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Minutes of Executive Board Meeting 85/78

3:00 p.m., May 22, 1985

R. D. Erb, Acting Chairman

Executive Directors	Alternate Executive Directors
	L. K. Doe
	D. C. Templeman, Temporary
	H. G. Schneider
	G. E. L. Nguyen, Temporary
	M. Z. M. Qureshi, Temporary
H. Fujino	
	B. Goos
	D. Hammann, Temporary
J. E. Ismael	Jaafar A.
	L. Leonard
	H. A. Arias
H. Lundstrom	
	J. M. Jones, Temporary
	M. A. Weitz, Temporary
	E. M. Taha, Temporary
	G. R. Castellanos, Temporary
J. J. Polak	J. de Beaufort Wijnholds
	A. Steinberg, Temporary
C. R. Rye	A. V. Romuáldez
G. Salehkhou	
A. K. Sengupta	A. S. Jayawardena
	T. A. Clark
S. Zecchini	
Zhang Z.	Wang E.

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

Also Present

IBRD: D. G. Reese, Western Africa Regional Office; A. Tsantis, South Asia Regional Office. Administration Department: V. R. Sertic. African Department: D. T. S. Ballali, E. L. Bornemann, R. O. Carstens, C. J. Hoban, J. W. Kratz, H. R. Lorie, R. L. Sharer. Asian Department: R. M. Broadway, L. H. De Wulf, A. K. McGuirk, D. A. Scott. European Department: L. A. Whittome, Counsellor and Director; B. Christensen, J. T. Reitmaier, G. Szapary, H. Ungerer. Exchange and Trade Relations Department: E. H. Brau, J. T. Boorman, K. M. Huh. Fiscal Affairs Department: G. Blöndal, S. K. Chand, A. Feltenstein. IMF Institute: J. M. Davis, F. Richter, R. Gayatissa, Participants. Legal Department: J. G. Evans, Jr., Deputy General Counsel; A. O. Liuksila. Middle Eastern Department: E. B. Maciejewski. Advisors to Executive Directors: K. A. Hansen, H.-S. Lee, J.-C. Obame, P. Péterfalvy, T. Sirivedhin, A. Vasudevan. Assistants to Executive Directors: H. Alaoui-Abdallaoui, J. R. N. Almeida, Bo T., Chen J., L. E. J. M. Coene, J. J. Dreizzen, G. Ercel, V. Govindarajan, N. Haque, G. D. Hodgson, J. M. Jones, S. Kolb, R. Msadek, K. Murakami, A. Mustafa, J. K. Orleans-Lindsay, M. Rasyid, D. J. Robinson, J. E. Rodríguez, A. A. Scholten, L. Tornetta, E. L. Walker, A. Yasseri.

1. GHANA - REVIEW UNDER STAND-BY ARRANGEMENT

The Executive Directors resumed from the previous meeting (EBM/85/77, 5/22/85) their consideration of the staff report for the first review under the stand-by arrangement for Ghana (EBS/85/110, 5/1/85).

The staff representative from the African Department explained that although capital expenditure as shown in Table 3 of EBS/85/110 appeared to be doubling over 1983-85, the increase in real terms was only about 30 percent. The outlays were primarily for capital expenditure on transportation: ports, roads, and railroads. An investment plan for 1986-88 would be presented by the Ghanaian Government to the Consultative Group meeting that was likely to take place in the middle of November. Preparations on the plan were under way; a staff member from the Fund had participated in one of two World Bank missions that had recently visited Ghana to work on resource mobilization.

The evidence that suggested to the staff that the exchange rate would still be overvalued at the end of 1985, even with a 20 percent real adjustment during the year, included the existence of the parallel market, which he agreed was not necessarily indicative of the equilibrium rate, the staff representative said. As a matter of fact, the rate on the parallel market fluctuated widely, for example, between ₵ 100 and ₵ 130 per U.S. dollar in the recent past. Another indication was the continued existence of import restrictions. If exports were to be raised sufficiently to make it possible to reduce those import restrictions, the exchange rate would have to fall further. A third indication was that transfers from Ghanaians living abroad through official channels were still limited.

The staff had been doing its best to persuade the Ghanaian authorities to accelerate the movement toward positive real interest rates, the staff representative noted. However, it should not be forgotten that the present Government had halved interest rates on assuming office; once the benefits of the program were more widely recognized, an acceleration of the process would become more acceptable politically. The Ghanaian authorities had kept their formal commitments in the past--they had even gone beyond them--and they might do so again. Meanwhile, the formula for adjusting interest rates was meant to ensure that the timetable for attaining positive real rates by June 1986 at the latest would be met.

An increase in the rate of both public savings and private savings was foreseen in the medium-term projections, the staff representative observed. Greater public savings would stem from efforts to mobilize resources in future. In that connection, he noted that the task of the Fund staff member participating in a recent World Bank mission, to which he had already referred, had been specifically to assess the possibility of mobilizing resources in the public sector. The expected increase in the savings ratio in the private sector would be based primarily on three factors: first, the return of a period of positive growth, with significant increases in incomes, including agricultural incomes; second, positive interest rates in real terms by the end of 1985 or by the middle of 1986; and third, the restoration of confidence in the banking system, which had been shaken two years previously by political developments.

Broadly speaking, wage increases in the private sector had followed those in the public sector, the staff representative said. However, remuneration for skilled positions in the private sector was probably higher than in the government sector. At the same time, employers had been resisting further wage increases resulting from collective bargaining agreements.

The medium-term outlook for the cocoa sector, as presented in the staff report, was perhaps on the optimistic side, the staff representative remarked. Unlike those by the World Bank staff, the projections in EBS/85/110 had been based on the figures of the Cocoa Marketing Board, primarily in order to demonstrate to the Ghanaian authorities that their objectives could be achieved only if certain other measures were taken. For instance, the projected increase in cocoa output certainly meant that the producer price would have to be raised much more in years to come, and that would be possible only if the exchange rate continued to be adjusted.

The liquidity problems of the timber sector originated in part in the tight credit situation of the economy overall, but for the most part they were due to the difficulties confronted by the timber enterprises in obtaining financing from commercial banks, the staff representative added. In considering new applications for credit, commercial banks had a tendency to look at past records, and the timber enterprises had experienced problems during the past period of general economic deterioration. The central bank of Ghana had discussed the problem with the commercial banks, and the Government had also assisted timber firms by stretching out the period over which it expected to receive counterpart funds from certain firms that had benefited from commodity loans from bilateral donors.

No subsidies were granted to public enterprises, except for water and sewerage enterprises, the staff representative stated. Public enterprises should, however, be making a larger contribution to budget revenue. Efforts were under way to revise tariff structures and prices upward so that public enterprises would be able to cover their costs and make profits. Unfortunately, the staff's knowledge of the public enterprise sector in Ghana was still inadequate. Much work needed to be done in terms of data collection; the World Bank, which was undertaking special projects and loans in the public enterprise sector, would be in the best position to carry out the largest part of that work, although the Fund staff would continue to cooperate closely with the World Bank.

The objective of reducing the rate of inflation from an average of 40 percent in 1984 to 20 percent in 1985 was attainable, the staff representative considered. Much would depend on the food crop in 1985. The increase in inflation had been only 3 percent over the year from March 1984 to March 1985, but in Ghana prices generally increased at a faster rate between April and June. It should also be kept in mind that the consumer price index reflected actual prices, rather than official prices. To the extent that certain consumer goods were being channeled through parallel markets, the consumer price index was capturing the increase in prices. Thus, exchange rate movements should not have too large an impact on the rate of inflation.

The operation of CIMAO, the cement plant in Togo that was jointly operated by Ghana, Ivory Coast, and Togo, had been suspended in 1984, mainly because of the drought, which had reduced water levels to such an extent that Ghana had had to halve its contractual deliveries of electricity to Togo and Benin, the staff representative explained. CIMAO had already been in difficulties because of competition from European sources of cement; when it had been deprived of its cheap source of electricity and had had to contemplate using power generated by coal or imported fuel, operations had become uneconomic and had been suspended. It was not yet clear under what circumstances CIMAO might resume operations.

The staff representative from the Exchange and Trade Relations Department observed that Ghana's external debt relative to GDP was not excessive. As Table 7 in EBS/85/110 indicated, the problem was the structure of that debt. In 1982, Ghana had incurred arrears in respect of oil credits, and had refinanced them commercially with short-term loans which were at present being rolled over. The appropriate solution would be to refinance those commercial credits on longer terms.

Mr. Salehkhou observed that the essential components of Ghana's economic progress, namely, its natural resource endowment, the favorable climate, and the political will of the authorities to adhere with determination to the spirit and provisions of its 1983 adjustment program had worked together to improve economic conditions. With adequate external financing, those same factors would determine the medium-term prospects until full recovery was attained, he hoped by the end of the decade.

As Executive Directors had recognized, the Ghanaian authorities had for the most part either met or exceeded the performance criteria under the stand-by arrangement, and had shown dedication and prudence in the management of their economy, Mr. Salehkhou added. Not much more could be expected by way of domestic policies, apart from the measures detailed in the staff report as having been implemented already or that were soon to be implemented in accordance with the program. The speedy and uninterrupted disbursement of external financing commitments that had been pledged for 1985/86 and beyond would therefore be a vital prerequisite for continued progress under Ghana's adjustment program. The international financial community would have to continue to demonstrate its responsiveness and full understanding, as it had shown at the recent Consultative Group meeting, of the difficult course ahead for Ghana. The existence of such a common front would assist Ghana to deal with any potential adverse weather conditions or other exogenous factors that were clearly beyond the control of the authorities.

The potentially adverse effects of the debt service burden were recognized by the Ghanaian authorities, Mr. Salehkhou remarked. The authorities were conscious of the need to maintain their financial credibility, as their excellent record in reducing arrears showed; it was not the first time that Ghana had surpassed expectations by overfulfilling its obligations under the performance criterion. Ghana was fully conscious of the revolving character of the Fund's resources and did not intend to be a prolonged user of those resources. The Ghanaian authorities had always been willing to introduce additional adjustment measures, or to advance measures, in order to speed recovery in the hope of making the economy self-sufficient and self-sustaining. Again, much would depend on the interplay of the factors that he had mentioned, and on the mutually supportive and cooperative contributions of the Fund, the World Bank, and other multilateral development institutions, and of Ghana's other partners in development.

The Executive Board then took the following decision:

1. Ghana has consulted with the Fund in accordance with paragraph 4(c) of the stand-by arrangement for Ghana (EBS/84/172, Sup. 4, 8/29/84) and paragraph 31 of the letter of intent signed by the Secretary for Finance and Economic Planning and the Governor of the Bank of Ghana dated July 30, 1984, attached to the stand-by arrangement, as supplemented and modified by their communication of November 28, 1984, in order to establish performance criteria subject to which purchases may be made by Ghana under the stand-by arrangement.

2. The letter dated April 26, 1985 from the Secretary for Finance and Economic Planning and the Governor of the Bank of Ghana shall be annexed to the stand-by arrangement for Ghana, and the letter dated July 30, 1984 shall be read as supplemented and modified by the communication of November 28, 1984 and by the letter of April 26, 1985.

3. Accordingly, the limits on net domestic assets of the banking system and net claims on the Government by the banking system for end-March, end-June, end-September, and end-December 1985 shall be as specified in paragraph 11 of the letter dated April 26, 1985.

4. The stand-by arrangement for Ghana is amended to read as set forth in Appendix I to EBS/85/110 (5/1/85), in accordance with Decision No. 7908-(85/26), adopted February 20, 1985.

Decision No. 7983-(85/78), adopted
May 22, 1985

2. AUSTRIA - 1985 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1985 Article IV consultation with Austria (SM/85/114, 4/24/85). They also had before them a report on recent economic developments in Austria (SM/85/124, 5/7/85).

Mr. Schneider made the following statement:

Following the discussions with the Austrian authorities for the 1985 Article IV consultation in Vienna last February, the staff has prepared an informative and concise set of papers together with a well-balanced assessment of developments and prospects of the Austrian economy.

Since Austria belongs to those smaller industrial countries with open economies that depend heavily on developments in other major industrial countries, it has become increasingly difficult for the Austrian authorities to pursue simultaneously their principal objectives, namely, to maintain price stability and high employment. While the authorities were successful in keeping the inflation rate fairly low, the unemployment rate rose from 2.4 percent in 1981 to 4.5 percent in 1983, but then stabilized at that level in 1984. This rate is rather high by Austrian standards but compares favorably with the unemployment rate in a number of other OECD countries.

Furthermore, the past prolonged recession has accentuated the existing structural weaknesses in certain sectors of the Austrian economy and has made it more difficult to consolidate the federal budget in an environment of moderate economic growth.

It is expected that 1985 will be the third consecutive year to show a moderate but steady cyclical upturn. The prospects for exports are encouraging, and rising domestic demand suggests that the economy will grow by about 3 percent this year. Unemployment will probably remain unchanged, and the rate of inflation is unlikely to exceed 4 percent. In early 1985, the inflation rate dropped somewhat faster than expected, thereby reducing the noticeable 1984 inflation differential vis-à-vis Germany, Austria's main trading partner. The rise in consumer prices over the last 12 months compares as follows:

1985	Austria	Germany
	(In percent)	
January	3.4	2.1
February	3.4	2.3
March	3.6	2.5

Moreover, in comparing the price and cost differentials between Austria and Germany, one has to keep in mind that in 1984 unit labor costs in manufacturing fell by 0.5 percent more in Austria than in Germany. Furthermore, the domestic component of the inflation rate, which does not affect the external competitive position, has been estimated for 1984 to have been in the neighborhood of 0.7-1.0 percentage points.

Austrian exports will remain buoyant, although the rate of growth will diminish somewhat due to the expected slowdown in the international business cycle. The outlook for tourism in 1985, unlike recent years, is very favorable. Final domestic demand, which is gaining momentum, will make a significant contribution to economic growth. Private consumption may grow by almost 2.5 percent, supported mainly by an increase in real disposable incomes. Investment in machinery and equipment is projected to rise even faster. Investment plans and the improvement of company profits suggest an increase of about 6 percent. The construction sector, however, is likely to remain stagnant. The number of employees will rise by about 16,000, or 0.6 percent, in 1985, with the increase confined to the nonindustrial sector. In industry, employment is likely to remain unchanged from 1984 as a result of efforts at rationalization. Employment growth will prove insufficient to reduce unemployment. The projected demographic developments in the medium term point to a steady decrease in the growth of the labor supply until 1990 and are expected to make a negative contribution from 1991 onward.

