiscal position. Ireland has made good progress in bringing down inflation from over 20 percent in 1981 to an anticipated rise of only 3 percent in the consumer price index this year, placing the country pretty much in line with its trading partners. Wage rate policy remains a cause for some concern, and in particular it may be necessary to draw the line more firmly against large wage increases in the public sector.

The key problem area is the continued very large fiscal imbalances of the Central Government and the public sector as a whole. I must say that performance has been generally disappointing. The borrowing requirements of the Exchequer and of the public sector last year exceeded those for 1984; the budgeted reductions in these deficits for 1986 would be modest and would be less than in the National Plan; the 1987 Plan targets have been scaled down and the less ambitious targets may not be met; and the outlook beyond 1987 for a further decrease in the fiscal deficits seems quite uncertain. While we recognize the difficulties of fiscal adjustment, recent actions with regard to public wages and social benefits in particular raise questions about the determination and the ability of the authorities to deal with the problem. Also, like the staff, we are not persuaded by any "dilemma" between a reduction in the fiscal deficit and its possible deflationary impact, especially over the medium term.

In fact, the medium-term outlook for reducing the fiscal imbalance does not look very promising. No progress was made last year in reducing the Exchequer borrowing requirement, and the public sector borrowing requirement was cut by less than 3/4 percent of GNP. This year there would only be a decline of 1 percent and 1 1/2 percent of GNP in the two deficit ratios. In contrast, in order to meet the 1987 Plan targets, the two deficits would have to be cut by 2 percent and 3 percent, respectively, which would be particularly hard during an election year. Even if the 1987 targets were met, the Exchequer borrowing requirement and public sector borrowing requirement ratios would still be 9 3/4 percent and 11 1/4 percent of GNP, respectively--very high by international standards--and central government dissavings would still amount to 5 percent of GNP. With a ratio of government spending to GNP of 58 percent and a revenue ratio of 46 percent in 1986, it seems clear that expenditure control needs to receive top priority. Current expenditures for the wage bill, social benefits--which have been growing faster than the income of the working population--and subsidies need special attention. We also think that attention needs to be given to all parts of the public sector, including the losses of the commercial public enterprises.

We support the staff's emphasis on a new medium-term approach to structural problems in the fiscal area, regarding both spending and the tax system. Some progress has been made in tax reform through reductions in the maximum marginal personal income tax rate, a broadening of the tax base, simplification of tax rates, and efforts at better tax compliance. But a maximum marginal personal income tax rate of 58 percent does not seem consistent with incentives to work and save, and there may be other tax areas that need attention if the tax burden is to be reduced.

Progress since our last consultation has been rather modest, and the economic outlook over the medium term remains clouded by the fiscal and labor market situation. We urge the authorities to focus particularly on medium-term plans for addressing more firmly both of these issues.

Finally, I can go along with Mr. Leonard's suggestion that we leave open the question of a possible change in the consultation cycle until the Board had discussed this matter in a more general way.

Mr. Fugmann made the following statement:

From the general point of view of Fund surveillance, the staff report on Ireland constitutes interesting reading because it contrasts a concerned staff appraisal with the frank admission of the authorities that although they share the concerns of the staff, the political possibilities of meeting those concerns--particularly in the fiscal area--are not that good. This political constraint seems to go beyond the fact that elections are approaching.

Considering the slow progress in reducing fiscal imbalances and the extremely high rate of unemployment, this constraint seems surprising to outside observers, but it also indicates that the domestic economic situation in Ireland is not amenable to a strengthened resolve to adopt less gradualistic adjustment policies. Rather, the authorities seem to be of the view that they can handle developments in the short run and that the major problems in the Irish economy can be dealt with only in the medium term.

I hope that the authorities' view is correct; in fact this view has some foundation when one looks at the significant improvements that have taken place during the past four years and not least in 1985. The rates of growth of consumer prices and of average hourly earnings in manufacturing have come down considerably, private fixed investment has finally started expanding in real terms, and the deficit on the current account of the balance of payments has been significantly reduced. Moreover, further progress is expected this year on all these fronts. It is true that some of these gains are due to favorable external developments, but rather than detracting from the results achieved so far these windfall gains should be viewed as an opportunity to strengthen the economic policy strategy so as to achieve further progress. In this connection, I would be somewhat more ambitious than the staff seems to be with respect to the external current account. For all the reasons mentioned in the last paragraph of the staff appraisal, I would advocate that the aim should be one of gradually strengthening the current account in the coming years, and I was pleased that this point was confirmed by Mr. Leonard.

With respect to economic policies, I agree with the important role assigned to supply-side measures, not least the tax changes that have been implemented in recent years and the reorientation of industrial policy. While I still need to be convinced that the very active industrial policy is not too costly from a budgetary point of view, it seems to have played an important role in the impressive export performance in recent years. Furthermore, efforts to integrate private foreign investment with the indigenous sectors of the economy seem to have started to show results. Even allowing for the contribution to exports from foreign direct investment, competitiveness of Irish industries seems to be comfortable, based on developments in export growth and in market shares. I also agree with the view of the authorities with respect to exchange rate policy within the European Monetary System and their preference for domestic adjustment and disinflation as the appropriate strategy.

Fiscal performance and public sector pay policy are disappointing. As regards fiscal policy, one way of characterizing past performance is to refer to gradual slippages rather than gradual progress. Based on experience in other countries--including some of those in my constituency--decisiveness in adjustment policies is crucial. A steady downward trend in the various measures of budget deficits would therefore seem to be more important than the actual size or amount of improvement. Some of the potential benefits of the medium-term adjustment program, begun in 1981, have probably been lost due to the unsteadiness of the authorities in addressing the large fiscal imbalance.

In the same vein, it is surprising to read in the staff report that "the Government's pay offer to the public service unions during the last wage round exceeded its own guidelines." Apart from the adverse budgetary impact, it is difficult to envisage the necesary further dampening in the growth of private sector wages if the Government's pay policy is seen to exceed its own guidelines. Last year the wage arbitrator acknowledged for the first time that "the Government's ability to pay was not unlimited." I take it that this situation is still valid. I would appreciate any comments that Mr. Leonard might have on this issue. The authorities should formulate a new multiyear program with realistic, but adequate, fiscal objectives that can be met and thus enhance the credibility of policies. Within such a framework there is, of course, no doubt that the major portion of improvement in public finances should come from the expenditure side. In view of the rather explosive growth in social welfare expenditure since 1980, I wonder whether a temporary freeze on entitlements should not be contemplated--a move that has been made easier by the reduced level of price increases in the economy. A tighter pay policy--at least, in nominal terms--also seems necessary for budgetary reasons and with a view to influencing wage developments in the private sector.

On the revenue side of the budget, the Government has committed itself not to raise the overall tax burden and to ease the burden on wage and salary earners. This seems to imply a broadening of the tax base to self-employed persons in agriculture and industry--a move that is hardly any easier to take in an election year. In this context, and in view of the fall in oil prices in dollar terms, an unchanged tax burden for consumers would seem to allow for some increase in energy taxation in order to increase national savings.

I agree with the staff's observations on monetary policy. Failure to deal with the budget deficit will increase the burden for monetary policy in the adjustment process; experiences from those member countries that have such a mix of policies do not seem to militate in favor of going in that direction. A strengthening of supply-side policies, inter alia by reducing state support to industry and increasing the market incentives within the industrial policy framework, would seem a useful supplement to a more credible fiscal policy. I do not agree with the authorities' view on the desirability of continued trade protection of the traditional labor-intensive industries; but in view of the severe unemployment situation, a more liberal policy will probably not be implemented in the foreseeable future.

In sum, the Irish authorities have a good opportunity to put policies in place that in the coming years would reduce the serious constraints on growth and employment opportunities.

After all, governments in other countries have sometimes been seen to win elections on the basis of credible policies designed to achieve such policy goals.

Finally, with respect to the consultation cycle, I sympathize with the request that an extended consultation period for Ireland be considered in the context of the forthcoming informal discussion by Executive Directors on that issue, and I could have supported Mr. Leonard's proposal. However, as I understand that the Board cannot leave the timing of the next Article IV consultation with Ireland open, the same result could be achieved by adding a sentence to the effect that a decision on the standard 12-month cycle be subject to the outcome of forthcoming discussions on guidelines for consultation cycles.