My Austrian authorities consider adjustment an ongoing process in order to keep pace with constantly changing circumstances. Moreover, improvements in the industrial structure can only be achieved over the medium term within the framework of the social partnership, which has proved resilient despite rising unemployment. Structural problems continue to be a matter of concern since Austria had a fairly large share of basic industries. It is the Government's target to make all nationalized industrial plants profitable by end-1986 or close them down--except the iron and steel industry. Due to cyclical developments and structural measures, developments in 1984 were encouraging; the combined deficit of the nationalized industries was reduced to S 2-3 billion in 1984 or to about half of that in 1983. Total turnover in 1984 increased by 8.6 percent, the cash flow almost doubled, and incoming orders rose by 19.7 percent. It can also be added that total employment of the nationalized sector declined from 118,000 in the middle of the 1970s to just over 100,000 at present.

To foster the formation of private venture capital, my authorities have decided to promote the issue of new shares by Austrian stock companies by introducing a new tax treatment beginning in 1986. The new shares will be exempted from wealth tax for ten years up to a limit of S 100,000. Moreover, the dividends paid on these shares will also be exempted from income tax for the same period.

In the fiscal field the room for maneuver is rather limited since only about 15 percent of expenditure can be adjusted in the short run, while the rest is legally committed. Therefore, my Austrian authorities consider it very important to gain greater flexibility in the budget process in order to achieve a more efficient use of public expenditure. For 1985, the federal budget has been designed to consolidate the reduction in the fiscal deficit achieved in 1984. Moreover, a comprehensive review of the system of government support for industry as well as a screening of other broad expenditure blocks to possible savings is being conducted.

It is fully recognized that three areas are the main cause of the federal deficit: the federal railroad system, the social security system, and the wage bill for the federal civil service. Needless to say, these areas are the most sensitive ones, not only in economic but also in political terms. The partial reform of the pension system--as implemented at the beginning of 1985--has to be seen in this light.

For a number of years my Austrian authorities have pursued the so-called hard currency policy. Considering Austria's specific institutional circumstances, they believe that it is the best monetary strategy for Austria. Apart from the conclusions to be drawn from the optimal currency area theory, the main reason is that the pattern of stable expectations built over more than a decade is of great value to the economy; it affects expectations relevant to exchange rates in foreign trade and in the area of international payments arising from foreign trade--minimizing rate guarantee costs and stabilizing leads and lags in payments; it also affects expectations in the financial markets, contributing to their stability; finally, it affects incomes policy through the tendency to import relative price stability from abroad. In 1984, Austria showed some "weakness in the fundamentals." The exchange rate relationship sought by the central bank--the basic stabilization of the schilling/deutsche mark exchange rate--requires a parallel trend over the medium term in fundamental macroeconomic factors with those of Germany. Austria experienced a marked deterioration in these factors in 1984, particularly with respect to prices, the current account, and the budget, all of which did less well in Austria than in Germany. However, as expected, the price situation has improved considerably since the beginning of 1985. The narrowing of the price differential has alleviated the most urgent concern or, to put it differently, there is nothing in the fundamentals that would directly jeopardize the exchange rate policy.

The last two years offer a good object lesson in the need for a flexible monetary policy. It is clear that the current account plays a dominant role in this respect. Interest rate policy was directed at achieving the narrowest possible gap between Austrian and German money market rates. Various measures, such as short-term expansionary open market and swap operations and an increase in the usable rediscount limit, contributed to this. In addition, it should be pointed out that, with a stable exchange rate, the relationship between domestic and German money market rates serves as an intermediate monetary target which, depending on the state of the current account, either discourages or encourages capital movements. With this approach, there can be no explicit money supply target; the money supply must be viewed as endogenous. It is important to note, however, that the central bank can influence the makeup of the money supply in terms of its domestic and foreign components.

In sum, the central bank will continue its present monetary policy and will continue to react as flexibly as possible.

The staff in its appraisal made a reference to the overall competitiveness of the Austrian economy in case of a significant strengthening of the German currency, and hence the Austrian schilling, vis-à-vis the U.S. dollar. In assessing the effect on the Austrian external competitive position, one also has to take into account the positive effects on import prices for primary products as well as energy and consequently on wage claims.

Let me now briefly turn to the question of excessive competition among Austrian commercial banks.

In the last year, the Austrian banking community has finally become more sensitive to the problem of the disturbed relationship between earning power and risk. It has now become clear to all participants that competition at any price is not a zero-sum game but has only losers. The credit institutions signed an agreement early last year standardizing their terms for cash advances, and around the middle of the year new recommendations concerning interest rates on deposits were agreed upon and strict adherence to the agreement concerning interest on advances was affirmed. Regulatory arrangements, including an agreement on competition, agreements on loan and deposit policy, organizational arrangements for the ongoing adjustment of business policies to market conditions, and possible sanctions, came into effect on March 1, 1985. My authorities are of the view that an improvement in the profitability of the banks is vital and that the best lever for achieving this is to raise the legally required level of equity resources. The equity resources regulations would have to be such as to affect competition as little as possible, but affect both the formation and distribution of profits.

My last remark is related to the low level of Austria's official development assistance (ODA). To increase future contributions, it is the firm intention of my Austrian authorities to provide S 1 billion over the next three years for cofinancing projects of the International Development Association. It is expected that ODA will increase to 0.3 percent of Austria's GNP in 1985 and to 0.4 percent of GNP in the following year.

Mr. Templeman remarked that it was rare to read in a staff report that the authorities of the country were "quite satisfied with the economic situation, and the staff believes that satisfaction is warranted" (page 12, SM/85/114). The Austrian economy had performed well in 1984: inflation had moderated, unemployment had stabilized, business profitability had increased, the financial position of nationalized industries had improved, the fiscal deficit had been reduced, and monetary aggregates had been brought under control. Nevertheless, some uncertainties and problem areas remained, including primarily the labor market situation, balance of payments position, and the fiscal accounts. Could the staff comment on those areas where the Austrian economy was operating with narrow safety margins?

Unemployment had stabilized at 4.5 percent of the dependent labor force, which was low by industrial country standards, Mr. Templeman noted. However, the labor force was likely to grow rapidly in 1985 and 1986, and the relief recently provided by early retirement schemes and the repatriation of foreign workers might be largely exhausted. To ensure continued improvement in the employment situation, wage restraint should be maintained, especially as it had been an important factor in strengthening business profits and reducing the losses of nationalized industries. The cooperation of the social partners in helping to contain wage pressures, which had been a chronic problem in some other European countries, was encouraging.

The Government's target of making all nationalized industries financially viable by end-1986 or closing them down--with the exception of the iron and steel industry--was commendable, Mr. Templeman remarked. The relatively low unit labor costs in Austria had helped to maintain the country's international competitiveness. Nevertheless, the concentration of public enterprises in old, basic industries and the extent of government financial support to those enterprises, which exceeded 2 percent of GDP, suggested the need for structural reform and raised the question of whether structural adjustment measures were being adopted quickly enough. The ratio of gross fixed investment, both public and private, had been slowly declining since 1980.

Despite the strengthening in the external accounts, the authorities should make further progress in reducing inflation, particularly in relation to inflation in Germany, Mr. Templeman stated. Did the latest trade data support the staff's suggestion that the outcome of the current account in 1985 might be somewhat less favorable than the Austrian authorities expected? The staff had indicated the possibility that some depreciation of the dollar vis-à-vis the deutsche mark in coming months could lead to appreciation of the schilling, with adverse consequences for Austria's export prospects. Mr. Schneider, however, had pointed out that an appreciation of the schilling could be helpful in containing the costs of imported energy and commodities. While those trade developments might not materialize, they should be closely monitored. The authorities' pursuit of a liberal trade regime was commendable, but the increasing role of official export financing in promoting Austrian exports was worrying.

The federal government deficit had been reduced in 1984, Mr. Templeman observed. Why had the authorities not opted for a further reduction in the deficit in 1985? The cut in some pension outlays and the increase in pension contributions in 1984, which had succeeded in limiting the need to finance the pension deficit from general revenues, was praiseworthy, and the comprehensive review of the system of government support for industry was welcome. However, the heavy government involvement in the economy--with revenues and expenditures of the public sector amounting to about 50 percent of GDP--was bound to affect incentives to work, save, and invest. Would the staff comment further on its suggestion that an increase in revenue-sharing and federal expenditures could lead to a worsening of the fiscal situation in the medium term? Did the authorities have any plans to address the problem of the high marginal income tax rate?

While the formation of a bank cartel to place limits on deposit rates and to set minimum lending rates could strengthen the capital base of the banks, it seemed inconsistent with broader macroeconomic aims, Mr. Templeman considered. He wondered whether those arrangements would be a permanent feature of Austrian financial markets. Could the staff or Mr. Schneider indicate whether progress had been made on the phasing out of the selective credit system. In conclusion, the authorities should take advantage of the present favorable macroeconomic environment to address the remaining uncertainties and structural problems in the economy.

Mr. Goos indicated his broad agreement with the staff's assessment of the Austrian economy. Recent economic developments and immediate prospects were quite satisfactory. The deceleration in inflation projected for 1985 should greatly facilitate the task of maintaining the hard currency policy pursued by the monetary authorities. It was also encouraging to note that the ongoing recovery in Austria was expected to become more broadly based, with a notable increase in the contribution of fixed investment to GDP--perhaps the most promising feature in the present economic picture given the poor investment performance since 1972.

Unfortunately, there was virtually no economic picture without flaws that constituted a continuous challenge to policymakers, Mr. Goos remarked. Despite the projected acceleration of economic activity, unemployment was expected only to stabilize. However, given the strong growth in the labor force, maintaining the unemployment rate in 1985 at the 1984 level would imply a considerable improvement in underlying labor market conditions. Furthermore, the authorities should take pride in having one of the lowest unemployment levels in the world.

It would be unfortunate if the relatively favorable cyclical conditions led the authorities to underrate existing structural deficiencies, particularly regarding the government budget, Mr. Goos commented. The fiscal measures adopted in late 1983 had produced only temporary relief, as evidenced by the steadily rising fiscal deficits projected for the years ahead in the absence of further fiscal action. It was disappointing that the authorities did not intend to take advantage of the favorable economic prospects for 1985 by aiming to reduce the deficit further. A few years previously, the authorities had considered a reduction in the budget deficit to 2.5 percent of GDP to be an appropriate longer-term target. Their recognition of the need for further corrective action particularly concentrated on across-the-board expenditure cuts, was encouraging. Although he noted from Mr. Schneider's introductory statement that the authorities' room for maneuver in the fiscal field was limited, the fiscal burden arising from subsidies to the enterprise sector and from transfer payments continued to be high. Furthermore, the high cost to the overall economy of subsidies and preferential tax treatment aimed at securing high employment levels should be considered. It could be argued that the economic costs of securing jobs should be weighed against the cost of higher unemployment. Such a comparison should take into account the fact that subsidization of loss-making enterprises was tantamount to diverting resources from more productive uses. In other words, while subsidies for unprofitable enterprises might save some of yesterday's jobs, they might also kill many of tomorrow's jobs. For that reason he supported the Government's efforts to restructure public enterprises and to improve their profitability.

Austria's external position remained vulnerable, Mr. Goos considered. Given the high import elasticity of consumption, which had revived strongly, the current account deficit could turn out to be higher in 1985 than in 1984. Could the staff explain the discrepancy between the figures presented by the staff and the Austrian National Bank for the 1985 current account deficit? The relatively high import elasticity and the history of trade balance deficits appeared to reflect to a considerable extent specific features in the structure of domestic production. Those features had thus far also prevented domestic production and employment from benefiting fully from the ongoing recovery. Progress could be made in that area if the recommendations of the OECD regarding industrial policies were adopted, including the promotion of industrial research and development and a reorientation of government assistance toward restructuring efforts. Those recommendations should be kept in mind during the authorities' ongoing review of the various government support measures. Could the staff or Mr. Schneider elaborate on that review, including the measures under consideration and their potential budgetary effects. The authorities' recent decision to encourage the formation of private venture capital was a welcome step in the right direction.

The authorities' commitment to pursue the so-called hard currency policy had remained beyond doubt, Mr. Goos observed. Nevertheless, that policy approach was subject to certain limits, which would definitely be reached if the inflation differential between Austria and Germany became too large. As experience had clearly indicated in 1984, when that differential had peaked at more than 4 percentage points, considerable interest rate increases might become necessary to prevent large-scale capital outflows and, hence, a weakening of the reserve position with potentially harmful effects on economic growth and employment. The authorities would be well advised to maintain the hard currency strategy. Given the close link between the Austrian and German economies, the pursuit of such a strategy clearly presupposed that Austria would undertake every effort to contain cost and price pressures. Any weakening in Austria's competitive position tended to contribute to a further deterioration in the bilateral current account balance with Germany, a balance which already showed a considerable deficit for Austria.

Information in the staff reports on the efforts to correct the narrow capital base and low profitability of Austrian banks was interesting, Mr. Goos considered. While the government-supported agreement between the banks might rectify the situation, he hoped that it was meant only as a short-term emergency device. Basing interbank relations on such an agreement for a long period of time would risk the creation of considerable distortions in financial resource allocation. The legislative steps regarding capital ratios and banking supervision should provide the basis for strengthening the financial situation of the Austrian banks in an appropriate market-oriented framework, thereby rendering the agreement superfluous.

Mr. Nguyen observed that prospects for Austria in 1985 were generally favorable and that the authorities' satisfaction with the economic situation was warranted. The authorities should be congratulated for the favorable performance in 1984 in the areas of economic growth, industrial production, and the external account. Even performance on the inflation and unemployment fronts could be compared favorably with other OECD countries.

However, the Austrian economy was not immune to the difficulties of other industrial countries, Mr. Nguyen remarked. There were at least three reasons why the authorities should temper their optimism: external competitiveness and the inflation differential with Germany, modernization of industries, and unemployment. The poor performance on the inflation front could be attributed in part to the authorities' pursuit of a hard currency policy with the deutsche mark, resulting automatically in an effective depreciation of the schilling against the dollar. The situation did not appear to be serious at present, as the negative effects of the depreciation of the schilling on the stability of domestic prices had been offset by an improvement in the competitiveness of Austrian products in the United States and a strengthening of the tourism balance. Mr. Schneider had appropriately pointed out the importance of maintaining Austria's competitiveness through low unit labor costs, given Austria's close economic links with Germany. A prudent wage policy was also called for. Could the staff comment on the effects of the recent wage settlements on external competitiveness?

The modernization of the industrial sector was long overdue, Mr. Nguyen considered. The Government's economic support programs had absorbed a large share of federal expenditure but had not been efficient in laying the basis for a sound industrial sector. Could Mr. Schneider elaborate on the comprehensive review under way to simplify the support system. The structural problems of nationalized industries, which represented one fifth of total production, one sixth of total industrial investment, and one third of exports, should be tackled. The assurances by Mr. Schneider that the authorities were considering action in that area were welcome. Investment was likely to remain buoyant in 1985.

The factors that had prevented unemployment from rising in 1984--a reduction in the number of foreign workers and early retirement schemes--were unlikely to recur, Mr. Nguyen commented. Moreover, demographic projections indicated that the employment situation would worsen. Given the sensitivity of the Austrian population to the unemployment problem, the remarkable social consensus achieved in Austria might be shaken or the authorities might have to implement costly and inefficient measures to avoid an increase in unemployment.

Fiscal and monetary measures were needed to sustain economic growth in Austria, Mr. Nguyen remarked. The staff's recommendations, particularly to reduce the fiscal deficit through expenditure cuts and to pursue an active interest rate policy, were appropriate. Structural reform was also called for, especially to improve the structure of the nationalized industries, broaden the tax base, eliminate tax evasion, and reform the pension system. Mr. Schneider's clarification of the banking agreement was interesting. Had the consumers' interests been taken into consideration sufficiently?

In sum, despite some weaknesses needing careful attention, the authorities' present policy stance was appropriate, Mr. Nguyen observed. The basic soundness of the Austrian economy, in which social consensus constituted a major element, and the flexible approach of the authorities should make the necessary adjustments smoother than in other countries. He welcomed the authorities' commitment to increase their official development assistance from its low level of 0.3 percent of GDP in 1985.

Mr. Leonard noted that economic developments in Austria over the past year had been satisfactory and were likely to remain so in the immediate future, largely owing to the authorities' commendable economic management. At the previous Board discussion on Austria (EBM/84/14, 1/25/84), he had expressed concern about the financial balance of the Federal Government, which was estimated to have risen to more than 6 percent of GDP in 1983, and about the extent of the liabilities that the Government was taking on in the form of export guarantees for industry, underwriting of road-financing credits, financial support for nationalized industries, and debt-servicing obligations of the state holding company of the nationalized industries (OIAG). In the event, his concerns had not been borne out. The federal budget deficit in 1983 had been lower than estimated and had been contained further in 1984; moreover, it was projected to be cut further in 1985. The obligations taken on by the Government had not caused undue strain on the fiscal position and they were unlikely to do so in future, given the review of the various government-support measures for industry being undertaken. The early transformation of the findings of the review into measures that would maintain the economy's competitiveness in the years ahead was called for.

A close examination of the staff papers did not reveal any faults of consequence in Austria's economic performance, Mr. Leonard commented. Even the unemployment situation was improving, and the risks in the medium term did not provoke great concern.

To the extent that the growth in real wages exceeded the growth of national productivity, as was the case in Austria, other forms of income must suffer, having adverse implications for savings and investment, Mr. Leonard considered. Compensation through increased incomes for higher living costs, including the effects of higher indirect taxes, meant that the burden of taxation was being shifted or that the state was failing to acquire the required resources through the tax system. Such a development was a potential source of trouble that should be watched. A shift in the direction of Austrian industry toward high-technology activities, in which Europe was deficient, was feasible and appropriate. Finally, the increase in official development assistance envisaged by the authorities was welcome.

Mr. Wijnholds stated that the Austrian authorities deserved high marks for the management of their economy. Economic growth and unemployment in Austria compared favorably with that of most other European countries, inflation was modest, and the balance of payments was roughly in equilibrium. No major difficulties were foreseen for 1985, and the possibility that the current account might show a somewhat larger deficit than expected by the authorities was hardly a cause for concern in the Austrian context. If there were any dark clouds looming on the horizon they would be related to structural problems in industry. Although the authorities were aware of those problems and were reviewing their industrial policies, they should implement rapidly any measures necessary to streamline industry. Experience in other European countries indicated that if serious structural imbalances were allowed to build up, the situation would be difficult to rectify. He hoped that the pragmatism demonstrated by the authorities and social partners in the past would enable them to avoid those pitfalls.

The staff report on recent economic developments in Austria contained an interesting description of developments and prospects in the labor market and threw a different light on the relatively low unemployment figures, Mr. Wijnholds observed. Between 1980 and 1984, the departure of foreign workers, the early retirement scheme, and the increase in the number of workers classified as disabled was estimated to have reduced the dependent labor force by about 2 percent. If that figure were added to the actual unemployment rate of 4.5 percent, the rate of unemployment for Austria would be similar to the OECD average. Clearly, other countries had also kept their unemployment rates lower than they would otherwise have been through similar measures, but the effect of those actions in Austria had been relatively significant. The authorities were discussing whether a reduction in working time would be a useful instrument to counteract the tendency toward higher unemployment. The semi-official study on that subject, referred to by the staff, had come to some cautious conclusions and had advocated that any shortening of working hours should be left to negotiations in each sector. That advice seemed sound, particularly as experience with work-time reduction schemes in other countries indicated that results had fallen considerably short of expectations.

The authorities had successfully taken measures in 1984 to stem the rise in the budget deficit, Mr. Wijnholds observed. Nevertheless, the deficit was expected to increase in 1985 unless further action were taken. The comprehensive review under way of government support for enterprises, which amounted to more than 2 percent of GDP, was welcome. With respect to domestic financing of the budget deficit, should the shift from the placement of bonds to long-term loans from banks and insurance companies be seen as a form of monetization?

The hard currency strategy followed by the authorities, while successful thus far, called for a lowering of the Austrian inflation rate, which had been higher than that of Germany in 1984, Mr. Wijnholds noted. However, price increases had decelerated in the beginning of 1985. The Board should not be particularly worried about the possible adverse impact on Austria's competitiveness of a strengthening of the schilling vis-à-vis the dollar via the link with the deutsche mark, a concern expressed in the staff appraisal. After all, Austria's trade was heavily concentrated in western Europe. Perhaps the staff had been hinting at something more, including the possible realignment of European currencies.

The Austrian banking system had suffered from undercapitalization and low profitability, Mr. Wijnholds observed. The functioning of the financial system of a country could have a wider impact than might be immediately discernible. Did the staff share the authorities' view that there had been excessive competition between the banks, and did it agree with the remedy of increasing margins by means of maximum deposit and minimum lending rates? Could the staff or Mr. Schneider indicate whether the low profits of the Austrian banks were related to special provisions they might have made against foreign loans, particularly those to eastern Europe, which were estimated at $7.2 million. The authorities should be commended on the good performance of the Austrian economy, but they should not allow structural problems to cloud the country's medium-term outlook.

Mr. Lundstrom remarked that economic performance in Austria continued to compare favorably with that of many other industrial countries. Overall output had increased faster than the average of European OECD countries in the past few years; inflation and unemployment remained low by international standards; and the external current account was broadly in equilibrium. Moreover, short-term projections pointed to a continuation of those favorable trends. Against that background, it was easy to understand the authorities' satisfaction with the present economic situation.

However, while the overall picture was favorable in the short term, underlying trends could cloud economic performance in the medium term, particularly in public sector finances, inflation, the labor market, and the manufacturing industries, Mr. Lundstrom observed. Although the federal budget deficit had been reduced recently, no further reduction was expected in 1985 despite increasing economic activity. Moreover, if no further fiscal action were taken, the deficit was likely to rise steadily after 1985 as expenditures were expected to increase faster than revenues and GDP. Deficit-reducing measures should be aimed at arresting expenditure growth. There also seemed to be significant scope for broadening the tax base, as about 30 percent of personal income was exempt from taxation. It was regrettable that the proposed streamlining of the tax system, including the large number of tax exemptions and allowances, had been postponed. While the staff in its report for the 1983 Article IV consultation with Austria had cautioned against an increase in the tax burden, it now suggested that a broadening of the tax base, without a reduction in tax rates, would be appropriate.

The hard currency strategy--the cornerstone of Austrian economic policy--had been working well and should be continued, Mr. Lundstrom considered. However, the practical application of that strategy required that cost and price developments in Austria did not differ significantly from those in Germany. It also implied that Austrian enterprises in the exposed sectors would be able to adjust flexibly to foreign competition in the wake of exchange rate pressures. The recent and prospective price and cost differentials in favor of Germany and the increasing structural problems of Austrian industry, while not matters of immediate concern, posed a serious challenge to the overall stance of economic policy in the medium term. For example, in the latter part of the 1970s, increases in unit labor costs had deviated substantially from the exchange rate target, contributing to significant external deficits not only in relation to Austria's previous record but also in relation to the OECD average.

While the rate of unemployment in Austria was one of the lowest in the industrial countries, signs were emerging of growing imbalances in the labor market, Mr. Lundstrom commented. Long-term unemployment had increased markedly over the past few years. Moreover, the decline in the participation rate in recent years resulting from early retirement schemes and a reduction in the number of foreign workers was likely to be reversed. The consequent increase in the supply of labor, combined with the efforts to rationalize industry, would increase the pressure on the labor market, making the promotion of economic growth even more important.

Over the past two decades, the expansion of Austria's industrial base had been impressive, Mr. Lundstrom observed. Productivity had grown rapidly by international standards, and the share of industrial employment was significantly higher than the OECD average. The value added of the manufacturing sector as a percent of GDP was among the highest in the OECD area. Despite those developments, however, the industrial structure in Austria was characterized by a comparatively large share of labor-intensive consumer goods and basic goods industries. According to various studies by the OECD and an Austrian research institute, the share of high-technology products in exports of manufactures was substantially below that of many other advanced industrial countries, including several smaller ones. Austrian exports were concentrated in basic product groups, a sector in which Austria was likely to continue to lose market shares to newly industrializing countries. The significant rise in bankruptcies in recent years might be explained in part by Austria's delay in reorienting its economy toward a more advanced export goods structure and by weakening demand for Austrian products.

The increase in government support to various industrial sectors, including the nationalized industries--in various forms of direct and indirect subsidization, including interest subsidies, which covered 30 percent of total bank loans to industry--had probably been instrumental in maintaining capital-intensive basic goods industries, Mr. Lundstrom noted. Moreover, by tying support measures to profit developments, government intervention had not favored the establishment of new enterprises. In sum, while the structural problems in the industrial sector did not appear to be of significant importance at present, their medium-term impact on the economy gave cause for concern. The comprehensive overhaul of industrial policy being considered by the authorities, including the target to make nationalized industries profitable by end-1986, was appropriate.

He welcomed the authorities' continued adherence to a free trade system, Mr. Lundstrom stated. As the present level of ODA was less than one half of the UN target of 0.7 percent of GDP, the substantial ODA increases envisaged by the authorities for 1985 and 1986 were heartening. Finally, he supported the proposal to hold the next Article IV consultation with Austria on the standard 12-month cycle.

Mr. Zhang stated that he endorsed the staff appraisal. The Austrian authorities should be congratulated for adopting appropriate macroeconomic policies that had resulted in continuous, good economic performance, particularly compared with that of other industrial countries in recent years. To what extent could the Austrian experience be applied to other industrial countries? The staff report pointed out that the favorable overall performance of the Austrian economy over the past decade had been largely the result of a continuous expansionary fiscal policy. What were the special circumstances that had made the pursuit of such a policy possible in Austria but impossible in other industrial countries? Were those special circumstances mainly institutional?

In spite of the high degree of dependence of the Austrian economy on foreign trade, real growth of GDP had been predominantly influenced and determined by domestic demand, Mr. Zhang observed. Foreign demand for Austrian goods had played a relatively minor part, or had been important only in a few years, in determining the rate of growth of GDP. That pattern was not typical of other industrial countries that also had high trade ratios to GDP. What caused that difference? Could it be attributed to the differences in their patterns of trade and payments?

The social partnership in Austria had brought about positive results, in sharp contrast to the experience of other industrial countries, Mr. Zhang noted. Could the incomes policy within such a framework continue to play the same role in the medium term? To what extent had wage moderation and low unemployment been associated with labor hoarding in the public sector? In general, what conclusions relating to labor market practices could be drawn for other countries? Finally, how had the conflicts between the internal and external policy objectives been resolved if all other policies had generally been subordinated to the exchange rate policy?

Mr. Doe commented that Austria's overall economic performance had been satisfactory in 1984. The economic recovery, begun in 1981, had continued in 1984, with real GDP growing at an annual rate of 2.2 percent, unemployment stabilizing at 4.5 percent, and prices increasing only moderately. Those favorable economic developments reflected the smooth working relationship between the Government, which had maintained an expansionary fiscal policy; labor, whose demand for wage increases had been moderate; and public enterprises, which had hoarded excess labor.

While the rate of unemployment in Austria was currently relatively low, the employment situation could deteriorate in the medium term as the supply of labor expanded rapidly, Mr. Doe considered. Two employment options were being considered by the authorities: shorter working hours and early retirement schemes. Could the staff indicate the effects on production costs and inflation of those options?

The authorities had adopted measures to contain the growth of expenditure by reducing some social security benefits and housing subsidies and by enhancing revenues through an increase in the value-added tax and the introduction of a tax on interest income, Mr. Doe noted. Furthermore, railroad and postal tariffs had been raised and the contribution to the unemployment insurance scheme increased. While those measures had exerted a restraining influence on the fiscal deficit in 1984 and might have a similar impact in 1985, the financial situation of the federal government could worsen in the years ahead in the absence of additional fiscal measures. The authorities must take steps to avoid such an outcome, in particular by broadening the tax base and reforming the pension system. The review under way of the various types of government support granted to public enterprises must be completed rapidly so that relevant policy actions could be taken.

At a time when several major industrial countries were intensifying protectionist measures, the Austrian authorities deserved particular commendation for maintaining free trade despite the weakness of their external sector, Mr. Doe commented. The increase in ODA mentioned by Mr. Schneider, while relatively moderate, was a step in the right direction.

Mr. Rye remarked that Austria represented a particularly interesting case study for those Directors who were concerned with the economic consequences of consensus politics, although they should be cautious in drawing any general lessons from the Austrian experience. On the face of it, Austria was a first-class advertisement for the virtues of consensus politics; the economy had consistently outperformed most other OECD countries in terms of higher growth and lower rates of inflation and unemployment. But Austria had a long history of consensus politics, and the circumstances fostering that policy were clearly different from those that applied in most countries.

Other factors had contributed to Austria's success, including successful policymaking and the country's close economic links with Germany, a major, well-performing economy, Mr. Rye noted. Consensus politics had costs that accumulated and, over time, became increasingly detrimental to economic performance. In particular, an expansionary fiscal policy and the pursuit of social policies by the large nationalized industrial sector had been important elements in maintaining the social consensus. Those policies, successful as they undoubtedly had been, were presenting major challenges to economic policy in Austria.