Mr. Suraisry made the following statement:

In some respects, the performance of the Irish economy in 1985 was encouraging. In particular, the rate of inflation continued to decline and the trade account registered a surplus for the first time in some 40 years. However, a number of difficulties have to be resolved. Unemployment remains at a very high level, and output growth has been sluggish at best over the last few years, given the growth in the labor force. Underlying these trends has been the existence of persistent imbalances in the public finances and rigidities in the labor market. The authorities are aware of the situation and have taken a number of measures to redress the fiscal imbalances in particular. Nevertheless, some aspects of economic policy were worth commenting on.

The repeated slippages in meeting stated fiscal objectives can only have had a depressing effect on expectations. In particular, in October 1982 the authorities undertook, within the context of a medium-term plan, to eliminate the current account fiscal deficit by 1986. However, while there has been commendable progress in restoring the fiscal finances, the current account fiscal deficit in 1985, despite the much lower rate of inflation, was equivalent to 8.2 percent of GNP, historically one of the highest ever recorded in Ireland. The corresponding public sector borrowing requirement was the equivalent of 15.7 percent of GNP.

In addition to affecting expectations adversely, deficits of this magnitude are unsustainable. The central government debt, much of which is external, reached 131 percent of GNP in 1985, a level at which it will potentially begin to feed upon itself. When this is taken into account in conjunction with the profit and dividend repatriation flows, the result is a significant and growing drain on the economy. For example, in 1985 the net factor income flow was negative and large, at some 13 percent of GNP. Further, as Chart 1 of the report on recent economic developments indicates, real GNP has remained more or less unchanged since 1980, while real GDP has increased by about 10 percent.

Given these considerations, I welcome the measures adopted by the authorities in the 1986 budget to reduce the deficit. However, it should be emphasized that these measures constitute only a first step. Priority should be assigned to implementing further expenditure reductions since the share of taxes in GDP increased by 5 1/2 percentage points between 1981 and 1984. Special attention should be devoted to restraining public sector pay and social transfers; the latter have registered particularly sharp real gains in recent years.

More generally, decisive policy action on the fiscal front at this time should have a beneficial effect on expectations. While I understand the authorities' concern not to exacerbate an already serious level of unemployment, the experience of Denmark, for example, suggests that rapid fiscal retrenchment need not be deflationary. Further, the current improved external environment offers a good opportunity for such action.

Fiscal developments in Ireland also have structural implications. In particular, reform of the structure of taxation continues to be of great importance in enhancing incentives in the economy. I commend the authorities for the significant measures they have already taken in this connection. However, more will need to be done. I note from Table 11 of the report on recent economic developments that the yield from both corporation and property taxation is low; perhaps Mr. Leonard or the staff could comment on the scope for tax-broadening measures in these areas. With respect to the deposit interest retention tax, I wonder whether by taxing financial deposits the net effect will be to make it easier for the Government to borrow, concealing the true cost of such borrowing. More generally, would this new tax encourage financial disintermediation? Finally, what are the possibilities for taxing unemployment benefits? My concern is that taxation has created a large wedge between gross and net wages. As a result, the relatively generous unemployment benefits may be exacerbating the high level of unemployment.

While there has been a welcome increase in the degree of free collective bargaining in wage negotiations, the tendency for wage awards to reflect past inflation rates has resulted in a significant increase in real wages in the recent period of deflation. When it is recognized that recent productivity gains reflected shifts in the composition of output toward capital-intensive industries, and when account is taken of Ireland's rapidly growing labor force, this trend in real wages is unfortunate. The authorities should encourage wage moderation so as to enhance employment opportunities.

The authorities can also help to alleviate the serious unemployment situation through changes in the incentive schemes offered by the Industrial Development Authority. I am encouraged by the increasing emphasis being given to the employment content of projects, as well as to greater linkages between foreign investors and domestic industry and to the nurturing of domestic industry itself. I trust that these policies will continue to make a major positive contribution to growth.