Fiscal policy was a matter of particular concern, Mr. Rye considered. The initial steps taken to reduce the budget deficit through expenditure cuts, including the partial reform of the pension system, were welcome, but clearly much more action was needed in that area. He hoped that the review of the support measures for industry would lead to a simplification, reorientation, and reduction of government support for enterprises. The authorities should be encouraged to approach the restructuring of nationalized industries with greater vigor than previously, especially as the economic situation was still relatively favorable and such action was easier to undertake from a political viewpoint. On the revenue side, there was an urgent need to broaden the tax base. However, the authorities' doubts about the feasibility of any action in that area were understandable.

In the short term, he welcomed the favorable prospects for 1985, Mr. Rye commented. Real GDP was expected to increase by 3 percent, and the rate of inflation was forecast to be 4 percent at most. One possible area of weakness was the balance of payments; the current account could be worse than expected by the authorities, with imports rising faster than projected given the vigor of the economy and the expected growth in private consumption of 2.5 percent in real terms. Should the current account worsen, net debt and net debt servicing might increase.

The Government's hard currency strategy in the monetary and exchange rate fields had worked well and could not be seriously faulted, Mr. Rye remarked. Mr. Schneider's opening remarks on monetary policy were somewhat unclear. He had stated that "the last two years offer a good object lesson in the need for a flexible monetary policy," but went on to demonstrate that the Austrian authorities regarded a flexible monetary policy as out of the question in their particular circumstances. Could

Mr. Schneider comment further on that issue? The authorities' dependence on interest rate policy to play an equilibrating role in the hard currency strategy could adversely affect economic growth and employment. However, the doubts expressed by Mr. Wijnholds about the validity of the staff's warning about the likely impact on Austrian competitiveness of the strengthening of the deutsche mark vis-à-vis the U.S. dollar were warranted. The authorities' adherence to a liberal trade policy was commendable, but the decline in ODA since 1982 was regrettable. Mr. Schneider's assurance that it was the firm intention of the authorities to redress that situation was welcome.

Mr. Taha stated that he was in general agreement with the staff appraisal. In most respects, the Austrian economy continued to perform well: output was rising, inflation remained low, and unemployment had stabilized. The authorities had followed prudent demand management policies, and some progress had been made in tackling structural weaknesses. The immediate outlook was favorable, particularly by current international standards. Despite those achievements, however, potential weaknesses needed to be addressed, in particular, those weaknesses related to the question of Austria's competitiveness, which was central to Austria's medium-term prospects given the policy of linking the schilling to the deutsche mark. While that policy had brought significant benefits to Austria, the benefits could be maintained, only if the major economic indicators in Austria moved closely in line with those of Germany. If they did not, monetary policy would have to be tight, with adverse consequences for investment and employment. The authorities should therefore enhance their efforts to strengthen Austria's competitive position and improve the prospects for sustained growth. To that end, coordinated policies were needed in three areas.

First, continued wage moderation was essential to keep inflation firmly under control and to narrow the differential with Germany, Mr. Taha considered. Developments in that area had been encouraging in 1984, but the staff suggested that wage settlements for 1985 might be on the high side. Could the staff elaborate on that point with reference to the corresponding trends in unit labor costs and productivity in Germany?

Second, Mr. Taha went on, further progress was needed in reducing the fiscal deficit to free resources for productive investment. In particular, the present rigidities in the structure of public finances should be reduced, in order to restrain the growth of government spending in the medium term.

Third, the authorities should press ahead with their plans to streamline the nationalized industries and restructure the industrial base, Mr. Taha remarked. The review under way of industrial support measures was welcome, and he hoped that it would lead to a clear, medium-term policy aimed at promoting efficient enterprises in areas where Austria had a comparative advantage.

Mr. Salehkhou recalled that at the Executive Board's discussion for the 1983 Article IV consultation with Austria (EBM/84/14), Directors had commended the authorities for the favorable economic performance. They had recommended that in order to reduce the budget deficit, the authorities should cut expenditures, rather than raise revenues. Directors had also expressed concern about the high level of government guarantees and about developments in the labor market, given that unemployment had been a critical factor in the agreement between the authorities and the social partners.

In 1984, progress had been realized in many fields, Mr. Salehkhou observed. The rate of growth had been 2.2 percent higher than the average of other European industrial countries. As exports had increased, the financial position of Austrian enterprises had improved, leading to an increase in employment, while unemployment had stabilized at 4.5 percent of the dependent labor force. However, prices had been influenced heavily by the introduction of a value-added tax, which had resulted in a modest fall in real earnings. Another tax had also been introduced on interest income at a rate of 7.5 percent on schilling-denominated accounts, leading to a contraction of the bond market. Government borrowing had been lower than in 1983, accounting for 17 percent of total financing, and the budget deficit had been reduced to 4.4 percent of GDP from 5.4 percent of GDP in 1983.

The drag on the fiscal deficit from the losses of nationalized industries had been reduced substantially through the introduction of structural measures, such as the shedding of excess labor, Mr. Salehkhou noted. Federal government support for enterprises stemmed from the authorities' objectives of alleviating regional economic imbalances and creating employment opportunities. Despite numerous schemes, such as credit guarantees and interest subsidies, outright grants remained a burden on the budget and had represented over 4 percent of total expenditures in 1984.

The authorities maintained a close link between the Austrian schilling and the deutsche mark, Germany being Austria's largest trading partner, Mr. Salehkhou pointed out. The depreciation of the schilling by about 11.5 percent in 1984 had provided a strong boost for exports to the United States. However, as imports of investment goods and energy had also increased, the current account deficit had remained at 0.25 percent of GDP in 1984, a margin small enough not to cause any worry to the authorities. The balance of services had recorded a surplus, as in previous years, with tourism maintaining a strong showing; and gross official reserves had risen to the equivalent of four months of imports at end-1984. Austria maintained a free trade system, but, like many small industrial countries, it was increasingly encountering protectionism in its markets.

The economic recovery initiated in 1983 had continued in 1984, Mr. Salehkhou observed. Prospects for 1985 were also favorable but depended on a number of factors affecting the agreement between the Government and the social partners. If unemployment were to remain at

4.5 percent, economic growth must be increased in 1985 to at least 3 percent from 2.2 percent in 1984. For such a growth rate to be sustained, exports must be increased, domestic consumption stimulated, and the rate of inflation reduced. Imports should grow less rapidly owing to the buildup of stocks in 1984. In those circumstances, the current account of the balance of payments could be expected to register a small deficit.

No new revenue measures were expected for 1985, Mr. Salehkhou noted. With a 15 percent reduction in expenditures, the budget deficit could be maintained at 4.4 percent of GDP. The authorities intended to restructure the nationalized industries and cut their financial losses so as to alleviate the burden on the federal budget. A change in the pension base of the social security system was expected to reduce the need for government transfers to the pension system in 1985. The Austrian economy had benefited from the positive effects of the social consensus achieved between the Government and the social partners. The hard currency policy linking the schilling and the deutsche mark had tempered wage increases, leading to stable labor conditions and enabling Austria to compete in the international markets, particularly in developing countries.

While Austrian bilateral technical assistance to developing countries was efficient and much appreciated, its ODA program was falling behind in relation to its past performance and compared with the OECD average, Mr. Salehkhou observed. He hoped that the level of ODA would be increased in 1985.

Mr. Zecchini remarked that Austria had managed to keep the social costs of the 1981-83 recession within acceptable proportions. Control over inflation had not induced major increases in the rate of unemployment, at least by international standards, and the rapid expansion in foreign demand had led to a healthy recovery in domestic activity while maintaining external equilibrium. Investment had picked up in 1984, stimulated by favorable demand prospects and low real interest rates. Overall, the country was experiencing a favorable cyclical position, and the authorities' policies were generally appropriate.

The public finances and the structure of the capital markets were two policy areas that might give rise to concern in the medium term, Mr. Zecchini said. Austria's public sector had persistently registered a moderate deficit. Public expenditures and revenues, as well as their major components, had remained remarkably stable in relation to GDP over a number of years at levels that indicated a high degree of public intervention in the economy. Rigidities had accumulated over time, preventing a flexible view of fiscal policy and making it difficult for the authorities to reduce the deficit substantially. Public support to enterprises, which had increased significantly in recent years, had not been used in an anticyclical fashion but had paralleled cyclical fluctuations. Total support payments were expected to expand noticeably in 1985, despite the expected continuation of the recovery. Furthermore, the strong increase in export incentives did not appear justified given the trends in export demand. Could Mr. Schneider elaborate on the main criteria on which the authorities based their incentive policy?

The functioning of the capital markets in 1984 justified some concern, Mr. Zecchini considered. Bond issues had been declining steadily, apparently owing to the imposition of a tax on interest income, which had not been followed by an increase in interest rates. Consequently, financing of the public sector deficit through the banking system had expanded further. The decline in bond issues had also been an important factor behind the expansion of foreign borrowing by banks. The main question to be raised was whether those developments might reduce the effectiveness of monetary policy by both increasing the degree of liquidity in the economy and reducing the impact of interest rate changes on the private sector's propensity to spend. That might be the case to the extent that the increased demand for bank credit by the public sector had a counterpart in a greater amount of deposits. As a consequence, the liquid components of the private sector's wealth became relatively larger, and the wealth effects of interest rate changes were reduced, with an even lower share of fixed interest bonds in the economy. However, if the banks expanded their foreign borrowing, implying essentially that the public sector deficit was financed abroad, the balance of payments might be affected through the services account in the medium term. Austria had not yet reached the stage where those developments constituted a cause for immediate concern. Nonetheless, the shrinking of the bond market was an unfavorable development, and competitive remuneration should be granted to bond holders.

Mr. Fujino observed that the Austrian economy had performed well and the authorities' achievements were commendable. GDP had grown at an average rate of 3 percent a year since 1970. Most noteworthy, the unemployment rate had been maintained at about 2 percent until 1981 and was currently the lowest in Europe. Prospects for 1985 were promising, with economic growth estimated at 3 percent, up from 2.2 percent in 1984.

The development of the Austrian economy since 1960 was interesting, as economic growth had been stimulated by an expansionary fiscal policy that had not adversely affected the performance of the economy, Mr. Fujino considered. Many other countries, including Japan, had been forced to use the same policy approach during that period, but most of them had been less successful in maintaining continuous moderate growth. As a result of a quick accumulation of debt, those countries had been obliged to take restrained fiscal measures at a much earlier stage. In Austria, the accumulation of debt and the unintended increase in federal budget expenditures in 1983 had forced the authorities to adopt a more restrained fiscal policy in 1984 and 1985, but the economy had not been significantly affected because of the favorable external environment.

The time had perhaps arrived when the authorities should exert additional expenditure restraint, Mr. Fujino remarked. Mr. Schneider's assurances that they were considering a more efficient use of public expenditures and were undertaking a comprehensive review of the system of government support for industries were welcome. The key to a successful transition from an expansionary fiscal stance to a relatively restrained fiscal policy might lie in sustained but moderate fiscal stimulus. Comments from the staff or Mr. Schneider on that point would be appreciated.

The decline in employment since 1980 had been particularly noticeable in the industrial sector and had perhaps been the result of efforts to improve the structure of industries, Mr. Fujino commented. Had productivity increased as a consequence of that decline in employment? Structural improvement in the industrial sector was an important task for the authorities in the medium term. To reduce unemployment and raise productivity in the industrial sector, investment in high-technology activities must be increased. The authorities' decision to promote private venture capital through new tax measures was welcome. However, those measures would be effective only if sufficient trading markets were developed. In an open economy with a hard currency policy, such as Austria's, competitiveness of export industries would be important for stable growth. Private initiative would need to be encouraged. The authorities' intention to adhere to the principle of free trade was welcome.

Mr. Sengupta stated that the authorities should be commended for their success in managing the Austrian economy; inflation had moderated, economic growth had increased, and wage developments in 1984 had helped to improve the performance of enterprises. However, some problems, notably structural problems, remained. The authorities recognized the need to take action, particularly to improve the structure of the nationalized industries.

The low level of Austria's official development assistance, which fell from 0.35 percent of GDP in 1982 to 0.23 percent of GDP in 1984, was regrettable, Mr. Sengupta commented. A 10 percent increase in ODA was projected for 1985, representing an increase of about 5 percent in real terms. Nevertheless, Austria's ODA would be only 0.3 percent of GDP, compared with 0.35 percent of GDP in 1982, and would be considerably below the internationally agreed target of 0.7 percent of GDP. Mr. Schneider's assurance that ODA would be increased to 0.4 percent of GDP in the next two years was welcome. While the provision of resources for cofinancing World Bank projects was a useful means of channeling resources to certain projects, such resources might be disbursed slowly. The authorities should ensure quick disbursement and broad geographic distribution of Austria's official development assistance. The staff suggested in Appendix II to SM/85/124 that Austria's ODA had declined partly because of unforeseen delays in the financing of some multilateral institutions and partly because of a reduction in bilateral export credits. The authorities might consider formulating alternative ways to transfer financial resources to countries in need.

Mr. Castellanos observed that the Austrian economy had performed well during the past few years. The link between the authorities' two main objectives of maintaining economic growth and improving income distribution had made economic adjustment easier in Austria than in other countries. The authorities should be commended for their economic adjustment efforts and for the positive results that were expected from the application of monetary models. The management of fiscal and monetary policies had been highly coordinated and strongly supported by the Government's program aimed at maintaining equilibrium in the external sector. His chair had repeatedly stated that the monetary model of adjustment presupposed an infrastructure of economic behavior not commonly found in many countries, and it had therefore supported all efforts of the Board to apply the adjustment model more flexibly.

The authorities' policy of maintaining a close link between the schilling and deutsche mark had been useful, Mr. Castellanos remarked. Other countries with open economies might find such a policy approach valuable.

The authorities deserved commendation for their efforts to solve the problems of the state enterprises, Mr. Castellanos stated. Austria was one of the few countries in which the performance of the public enterprises had not hindered the Government in its stabilization and development efforts. However, the authorities must take complementary measures to strengthen private investment and should reduce progressively the support for enterprises in order to achieve the appropriate balance between efficiency and market prices.

He congratulated the authorities for their remarkable performance during 1984, specifically their ability to maintain a sustainable path of noninflationary economic growth, Mr. Castellanos commented. However, the unemployment situation and the policy regarding foreign workers gave cause for concern. While national governments were entitled to set their own economic priorities, the positions of other countries with substantial problems should also be taken into account.

The staff representative from the European Department commented that the Austrian economy was subject to various influences that might result in some adverse developments. As Austria was an open economy, the balance of payments was sensitive to external shocks and domestic cyclical developments. In the 1970s, for instance, there had been a considerable difference in developments between Austria and Germany, which had had an immediate impact on Austria's balance of payments position. Furthermore, the rigidities in the budget tended to increase the risk that any attempt to follow an anticyclical policy would have strong repercussions on the budget deficit.

There were particular features in the Austrian economy, such as the social partnership, which allowed the authorities to pursue an expansionary policy without endangering competitiveness through wage increases, the staff representative pointed out. However, there was a price to be paid in the medium term for the expansionary policies pursued by the Austrian authorities. A particular consequence of that policy was the relatively large budget deficits and increasing public debt and debt service obligations, which would be difficult to reduce. Furthermore, the structural problems in industry in general, and in nationalized industries in particular, had not been attacked. In sum, while the expansionary policy had been successful in the early stages, a price had been, and remained to be, paid by the Austrian economy.

With respect to the question whether other countries should follow Austria's example regarding the social consensus, the Austrian experience was unique, the staff representative remarked. The social partnership was resilient and was likely to continue; it had been maintained even in the face of an increase in unemployment.

The staff was of the view that the recent wage settlement had been too generous in compensating for inflation, including the special effect of the increase in the value-added tax, and that it would probably impair Austria's competitiveness in the future, the staff representative continued. It would be difficult to measure precisely the effect on unemployment of early retirement schemes and the return of foreign workers to their home countries. Early retirement schemes should be avoided in the future as they were costly. The decline in industrial employment had accelerated, particularly in the nationalized industries. However, unlike the experience in most other European countries, increased unemployment in Austria had been accompanied by increased total employment.

The authorities recognized that they must attack the structural problems in the nationalized industries, the staff representative commented. Measures designed to address those problems would take some time to implement, and the authorities would need to act within the framework of the social consensus. There was a trade-off between the speed of adjustment and maintaining the social consensus, which had proved to be a successful element in Austrian economic policy.

Although the balance of payments had performed well in the first quarter of 1985, it was difficult to predict developments in the external current account over the next 18 months, the staff representative remarked. The share of basic goods in total exports was relatively high, and the share of high-technology goods was relatively low. However, exports, particularly of high-technology goods, had increased rapidly, a trend that the authorities hoped would continue. The discrepancy between the figures of the Fund and the central bank for the external current account arose because the central bank compiled its figures from monthly data that excluded certain categories of transactions. At year-end, the central bank carried out a special survey to correct for underrecording. On an adjusted basis, there was no difference between the figures of the Fund and the central bank.

Subsidies should be not only reduced but also made more efficient, the staff representative considered. They should be directed away from broad objectives, such as encouraging employment and influencing regional development, toward more specific objectives, such as encouraging high-technology exports and improving productivity. Progress on that front would be difficult as there were a variety of interests involved that would have to be dealt with on the political level.

There was little prospect of a tax reform in the near future, the staff representative indicated. The staff had changed the emphasis since the 1983 Article IV consultation with Austria and now advocated a broadening of the tax base, although it continued to emphasize the particular need for action on the expenditure side. Tax evasion in Austria was high; about one third of income was subject either to no tax or to preferential tax rates. A broadening of the tax base could either be neutral or lead to an increase in the tax burden for the economy as a whole.

Directors had rightly identified the budget deficit as a major cause for concern, the staff representative observed. The authorities were trying to identify areas in which discretionary changes in expenditures could be made. Their medium-term target of maintaining the budget deficit at about 2.5 percent of GDP has been defined only in the late 1970s. In the early 1980s, the budget deficit had increased to some 5 percent of GDP. The authorities hoped to cut the deficit in 1985. The switch from bond financing to bank financing of the budget deficit was a temporary change related to the introduction of a withholding tax on interest, which had been controversial in Austria and had had a tremendous psychological impact on investors. The issue of bonds had risen sharply after the authorities had announced that the withholding tax would be reduced from 7.5 percent to 5 percent. Bank financing of the deficit was therefore likely to moderate in 1985.

He agreed with Mr. Zecchini about the rigidities in, and the limited role of, the capital market, the staff representative stated. Those characteristics reflected the conservative attitude of the typical Austrian investor, who would put his money first into deposit accounts and only last into shares. That deficiency of the Austrian economy would have to be faced by the authorities.

Regarding the question whether the public sector was larger or smaller in Austria than in other countries, no figures were available on the size of the public sector, broadly defined to include nationalized industries, that would allow a comparison with other countries, the staff representative indicated. However, there were probably a few countries in Europe that had larger public sectors than that of Austria. With respect to the narrowly defined public sector, Austria compared favorably with similarly sized European countries, such as Belgium, Denmark, the Netherlands, and Sweden. Austria also compared favorably with those countries in terms of the ratio of public debt to GDP. On a related point, the authorities had never followed a deliberate policy of nationalizing the industrial sector; following the Second World War the Government had taken over various industries to avoid their seizure by the occupation forces.

The authorities had encouraged credit institutions to sign the competition agreement, which was intended to be only temporary in nature, the staff representative said. The authorities' earlier decision to deregulate the banking sector--freeing interest rates and allowing all banks to establish branch offices--had coincided with a downturn in the economy. A further improvement in the profitability of the banks would be difficult to achieve, however, if the Austrian banking system were truly oligopolistic.

A number of Directors had expressed concern about the extent of export guarantees, the staff representative recalled. It was unclear from the authorities whether those guarantees had a strong impact on the volume of exports, but they did help to encourage trade with the Eastern European countries. The Austrian authorities had traditionally placed strong emphasis on maintaining good political and economic relations with Eastern European countries.

Experience demonstrated that a real appreciation of the deutsche mark led to a marked real appreciation of the schilling, impairing Austrian competitiveness as a consequence, the staff representative from the European Department stated. The index of the effective exchange rate based on the Fund's multilateral exchange rate model (MERM) took third market effects more into account than did the Austrian index (WIFO).

Mr. Schneider commented that policymaking recently had become more difficult in Austria. In the first instance, a coalition Government--the first one since 1970--had had to be formed after the general election in 1983. In addition, in September 1984 there had been a reshuffling of Ministers within the Government. A new Minister of Finance had taken office six weeks before the budget was to be presented to Parliament. In effect, he had had to accept the revenue-sharing arrangements already negotiated between the Federal Government, the provinces, and the local authorities--an arrangement that was costing the Federal Government about S 2.5 billion in 1985. Moreover, the general public was much more aware of environmental problems, particularly related to the construction of power plants; nevertheless, protest movements in Austria had remained relatively peaceful.

Directors had been particularly concerned about fiscal policy, Mr. Schneider recalled. His authorities were fully aware of the need to consolidate public finances and gradually reduce the budget deficit. In an effort to reduce the budget deficit below the planned amount, emphasis would be placed on expenditure restraint. Attention had also been focused on ways to deal with unemployment and the social security system, one of the major contributors to the fiscal deficit. Apart from considerations of a reduction in working hours and early retirement schemes, the Minister of Social Affairs had begun to argue that in view of rapid progress in high technology and the expected concomitant reduction in the demand for labor, there should be a shift away from taxation of labor toward taxation of the value added of enterprises. At present, contributions to the social security system were shared equally by employers and employees. However, there was an underlying concern that in view of the demographic structure of the Austrian population, the burden of financing the social security system on a shrinking active labor force might grow too heavy in the long term. The negative repercussions of such a change, particularly on Austria's competitive position, would be considered carefully.

The authorities were concerned that too hasty an implementation of structural adjustment measures might endanger the social partnership, Mr. Schneider said. The advantages of speedy adjustment should be weighed against the loss of the social consensus. He was strongly in favor of maintaining the social partnership, even at the expense of slower structural adjustment. The extent of structural adjustment in small and medium-sized enterprises was difficult to determine owing to a lack of statistics. Those enterprises had apparently implemented structural adjustment rapidly, as indicated by their gain in export shares. High-technology production had increased in Austria; for example, progress had been made in the production of computer chips and automotive parts. Eighty percent of car imports were covered by exports of automotive parts, even though Austria did not produce cars.

A slight increase in unemployment was forecast for 1985, Mr. Schneider pointed out. However, there was public awareness that Austria could not isolate itself completely from developments in other OECD countries. Compared with those countries, Austria's unemployment rate was relatively low. As to wage settlements, the projected loss of real income was perhaps more than could be asked of the unions, given macroeconomic variables and the framework of economic policymaking in Austria. There would be no reduction in income tax in 1985 or 1986, but a downward adjustment in income tax was not excluded for 1987.

Austrian companies found it difficult to compete in international markets with larger companies from other industrial countries, Mr. Schneider remarked. For that reason, Austria had developed a sophisticated export guarantee system to cover exports for political and commercial risks. Developments were monitored closely by the Export Council, in which the Government, the central bank, industry, and labor were represented. In view of the increase in total exports covered by the Government, the central bank was involved in screening requests for guarantees.

The banking agreement was seen as a temporary arrangement by the authorities, Mr. Schneider stated. It was their firm intention to amend the 1979 Banking Act by mid-1986. The main aim of the proposed amendment was to improve the capital base of the banks.

The inflation differential vis-à-vis Germany had been large in 1984, with the consequence that the Austrian central bank could not follow the reduction in interest rates that had taken place in Germany, Mr. Schneider commented. It had maintained a high interest rate differential in order to make up for the inflation differential. The Austrian National Bank had pursued a flexible monetary policy in 1983 and 1984 because the principal target of monetary policy had been to maintain a viable external position rather than to improve the employment situation. In the first few months of 1985 the inflation differential had again narrowed to an acceptable level.

The Acting Chairman made the following summing up:

Executive Directors commended the Austrian authorities for the favorable performance of their economy, with expansion continuing in a climate of relative internal and external balance.

While the effect of the past downturn on unemployment had been large by Austrian standards, despite measures to reduce the supply of labor, the rise in unemployment had been arrested at a level that was quite moderate by present international standards. The social partnership, one of Austria's important assets, had remained effective and wage restraint had played an important role in the favorable developments of the Austrian economy.

Directors welcomed the progress that had been achieved during 1984 in reducing the federal deficit. Many Directors noted with regret, however, that despite the likely continuation of the economic upswing, no further reduction in the deficit was planned for 1985. Given the possibility of a renewed increase in the size of the deficit in the years ahead, Directors stressed the importance of the intended comprehensive screening of government outlays. They welcomed the recent pension reform, but noted that to achieve a lasting reduction in federal transfers to the pension system, further economies would be required. A number of Directors advocated a modernization of the tax system and a broadening of the tax base, including efforts to reduce tax avoidance and tax evasion.

Directors welcomed the authorities' commitment to ensuring that the nationalized industries would return to financial viability by 1986 and the stepped-up structural reform that that entailed. The results in 1984 showed that progress was being made, but Directors believed that the generally satisfactory position and outlook of the economy warranted a faster pace of structural change in industry in order to improve the utilization of resources, including the creation of employment opportunities. Moreover, a number of Directors stressed the desirability of reversing the previous downward trend in productive investment and the continuing need to strengthen competitiveness.

The intended rationalization of the complex and costly system of government support for industry in general was welcomed and it was stressed that the recovery in industrial profitability provided an opportunity for the necessary pruning of industry support. Some caution was expressed with regard to the budgetary risks and the possible economic distortions entailed by the use of government guarantees, including those for exports.

Directors endorsed the hard currency strategy of Austrian exchange rate and monetary policies. They noted that commitment to and acceptance of this policy had not wavered even though maintaining stability in the schilling/deutsche mark exchange rate had implied significantly tighter monetary conditions in 1984 than in 1982-83. Several Directors stressed that in the medium term a noticeable inflation differential vis-à-vis

Germany could not be permitted if a strain on the hard currency policy were to be avoided. This would be particularly important, it was noted, if there should be a marked strengthening of the deutsche mark vis-à-vis the U.S. dollar and other currencies. In this context, it was noted that the wage agreements for 1985 included virtually full compensation for price increases in 1984, including the component attributable to the raising of value-added tax rates. Several Directors held the view that the external current account might show a larger deficit in 1985 than currently forecast by the authorities.

Directors noted the recently concluded competition agreement between commercial banks, but a number of Directors expressed concern about the implications of the agreement, including implications for consumers. They expressed the hope that a more permanent improvement in the financial resilience of the banking sector could be reached by means other than limiting competition. In this connection, Directors noted that legislative steps in the areas of minimum capital ratios and of banking supervision were being prepared.

Directors commended Austria for its firm adherence to a free trading system and also welcomed the authorities' decision to raise ODA in terms of GDP.

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

3. SRI LANKA - 1985 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1985 Article IV consultation with Sri Lanka, together with a proposed decision concluding the 1985 Article XIV consultation (SM/85/101, 4/9/85). They also had before them a report on recent economic developments in Sri Lanka (SM/85/112, 4/25/85).

The staff representative from the Asian Department stated that recent information from Sri Lanka indicated that in April 1985 the cost of living index compiled by the Central Bank had been 3.5 percentage points lower than a year previously, reflecting largely a decline in food prices. The annual rate of growth of money supply had remained at about 11 percent in the year ended March 1985, while the growth of broad money had declined somewhat to 14 percent in the same period. The decline in the consumer price index, together with the general weakening of the U.S. dollar and the further depreciation of the Sri Lanka rupee against the dollar, had led to a real depreciation of the rupee of about 12 percent between February 1985 and April 1985. Some of those calculations were based on preliminary data.

Mr. Jayawardena made the following statement:

As Directors are aware, Sri Lanka initiated a widespread program of economic liberalization in 1977, after over three decades of slow growth and increasing controls. This move released vast pent-up energies that well exceeded the expectations of the authorities and helped tide Sri Lanka over one of the worst world recessions in recent times, with a resilient economy. The contribution from the IMF and the international community to this transformation has been immeasurable. However, as in most success stories, many new problems have been created, and my authorities are currently grappling with them with some success.

The dominant factor influencing the economy in 1984 has been the improvement in the terms of trade for the second successive year, a welcome relief to a country that has suffered continuous deterioration in this regard for most of its recent history. Export receipts grew by 45 percent, half of which was due to improvements in the terms of trade, and the other half to growth in export volume. Imports grew only modestly, and the external current account deficit declined by 8 percentage points, to 1.1 percent of GDP, or 3.6 percent of GDP if foreign grants are excluded. The balance of payments recorded an overall surplus of SDR 297 million--5 percent of GDP--and gross official reserves rose sharply at year-end to SDR 522 million, which was equivalent to 3.4 months of imports.