It is clear that monetary policy is significantly constrained by the conduct of fiscal policy and by the authorities' commitment to maintaining the Irish pound within the European Monetary System. Nonetheless, there is much that can be done to enhance the efficiency of the financial system. In this context, I commend the authorities for the measures they have taken to encourage competition between the associated banks. I hope that the authorities will continue to monitor exchange rate developments closely, particularly as the Irish pound has appreciated against the pound sterling, the currency of a major trading partner.

Although the Irish authorities have achieved much, it is becoming increasingly important that their adjustment efforts be intensified. This is necessary if Ireland's future growth prospects are not to be compromised. Finally, I can go along with Mr. Leonard's request that the question of the timing of the next Article IV consultation be set aside temporarily.

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

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/86/120 (7/21/86) and EBM/86/121 (7/25/86).

4. RULES FOR 1986 REGULAR ELECTION OF EXECUTIVE DIRECTORS - REPORT AND DRAFT RESOLUTION

1. The Board of Governors is requested to vote without meeting pursuant to Section 13 of the By-Laws of the Fund upon the draft Resolution, entitled 1986 Regular Election of Executive Directors, set forth in Attachment II to Annex II to EBD/86/199 (7/16/86).

2. The Secretary is directed to send the Report of the Executive Board to the Board of Governors on the 1986 Regular Election of Executive Directors, in Annex II, and the draft Resolution entitled 1986 Regular Election of Executive Directors to each member of the Fund by mail or other rapid means of communication on or before July 25, 1986.

3. To be valid, votes must be cast by Governors or Alternate Governors on or after July 25, 1986 and must be received at the seat of the Fund on or before 6 p.m. Eastern Daylight Time on August 28, 1986. Votes received after that time will not be counted.

4. The effective date of the Resolution of the Board of Governors shall be August 28, 1986, the last day allowed for voting.

5. All votes cast pursuant to this decision shall be held in the custody of the Secretary until counted, and all proceedings with respect thereto shall be confidential until the Executive Board determines the result of the vote.

6. The Secretary is authorized to take such further action as he shall deem appropriate in order to carry out the purposes of this decision.

Decision No. 8346-(86/121), adopted
July 23, 1986

5. SENEGAL - STAND-BY ARRANGEMENT - REPORT ON NONCOMPLYING PURCHASE AND WAIVER OF NONOBSERVANCE

The Fund notes the report of the Managing Director set forth in EBS/86/151 (7/14/86) on the noncomplying purchase made by Senegal on June 16, 1986 under the stand-by arrangement for Senegal (EBS/84/267, Sup. 3) and decides to waive the nonobservance.

Decision No. 8347-(86/121), adopted
July 23, 1986

6. BENIN - TECHNICAL ASSISTANCE

In response to a request from the Benin authorities for technical assistance in designing and implementing monitoring procedures to deal with domestic payment arrears and in implementing tax measures, the Executive Board approves the proposal set forth in EBD/86/200 (7/21/86).

Adopted July 24, 1986

7. JOINT COMMITTEE ON REMUNERATION OF EXECUTIVE DIRECTORS - SUBMISSION OF REPORT TO BOARD OF GOVERNORS - EXTENSION OF VOTING PERIOD

The Executive Board approves the proposal set forth in EBAP/86/137, Supplement 2 (7/22/86).

Adopted July 23, 1986

8. ASSISTANT TO EXECUTIVE DIRECTOR

The Executive Board approves the appointment of an Assistant to Executive Director as set forth in EBAP/86/175 (7/18/86).

Adopted July 23, 1986

9. APPROVAL OF MINUTES

The minutes of Executive Board Meeting 85/178 are approved. (EBD/86/197, 7/15/86)

Adopted July 21, 1986

10. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/86/160, Supplement 2 (7/22/86), EBAP/86/176 (7/21/86), EBAP/86/179 (7/22/86), and EBAP/86/180 (7/23/86) and by Advisors to Executive Directors as set forth in EBAP/86/179 (7/22/86) and EBAP/86/180 (7/23/86) is approved.

11. STAFF TRAVEL

Travel by the Managing Director as set forth in EBAP/86/178 (7/22/86) is approved.

APPROVED: April 9, 1987

LEO VAN HOUTVEN
Secretary