Underpinning this performance was the continued resilience of the domestic economy, which grew by 5.1 percent, thus continuing the trend since 1977, with the economy growing at twice the rate achieved during 1970-77. It is noteworthy that this occurred despite unseasonable and heavy rains during most of the year and widespread floods in the early part of the year, which affected domestic food production. The traditional tree-crop sector recorded a strong revival and, aided by plentiful energy supplies, the industrial sector recorded strong growth. Domestic savings rose sharply from 16.4 percent of GDP in 1983 to 22.5 percent in 1984, a rate quite high for a low-income country. The staff has described this performance as "fairly favorable."

The basic thrust of macroeconomic policy in these circumstances was to contain the inflationary impact of the terms of trade improvement, to reduce foreign and domestic indebtedness, and to accumulate a reasonable level of reserves. The policies were basically anticyclical. Aided by a 45 percent growth in revenue--vis-à-vis 24 percent growth in expenditure--the budget deficit was reduced by 3 percentage points of GDP to 7.4 percent--or 11.3 percent when grants are excluded--enabling a sharp reduction in domestic borrowing and a substantial repayment of debt. The rate of liquidity growth was slowed--M-1 from 25 percent to 14 percent, and M-2 from 22 percent to 17 percent--by tight monetary policy and the above-mentioned fiscal strategy. Public sector credit declined by 15 percent, following a reduction of net credit to Government of 17 percent and to public enterprises of 5 percent. Private sector credit growth declined from 34 percent in 1983 to 14 percent in 1984. These were the results of a substantial tightening of credit initiated in 1983 and intensified in 1984. The Central Bank mopped up additional liquidity through the sale of its own securities. Interest rates remained positive in real terms. The scope of concessionary central bank refinancing was substantially reduced. These policies, combined with better agricultural performance in the second half of the year, were successful in bringing down inflation from about 22 percent at the end of 1983 to about 7 percent at the end of 1984. The staff has characterized this performance as "broadly successful."

Meanwhile, the external debt service ratio, based on exports of goods and services, declined from 24 percent in 1983 to 17.4 percent in 1984, largely on account of the improved balance of payments performance. When related to current receipts, the ratio shows a decline from 20 percent to 15 percent. Further, a substantial repayment of short-term foreign commercial debt was made. As a result, net capital inflows on commercial terms declined from SDR 150 million in 1983 to SDR 9 million in 1984.

My authorities wish to continue the tight demand management and appropriate supply-side policies of the recent past within an open economic framework. As expected, tea export prices declined in early 1985. A part of this decline is seasonal, but overall, the very high and unsustainable tea prices of 1983-84 are expected to be 18-20 percent lower and the external current account deficit is now estimated to be higher--SDR 390 million as against SDR 310 million--or 6 percent of GDP, excluding grants. Meanwhile, imports and private capital inflows, net, are expected to be slightly lower. Thus, the overall surplus of the balance of payments, which was expected to be SDR 281 million at the time of the consultations, has been revised to a more modest SDR 177 million. My authorities believe that the medium-term balance of payments scenario for 1986-90 could remain broadly unaffected, except that a more modestly declining external current account deficit profile may be warranted.

A tight rein on the fiscal situation will be necessary to achieve the above objective. The 1985 budget projects a further reduction in the fiscal deficit of 1.5 percentage points of GDP, but as the staff suggests, careful expenditure control will be necessary to achieve this target, as the revenue from tea is likely to be lower than anticipated. Already, the Cabinet has decided not to entertain any supplementary expenditures in 1985 other than for higher aid absorption; and any new projects approved during 1985 will be considered for implementation only in 1986, and only if resources are available. Also, now that the public enterprise evaluations are being completed, a speedy implementation of reform, including privatization, can be foreseen. Budgetary pressures arising from the large public investment program are being eased with the completion of major projects. The Fund will be sending a fiscal technical assistance mission in mid-1985 to assess the emerging outlook. As in the past, my authorities stand ready to take corrective action, when necessary.

Monetary policy will have to maintain its restrictive stance during 1985, now that it has proved its usefulness in containing inflationary tendencies. Some moderation in lending rates has taken place in view of the liquidity growth in the banking system, and this may provide a stimulus to private investment, but the authorities will be watchful to ensure that interest rates remain positive. Meanwhile, the continued buoyancy of the economy, as evident from early returns, indicates that inflation could be contained at levels lower than the envisaged rate of 8 percent. The latest data for the Central Bank's cost of living index (April 1985) show that annual inflation is, in fact, minus 3.5 percent. Hence, my authorities expect inflation at the end of 1985 to be about 5 percent.

With regard to exchange rate policy, my authorities have followed a flexible policy of frequent, almost daily, adjustments relative to a basket of major trading partner currencies. Latest (April 1985) data show that, based on the 1983 basket, the rupee has depreciated in real effective terms by 4.5 percent--using the adjusted wholesale price index--and by 13 percent--using the consumer price index--since the previous consultation in August 1984. Real effective depreciation during 1985 so far has been 5.9 percent and 12.3 percent, respectively. In terms of the Fund's notification basket, there has been a slight appreciation of 2.6 percent--using the adjusted wholesale price index--since the last consultation, but a depreciation of 6.4 percent using the consumer price index. My authorities feel that this method of frequent adjustment is preferable to major discrete adjustments, because it will have a beneficial impact on domestic prices, and provide a longer-term view of relevant factors, thus avoiding short-term fluctuations that could arise from exceptional factors. They will make every endeavor to keep the economy internationally competitive.

The economy is expected to grow by over 5 percent in 1985 and beyond. In fact, two major structural reforms implemented recently are likely to have a positive impact, which is not quantifiable at this stage. First, a major structural reform has been initiated to restore incentives in the plantation tree-crop sector. Second, the recent tariff reform has eliminated some of the major antiexport biases in the economy. Moreover, the increased energy and water resources available from the major public investment projects now being completed will greatly enhance agricultural and industrial productivity.

Mr. Ismael remarked that the continued improvement in Sri Lanka's terms of trade, good weather conditions, and the generally sound policy orientation of the authorities in the past few years had allowed a strong economic performance in 1984. The economy continued to register a respectable rate of growth, and substantial progress had been made in reducing the rate of inflation, current account deficit, and fiscal deficit. Expenditure restraint and the relatively tight monetary policy had moderated the increase in domestic demand, despite the substantial rise in government and private sector income. Those developments had permitted the Government to improve the balance between domestic savings and investment, strengthen the international reserve position, and reduce commercial indebtedness.

Nonetheless, the underlying structure of the economy needed to be strengthened further, Mr. Ismael considered. The substantially improved external position and higher domestic savings in 1984 were attributable largely to buoyant tea exports, which might not continue in the coming years. The medium-term outlook clearly indicated that a significant increase in the propensity to save and in nontraditional exports was essential to put the economy on a path of sustained growth and to achieve a viable balance of payments position. The strategy adopted by the authorities was appropriate to those ends, with the focus on increasing government savings and enhancing the role of the private sector by restoring economic incentives and scaling down public sector investment.

Despite some expenditure overruns, the progress made in curtailing government expenditure in 1984, particularly current expenditure, together with higher tax revenue, had increased government savings and reduced the fiscal deficit substantially, Mr. Ismael noted. The 15 percent cut in capital expenditure planned for 1985 was welcome. However, total revenue was projected to decline as a ratio to GDP owing to tax relief and exemptions, while current expenditure was budgeted to increase as a ratio to GDP, resulting in a decline in government savings that could hinder the efforts to reduce the fiscal deficit, particularly if tea revenue turned out to be lower, and defense expenditure larger, than budgeted. Extreme caution should be exercised in reducing government revenue, given the sensitivity of the various revenue and expenditure components. The authorities needed to increase the elasticity of the tax system. With respect to expenditure, the plan to reform the food and kerosene subsidy system by narrowing the number of beneficiaries was noteworthy and should help to reduce gradually the burden on the budget. The proposed review of the control system and rationalization of the operations of public enterprises were appropriate. He supported technical assistance by the Fund in the area of expenditure control.

The measures taken by the authorities in 1984 to contain monetary growth, including the large net repayment of government debt to the banking system, the curtailment of private sector credit, and the introduction of a system for auctioning central bank securities, were commendable, Mr. Ismael commented. The authorities appropriately intended to exercise even tighter control in 1985 in view of the projected excess liquidity of the banking system and the need to reduce inflation further. Central bank securities should continue to be sold to mop up excess liquidity with a view to developing a more sophisticated monetary instrument that would replace the quantitative credit restrictions currently being used to control liquidity expansion. The recent measures to liberalize the money market had led to a decrease in deposit rates, which, however, remained positive in real terms. Removal of the quantitative credit ceiling would help to reduce the present stickiness of lending rates.

Exchange rate management was another crucial aspect of an outward-oriented growth strategy, Mr. Ismael considered. Mr. Jayawardena's indication that the authorities had begun to manage the exchange rate with greater flexibility was encouraging. Given the low inflation rate and continued monetary restraint, the adoption of a more active exchange rate policy was appropriate as it would reverse the real appreciation of the rupee over the past few years. The consequent improvement in Sri Lanka's competitive position and the restraining impact on demand for imports would allow the authorities to liberalize trade and reduce industrial protection.

The substantial cutback in commercial borrowing in 1984 and the acceleration of repayments of commercial loans, possibly because of the improvements in the current and capital accounts, had reversed the increasing share of commercial debt in total external debt, Mr. Ismael observed. The authorities should be encouraged to continue their policy of avoiding an excessive debt service burden. However, as concessionary capital was expected to decline in the coming years, policies to encourage non-debt-creating flows should be strengthened. In addition to tax incentives, some existing regulatory restrictions, such as the requirement of 51 percent domestic ownership of shares in investment with access to local markets, might need to be reviewed.

The authorities should be commended for the continuous and steady progress being made to improve the financial position and efficiency of the public enterprises, Mr. Ismael remarked. The importance of that policy exercise and its repercussions on public finances, employment, and the competitive strength of domestic industry should be emphasized. He encouraged the authorities to continue pursuing restrained income and wage policies and generally sound and effective energy and income distribution policies. Finally, he supported the proposed decision.

Mr. Zhang observed that the staff had concluded that the reforms of 1977 had heralded a new era of economic policy and marked a turning point in the economic performance of Sri Lanka. The economy had grown rapidly after 1979, achieving an average annual rate of growth of 6 percent of GDP in 1978-84, twice the rate prevailing in 1970-77. That achievement was all the more remarkable as it had taken place at a time when the world was going through one of the worst recessions and when growth in many countries had ceased or even declined.

The staff had also identified two important weaknesses that had serious long-term implications: inadequate growth of exports and low domestic savings, Mr. Zhang considered. The virtual stagnation of domestic savings observed by the staff was not borne out by facts. Domestic savings as a percentage of GDP had risen from about 14-15 percent between 1978 and 1982 to 16.4 percent in 1983 and 22.5 percent in 1984, a ratio that was high for a developing country like Sri Lanka where per capita income was only about SDR 320 a year. The so-called poor savings performance in 1978-82 and the improvements since then were attributable partly to terms of trade factors--the sharp deterioration in the terms of trade between 1978 and 1982 and the equally sharp improvement in the terms of trade in 1983 and 1984.

The effect of the terms of trade on savings in a highly trade-dependent small island economy was clear, Mr. Zhang continued. However, the staff tried to attribute those developments to changes in real interest rates, which had been negative for most of the period 1978-83. Experience had shown that positive real interest rates could not improve savings performance in an economy suffering from adverse terms of trade. Moreover, the staff's view that domestic savings had been inadequate had apparently been based on the fact that Sri Lanka was importing a large volume of foreign savings mobilized on concessional terms during the period. Foreign savings had risen to nearly 20 percent of GDP in 1980 and had declined thereafter to about 12 percent of GDP in 1983, with the completion of the Public Investment Program. In 1984, foreign savings had amounted to only 4 percent of GDP. The fact that foreign savings accounted for a large part of domestic investment should not itself lead to the conclusion that domestic savings had been inadequate. In its reports, the staff invariably ignored the institutional factors that might affect the mobilization of savings in developing countries and did not always take into account the adverse effects of increases in real interest rates on domestic investment and government expenditure when evaluating a country's macroeconomic policies.

Under the 1984 tariff reform, tariffs covering some 2,500 items had been changed, with import duty rates being reduced on most items, Mr. Zhang observed. Thus, the staff had concluded that the tariff reform was an important step toward a more rational incentive system that would eliminate the antiexport bias of the tariff structure. Sri Lanka was another important example of a developing country that had lifted protectionist barriers at a time when many other countries were increasing them.

The staff claimed that the real appreciation of the rupee had seriously eroded export competitiveness, Mr. Zhang noted. But with a 45 percent increase in the value of exports in 1984, Sri Lanka had achieved one of the highest export growth rates in the world. While that increase had been due largely to a rise in export prices, there had also been an expansion in the volume of exports, which had been 20 percent higher in 1984 than in 1980. It was inconceivable how that increase could have been achieved if the exchange rate had been significantly out of alignment. Export performance in Sri Lanka was subject to diverse influences: agricultural exports were heavily influenced by climatic conditions; garment exports had been affected by protectionist measures in importing countries; and major traditional exports were recovering only after long years of neglect. Exchange rate action alone would not necessarily generate additional exports.

An appropriate measurement of a real effective exchange rate was difficult to determine, and any measurement should therefore be used with caution, Mr. Zhang considered. Mr. Jayawardena had referred to various real effective exchange rates. Depending on which price index was used, the results could be quite different. Indeed, it was unclear whether there had been a slight appreciation or a significant depreciation of the rupee since the 1984 Article IV consultation with Sri Lanka. On which calculation should Sri Lanka base its exchange rate policy? The disequilibrium among the exchange rates of major international currencies, especially vis-à-vis the U.S. dollar, made the task of determining and managing the exchange rate particularly difficult. The rupee had depreciated continuously vis-à-vis the dollar in nominal terms, but the appreciation of the dollar, combined with Sri Lanka's relatively high rate of inflation, had canceled some of the gains.

As for exchange rate policy in future, Mr. Zhang went on, he supported the authorities' preference for frequent and small adjustments of the exchange rate when needed, rather than large discrete adjustments, which would have an abrupt adverse impact on domestic prices of imports, including essential investment and consumption goods. On the export side, it was unclear whether a devaluation was necessary at present to increase the competitiveness of nontraditional exports. For example, the volume of exports of garments and textiles had increased by 760 percent between 1978 and 1984 and the volume of other manufactured goods, essentially oils and jewelry, by 160 percent, despite the increase in export prices of those goods. In other words, the price factor had probably not been an important determinant in that increase in export volume.

Mr. Leonard remarked that tighter monetary policy and a reduction in the government budget deficit, combined with a more favorable external environment and good weather at the end of 1984, had enabled the authorities to make progress in the past year in reducing the economic imbalances. The external current account deficit had declined sharply from more than 12 percent of GDP in 1983 to less than 4 percent of GDP in 1984; inflation had slowed significantly; and the economy had grown by 5 percent in real terms, reflecting, in part, a recovery from the civil disturbances of 1983. The authorities had wisely taken the opportunity to reduce external debt, add substantially to official reserves, reduce tariffs, and repay some of the outstanding debt to domestic commercial banks.

To some extent, the progress made had been due to favorable developments that might be reversed, Mr. Leonard observed. In particular, if tea prices did not recover substantially from their 20 percent fall in March 1985, government revenue would decline, the budget deficit would increase, and the external accounts would deteriorate. There was therefore no room for relaxation of the corrective action being undertaken by the authorities, and the favorable developments of 1984 should not be allowed to obscure the underlying weaknesses in the economy that needed to be tackled urgently.

Those weaknesses lay primarily on the external side and in the low level of domestic savings, Mr. Leonard continued. The substantial investment expenditure of recent years and the consequent rapid economic growth had been possible only at the cost of the development of strains in the balance of payments, a buildup of external debt, and an increasing debt service burden. To ease those pressures, the emphasis of future policy must be largely on export-led growth. The tariff reform and the plan to lower effective protection were therefore welcome and should contribute to a more internationally competitive industrial sector. The authorities' efforts to revitalize traditional agricultural exports were also in the right direction. He particularly welcomed the granting of greater managerial autonomy and financial accountability to state plantations and the further lowering of export duties.

Those specific measures would need to be supported by an appropriately flexible exchange rate policy, Mr. Leonard went on. While the loss of competitiveness resulting from the real effective appreciation of the exchange rate since 1978 had been offset recently by increasing commodity prices and the recovery of world demand, those fortuitous factors could not be counted upon to persist. Moreover, without stronger incentives for private businesses to expand their exports, it would be difficult to diversify nontraditional exports beyond the present narrow range of textiles and garments, while maintaining the minimum 15 percent growth rate of nontraditional exports identified as necessary by the staff if the debt service ratio were to be contained. A depreciation of the exchange rate would provide the necessary incentive to exports and would be particularly opportune given the decline in the rate of inflation. The study on export promotion currently being undertaken should consider that opportunity.

The successful management of an exchange rate depreciation would require a continuation of tight monetary policy, Mr. Leonard considered. The authorities' objective to limit the growth of M-1 to 8 percent in 1985 was important, as the high rate of inflation in Sri Lanka compared with its trading partners had been the primary reason for the past appreciation of the real effective exchange rate. While open market operations, an increase in the deposit ratio requirement for banks, and net repayments by the Government to the banking system in 1984 had contributed to reducing the rate of growth of broad money, it still remained relatively high at 17 percent at end-1984 and would need to be reduced further if the gains in reducing the inflation rate were to be maintained.

Balanced economic growth in the medium term would require, in addition to a strong export sector, a lasting improvement in the domestic savings ratio, which, in turn, would depend on an improvement in the finances of the public sector, Mr. Leonard pointed out. Despite some improvement in 1984, the budget deficit remained high at more than 7 percent of GDP and, together with the external deficit, was likely to come under strong pressure in the future as the Mahaweli project was completed and foreign aid declined. The authorities would, therefore, have to maintain a firm grip on the management of public finances.

He shared the staff's doubts about the outturn of the authorities' program of expenditure restraint coupled with a program of tax relief, Mr. Leonard stated. He understood their desire to reduce the tax burden but feared that in the absence of further adjustment measures, expenditure would not decline as envisaged. In particular, the projected dramatic decline in subsidies to public enterprises seemed uncertain. The efforts to reduce those subsidies through privatization were scarcely sufficient to bring about the savings that were sought. The higher estimates for expenditure on subsidies provided by the staff were more appropriate than the authorities' estimates. The authorities would therefore be well advised to ensure that total expenditure was kept in line regardless of developments in subsidies, given the need to control the growth of public expenditure at present and in the medium term. The authorities' request for technical assistance from the Fund in that area was welcome. He supported the Bank and Fund staff in their call for measures to improve the finances of the public enterprises and hoped that the study being undertaken on that sector by the authorities would promptly result in a more assured fiscal position.

On the revenue side, substantial risks existed both in 1985 and in the medium term with regard to tea prices, Mr. Leonard continued. If the lower prices for tea persisted, government revenue would be weakened because of the decline in receipts from export duties on tea, which were expected to account for more than 13 percent of revenue in 1985. Income tax collection would also be adversely affected. A major defect to be overcome was the inelasticity of the tax system, which had yielded revenue of almost 24 percent of GDP in 1978 but was projected to yield only 17 percent of GDP in 1985. Any reform of the tax system should reduce the reliance on revenue from trade taxes because of the disincentive to exports and the inefficiencies they would promote. In addition, while the authorities' desire to improve economic incentives was understandable, the tax base should be broadened and the tax effort intensified. In sum, the authorities were successfully correcting financial imbalances and promoting the growth of the economy; the current favorable external situation presented the opportunity to increase real per capita income and to improve economic welfare.

Mr. Hammann commended the authorities for having laid the basis for improvement in Sri Lanka's overall economic situation, which had been due partly to favorable weather conditions but largely to the increased emphasis on providing market incentives and on strengthening efficiency.

The steps taken to reform the system of customs and tariffs and the maintenance of a virtually unrestricted exchange system for current payments and transfers were particularly commendable given the difficult social situation in Sri Lanka. The achievements on the external side had also been remarkable. However, similar positive developments could not be expected in 1985 as market conditions had become less favorable for Sri Lanka's exports. Unfortunately, the authorities had not exercised the necessary degree of fiscal restraint, notably with respect to current expenditure, when external developments had been favorable in 1984. Adjustment would be more difficult in the future.

He broadly agreed with the staff's recommendations, Mr. Hammann commented. The stance of future policies should be geared primarily toward consolidating the increase in national savings, reducing the resource gap, diversifying the export base, and rehabilitating public enterprises. The medium-term forecast presented by the staff underlined the importance of corrective measures in those areas.

More specifically, while budgetary performance had been favorable thus far, further determined efforts to consolidate the budget deserved the highest priority, all the more so given the likelihood of decreasing external financial support as a result of social unrest in Sri Lanka, Mr. Hammann observed. Fiscal adjustment measures should concentrate on containing public expenditure and increasing the elasticity of the tax system. The envisaged changes in the system of subsidies and in the tax system were welcome. Priority should also be given to strengthening the financial position of public enterprises. It was unfortunate that the recommendations of the World Bank regarding public enterprises had apparently been implemented only halfheartedly. There was considerable room for maneuver in that area, including the privatization of some enterprises.

The decline in the inflation rate was remarkable given the growth of monetary aggregates and the inflationary impact of changes in the terms of trade, Mr. Hammann considered. Could the staff or Mr. Jayawardena provide explanations for that development, other than the enhanced food supplies? It was of some concern that the overall conduct of monetary policy was still being impaired by the rediscount facility offered at favorable terms to the tree-crop sector. That facility should have been eliminated when other steps had been taken at end-1984 to limit credit growth. The current favorable world market prices for tree crops and the generous domestic liquidity supply lent further support for an early termination of the rediscount facility.

He associated himself with the remarks made by Mr. Leonard on external policy, Mr. Hammann stated. Finally, could the staff explain why the 1985 Article IV consultation had been held only nine months after the previous consultation?

Mr. Fujino stated that the Sri Lanka authorities should be commended for the generally favorable economic performance since the liberalization reforms of 1977. The average annual rate of economic growth of about

6 percent in 1978-84 was impressive, particularly as it had been achieved during a period of prolonged worldwide recession and domestic security problems caused by ethnic conflict. The expansion of the public sector investment program and its visible effect on irrigation and energy development were welcome. The deregulation and revitalization of the private sector were stimulating the economy, although temporarily it might be adversely influenced by the deterioration in security conditions. In 1984, the authorities had taken advantage of the favorable external environment, notably the high tea prices, to reduce the large external and fiscal imbalances, while maintaining growth momentum. The large balance of payments surplus in 1984 had allowed the authorities to accumulate external reserves and to reduce substantially outstanding commercial debts.

There remained a number of structural weaknesses in the economy and some problems in demand management policy, Mr. Fujino pointed out. A lack of control over expenditure and the poor performance of public enterprises had made it difficult for the authorities to tighten fiscal policy adequately. The recent fall in the inflation rate appeared to reflect the effects of good weather on food production, rather than a prudent monetary policy. On the external side, the continued appreciation of the rupee in real effective terms was a matter of concern.

The prospects for the external balance were not particularly bright in the medium term, Mr. Fujino noted. Tea prices had dropped sharply in March 1984 and their future was uncertain, while foreign aid disbursements were expected to slow with the completion of the major development program. Recent successes left little room for complacency.

Important progress had been made in reducing the budget deficit over the past few years, although it remained at about 10 percent of GDP, before grants, in 1984, Mr. Fujino observed. It was regrettable that the budget deficit had been higher than projected in 1984 because of the supplementary capital outlays approved at the beginning of the year. The authorities were contemplating cutting capital expenditure by 15 percent in the 1985 budget and reducing treasury advances to the public corporations; he strongly endorsed those targets. The staff's concern about the risk of overspending was appropriate. The Cabinet's decision to refrain from any supplementary expenditures in 1985 other than for higher aid absorption was welcome. Any new projects approved during 1985 would be considered for implementation only in 1986 and only if resources were available. The authorities should strengthen their monitoring of the capital expenditure program and accelerate efforts to improve the performance of the public enterprises. Budget transfers and loans to those enterprises had risen sharply in 1984, accounting for more than 20 percent of government expenditure. Perhaps the World Bank could play a role in reviewing the authorities' investment priorities and in improving the flexibility of pricing and labor policies. The lack of current statistical data on the overall financial position of the public enterprises was cause for concern. He hoped that the ongoing study by the Parliamentary Committee on Public Enterprises would solve those problems in the near future.

The authorities' intention to reduce the overall tax burden in the medium term in order to improve incentives for the private sector was appropriate, Mr. Fujino considered, and subsequent tax measures should be aimed at export promotion. However, efforts to improve private incentives should be accompanied by measures to enlarge the tax base and strengthen tax administration. The sizable increase in tax revenue for the second consecutive year in 1984 had been largely a reflection of cyclical factors and one-time revenue-raising measures. Efforts to broaden the tax base by re-examining the existing tax exemptions were particularly important.

The authorities' objective to limit the growth of M-1 to 8 percent in 1985, aiming to keep the rate of inflation at about 5 percent, was commendable, Mr. Fujino commented. Although the authorities had made an effort to tighten monetary policy so that the external surplus would not jeopardize the objective of controlling inflation, the growth of broad money of about 17 percent in 1984 seemed high.

Could the staff elaborate on its suggestion that the current real effective appreciation of the rupee should not be allowed to continue, in the light of Mr. Jayawardena's opening comments on the exchange rate, Mr. Fujino inquired. Total export receipts had risen sharply in 1984, reflecting the favorable terms of trade and the recovery of tea production following the drought. But most nontraditional exports, except for garments, had not performed so well. The staff's medium-term projections showed that, given the limited scope for growth in the plantation sector, nontraditional exports would have to increase at an annual rate of about 15-25 percent in order to achieve a reasonable growth with a viable external position. Such a rate of growth would be difficult to achieve and would require a comprehensive strategy to develop an export-oriented manufacturing sector. Notable progress had been made in the garment industry, where exports had increased by almost 50 percent in 1984. The recent tariff reform was also an important step toward that objective. But clearly much more needed to be done to broaden the export base of the manufacturing sector. Finally, the current favorable external conditions provided an excellent opportunity for the authorities to tackle the structural weaknesses in the economy.

Mr. Doe stated that the striking progress of the Sri Lanka economy following the major economic reforms of 1977 and 1978 were encouraging. Since then, the authorities had steadily proceeded with their adjustment efforts, which had been strengthened in 1982 and 1983 through the implementation of several corrective measures in difficult domestic circumstances and an unfavorable international environment.

The sharp decrease in the external current account deficit to about 4 percent of GDP in 1984, the substantial reduction in the budget deficit for the second year in a row to the equivalent of 10 percent of GDP, and the decline in domestic liquidity expansion were manifestations of the financial and economic improvements, Mr. Doe pointed out. Real economic growth had remained high at about 5 percent over the past three years.

The balance of payments position was estimated to have strengthened significantly, registering an overall surplus of close to SDR 300 million in 1984 and gross official reserves exceeding three months of imports.

The authorities' aim to reduce the budget deficit further in 1985 was welcome, Mr. Doe remarked. The evolution of outlays should be closely monitored and the projects to be scaled down promptly identified in order to avoid expenditure overruns in 1985. The authorities' recognition of the need for a thorough review of the expenditure control system and their request for Fund technical assistance in that area were welcome. They were also aware of the need to examine the tax system and improve the buoyancy of government revenue. Those reviews should be initiated soon and completed rapidly in order to provide the Government with the necessary guidance for timely and prompt actions to improve revenue performance and expenditure restraint.

The authorities must concentrate their attention on establishing favorable conditions for a continued improvement in domestic savings, Mr. Doe considered. Efforts being made to maintain positive real interest rates were commendable and would go a long way toward stimulating local savings. Similarly, the implementation of a tight monetary policy in 1985 should have a favorable impact on inflation and alleviate pressures on the external payments position.

The medium-term prospects for the Sri Lanka economy appeared encouraging, but uncertain price developments for traditional exports, particularly tea, suggested the need for appropriate policies to accelerate the growth of nontraditional exports, especially in the manufacturing sector, in order to restore or maintain competitiveness, Mr. Doe remarked. He hoped that the recommendations of the high-level committee on industrial strategy would lead to the implementation of such policies. In conclusion, impressive progress had been made in narrowing the imbalances in the economy over the past two years, and the authorities should be encouraged to pursue their adjustment efforts with determination.

Mr. Steinberg noted that the authorities could take pride in their economic achievements, which included an improvement in the balance of payments, a significant cut in inflation, and a continued high rate of economic growth. Those successes were due partly to exogenous factors, such as favorable terms of trade and good agricultural production, and partly to the authorities' efforts, particularly in the fiscal and monetary areas. The comfortable economic environment had provided Sri Lanka with an opportunity to work toward its national goals and prepare for more difficult times in the future.

In 1984 the Government's main goals had been to reactivate the private sector and encourage foreign private investment through the improvement of infrastructure, provision of market incentives for export growth, pursuit of a realistic exchange rate policy, and control of inflation, Mr. Steinberg recalled. While the inflation target had been reached, exchange rate policy had been disappointing and had not provided the needed stimulus for export diversification and growth. It was encouraging to learn that the authorities agreed with the staff's recommendation that the exchange rate should be adjusted and a flexible exchange rate policy pursued to enhance competitiveness of both traditional and nontraditional exports. While the share of traditional exports in total exports was on the decline, it still comprised more than one half of total exports. Sri Lanka should reduce its dependency on exports that were affected by developments beyond the authorities' control, particularly by encouraging the growth of nontraditional exports. The authorities had demonstrated their ability to deal with inflation, and they should be encouraged to adjust their monetary policy. The tariff reform under way, which would remove the bias against exports, was welcome and should be completed rapidly.

The staff had pointed out the lack of domestic savings in Sri Lanka to support a satisfactory level of investment, Mr. Steinberg noted. Clearly, with the decline in net capital inflows, additional resources would have to be mobilized domestically to reach the goal of a 5 percent growth in GDP without an increase in the external debt service burden. Those resources might be raised from the public or the private sector. An increase in the private sector's share in economic activity and the sector's profitability would be required. The authorities would also have to introduce monetary incentives and maintain positive real interest rates. However, some additional flexibility could prove useful in adjusting nominal interest rates in line with price movements.

The public sector had performed satisfactorily in 1984, apart from the level of lending to the public enterprises, Mr. Steinberg remarked. However, the budget estimates for 1985 seemed bleak, particularly given the high expenditure level, which would result in a larger deficit and heavier domestic borrowing needs than previously. As the public enterprises also financed part of their deficits from the domestic banking system, the amount of credit available to the private sector would be reduced, thereby hindering the authorities' efforts to increase the role of the private sector in the economy. The poor performance of the public enterprises was cited by the staff as a serious weakness. While the authorities' efforts to close down or privatize some public enterprises and to improve the performance of others were noted in the staff report, no indication of the size and magnitude of the 125 public enterprises had been provided. In conclusion, Sri Lanka was in the distinct position of being able to work toward its long-term national goals with less short-term pressures and constraints than many other countries. However, there was no room for complacency. The adoption of more flexible exchange rate and interest rate policies and the completion of the tariff reform would be instrumental in improving the economic infrastructure.

Mr. Templeman observed that the economic policies adopted by Sri Lanka eight years previously had transformed the country into a model of economic growth and development, substantially through a free-market, private enterprise strategy. The positive results of those policies, combined with the recent rise in tea prices, had resulted in the economic transformation of a developing nation with few natural resources and difficult security problems. The authorities had successfully met almost all of their economic targets outlined during the 1984 Article IV consultation discussions. While the macroeconomic targets for 1984 had been largely surpassed, much of the success had, admittedly, been due to the favorable tea prices. For example, the substantial increase in tea receipts had helped to raise the domestic savings ratio, maintain the rate of real economic growth, allow budget-cutting measures and large repayments by the Central Bank to the banking system, and improve the terms of trade, current account, and overall balance of payments situation.

Annex I of SM/85/112, International Tea Trade and Prices, was useful, Mr. Templeman commented. However, the staff's conclusion that the price prospects for tea for the remainder of the year remained uncertain was worrying in its implications for the medium-term balance of payments and growth outlook for Sri Lanka. The balance of payments projections assumed a 2 percent decline in tea prices in 1985. Average tea prices as of May 1, 1985 were, in fact, 30 percent lower than 1984 prices. While they might be extraordinarily low owing to overreaction to India's export controls and the projected increase in overall supplies of tea in 1985, it seemed likely that tea prices would be about 20-30 percent lower during 1985 than projected by the staff. It would have been useful if the staff had provided a supplement to SM/85/101 including a revised table on the medium-term outlook of the balance of payments. A 30 percent decrease in tea prices would have a substantial impact on export receipts and would imply the need for revisions of the policies designed to achieve the balance of payments and growth objectives established by the authorities. Policies would have to focus on the fiscal and nontraditional export sectors, as a reduction in the already low level of international reserves was not feasible, and any lowering of the real growth rates should be minimized or avoided if possible.

The public sector deficit must be addressed with determination in order to increase domestic savings, Mr. Templeman considered. The management and financial operations of the public enterprises must be reformed. The authorities' efforts to privatize the public sector were encouraging. Could the staff elaborate on the prospects for measures to speed up progress in that area?

He urged the authorities to exercise expenditure restraint, particularly through lower public advances to corporations and greater control over last-minute capital expenditure, Mr. Templeman stated. It was encouraging to note the authorities' awareness of the need to hold a tight reign on the fiscal situation. The restructuring of the tax system to provide more incentives for the economy was appropriate. The Fund might provide useful technical assistance in that area. He wondered whether the establishment of a commodity stabilization fund was still feasible given the difficulties of financing such a fund during a time of declining tea receipts.

In addition to action in the fiscal area, Mr. Templeman went on, the authorities must take action to stimulate the nontraditional export sector. While steps had been taken to improve the plantation sector, some serious limitations prevented future growth in that sector. There was some room for continued improvement in import substitution and the development of additional exports, but efforts should be directed principally to the development of an export-oriented manufacturing sector through the use of private-sector, market-oriented strategies that had proved successful elsewhere in the economy and through a flexible exchange rate policy. Could the staff or Mr. Jayawardena comment on what the authorities might do to effectively encourage nontraditional exports? Could Mr. Jayawardena elaborate on why the authorities considered that frequent exchange rate adjustments would be preferable to major discrete adjustments? The time was right for more substantial exchange rate movements. In conclusion, it was a pleasure to consider a developing country beset by difficult security problems that had, nonetheless, achieved a successful development path through the use of private-sector initiatives.

Mr. Jones noted that Sri Lanka had made further progress in 1984 toward economic stabilization. The budget deficit had declined by about 3 percentage points of GDP, the balance of payments had registered a surplus, and inflation had dropped sharply. Those developments had proceeded simultaneously with a relatively satisfactory rate of growth, reflecting largely the balanced approach to adjustment that the authorities had adopted by implementing both demand management and structural adjustment policies. Efforts aimed at rehabilitating the plantation sector and reducing administrative controls with a view to making the investment climate more attractive to private investors were examples of the authorities' success. The garment industry had responded well to the new incentives and, in 1984, was one of the main sources of economic growth.

Sri Lanka's achievements had been due partly to the sizable aid extended to the country on concessional terms, which had filled the savings gap in the public sector and made it possible for the Government to undertake a number of major investment projects, Mr. Jones pointed out. The recovery of the global economy had also had a salutary effect, in terms of both the pickup in demand for Sri Lanka's exports and the remarkable improvement in the terms of trade. Good economic performance in developing countries with characteristics such as those of Sri Lanka depended on the right mix of a number of factors: sound domestic policy, adequate financial help from the international community, and a favorable external environment.

The authorities expected the economy to maintain its growth momentum in 1985, Mr. Jones observed. With population growth at about 1.6 percent, per capita income was likely to continue increasing, unlike the situation in many other developing countries where gains in production were offset, if not outstripped, by population growth. Nevertheless, it was of some concern that the economy's productive base remained narrow and that its dependence on a few export commodities left it highly vulnerable to adverse developments in the international market. For example, Sri Lanka's terms of trade were likely to deteriorate in 1985 because of a decline in tea prices, while industrial production was expected to slow in response to weakening external demand. The medium-term strategy should address those issues if growth were to be sustained.

The tendency for investment demand to exceed available domestic resources could hinder economic growth, Mr. Jones said. However, prospects could improve if investment that had been undertaken produced higher income, resulting in an increase in savings. That private savings had increased substantially during 1984 in response to the rise in earnings from tea production suggested a link between savings and income. In the immediate future, however, domestic resource mobilization could be enhanced by improving the performance of public corporations. The report on recent economic developments indicated that even the 7 percent rate of return of those enterprises estimated for 1981, down from 20 percent in 1979/80, was inflated.

On the Government's investment program, the authorities made the right choice to proceed with the Mahaweli project, making use of concessionary financing from abroad, Mr. Jones commented. The project was expected to have long-range benefits for the economy: providing larger quantities of hydroelectric power, thereby reducing dependence on oil imports; increasing water resources for irrigation; and promoting ancillary activities such as fishing, land resettlement, and crop diversification. Those developments should help to reduce unemployment, which had been about 12 percent in 1984. The project was already beginning to have a positive impact on the production of paddy, and Sri Lanka would soon become self-sufficient in rice. The authorities' agricultural policy, emphasizing both food production and the development of tree crops for export, was appropriate.

The authorities' intention to continue their policy of fiscal restraint was suitable, Mr. Jones observed. However, they must exercise tighter control over expenditure, particularly the wage bill, which was projected to rise by 19 percent in 1985. There was also a need to increase the elasticity of the tax system.

Nontraditional exports should be expanded as part of the general effort to widen the country's export base, Mr. Jones considered. Sri Lanka must have access to foreign markets in order to benefit from the policy aimed at increasing the competitiveness of its exports. The country was beginning to be affected by market restrictions on garments in both the European Communities and the United States. Import substitution efforts had shown some degree of success; foodgrain and sugar imports had declined from one fifth to one tenth of total imports between 1978 and 1984. Petroleum imports had also fallen. However, commercial debt had increased rapidly in recent years, from the equivalent of 7 percent of GDP in 1980 to 20 percent of GDP in 1983, before declining to 16 percent of GDP in 1984. The authorities were endeavoring to manage the situation in a prudent manner, using foreign exchange earnings to accumulate reserves and reduce commercial indebtedness. The flexible approach to exchange rate management being pursued by the authorities would best serve the needs of Sri Lanka. Finally, he supported the proposed decision.

Mr. Clark stated that he agreed with most of the remarks made by previous speakers. In the past two years, Sri Lanka's terms of trade had improved substantially, which in turn had had beneficial effects on government finances and the external position. The authorities had prudently applied some of those gains to reduce the level of short-term external debt and to build up reserves to a more adequate level. However, the favorable environment might not continue. In 1985 there had already been a sharp fall in tea prices, which would result in an annual loss in export earnings equivalent to approximately 2 percent of GDP. Even if tea prices rose in future, as the staff's medium-term scenarios assumed, significant increases in nontraditional exports would clearly be needed if the debt service ratio and reserves were to be kept at comfortable levels. Correspondingly, additional measures were needed to encourage those exports, while preserving the productive capacity of the traditional sector. He therefore welcomed the program, supported by the World Bank and the Asian Development Bank, to rehabilitate the state plantations.

The recent reform of the tariff structure, which had reduced the effective protection afforded to domestic industry and had strengthened the incentive to export, was appropriate, Mr. Clark continued. He looked forward to learning of any initiatives the high-level committee on industrial strategy might propose. The results of structural policies would take time to emerge; meanwhile, more efforts were needed, particularly in the area of public finance, in order to achieve the authorities' short-term macroeconomic objectives.

The authorities aimed to reduce the fiscal deficit in 1985 to just under 9 percent of GDP, about the same level planned in the revised budget for 1984, although the staff had doubts whether that target would be achieved, Mr. Clark noted. One factor operating to weaken the fiscal position was the projected decline in tax revenue as a percentage of GDP, which in turn reflected the authorities' objective of improving incentives by reducing the tax burden. While he endorsed that objective, taken on its own, he was less certain that it should be pursued at the expense of progress in cutting the fiscal deficit. More specifically, he wondered whether it was wise to implement tax cuts when the fiscal deficit, like the external account, was highly sensitive to developments in tea prices, which were already below the levels assumed in the budget projections. The authorities should perhaps consider delaying tax cuts until the elasticity of tax revenue had been improved and the tax base broadened, and until expenditure was more predictable and under better control. The authorities had requested technical assistance in those areas, and perhaps action might await the outcome of the technical studies to be undertaken.

It would be useful if the staff paper for the next Article IV consultation with Sri Lanka were to include a fuller discussion of developments in the parastatal sector and a progress report on reform measures, Mr. Clark remarked. On a related matter, he agreed with the staff that any proposed stabilization funds should be self-financing and should not become a further drain on the public finances. He endorsed the staff's view that higher commodity prices in general made it unnecessary to continue providing concessional refinancing facilities to the tree-crop sector. The establishment of any stabilization fund would provide further reason for eliminating those facilities.

Monetary growth, while slower, remained in double figures, and further restraint would be needed if the authorities were to succeed in holding inflation to their target of 5 percent, Mr. Clark considered. The staff projected that the GDP deflator, perhaps a better indicator of the underlying rate of inflation, would increase by 8 percent in 1985. The authorities should reduce their reliance on direct monetary controls. The apparent tendency of interest rates on deposits to fall reflected attempts by banks to discourage deposits, as their lending opportunities were rationed. More flexibility on both sides of the balance sheet should lead to a more efficient allocation of credit and a higher level of private savings. In conclusion, he supported the proposed decision.

Mr. Rye stated that the authorities should be commended for the remarkable performance of the Sri Lanka economy. He hoped that the authorities would rapidly find a solution to the country's security problems and would continue to build upon the outstanding economic achievements of recent years.

The staff representative from the Asian Department pointed out that domestic savings, having fluctuated around 15 percent through 1982, had increased sharply in 1983 and 1984 largely owing to the temporary boost to government revenue and private incomes from high tea prices. However, with a decline in tea prices the savings ratio would probably fall to a level that was inadequate, particularly given the decline in foreign savings projected for the coming years. Real interest rates, while not the only factor influencing private savings, should remain positive in order to encourage private savings. Considerable improvement could be made in government savings, which had been negative for many years, through the public enterprise sector. The authorities had relied increasingly on commercial borrowing, which had increased sharply the external debt service burden.

A large part of the rise in exports in 1983 and 1984 had resulted from higher tea prices, the staff representative stated. Nontraditional exports had declined by about 14 percent in real terms in 1983 and had increased by only 16 percent in 1984. The exchange rate had a role to play in encouraging the diversification of exports. There was no single or best measure of the real effective exchange rate. However, all the price indices available in Sri Lanka indicated a fairly strong appreciation of the rupee over the past five years.

The depreciation of the real effective exchange rate in the past few months was largely the result of a decline in food prices, the staff representative remarked. In particular, tea prices, which represented between 12 percent and 15 percent in the consumer price index, had come down, and other food prices, which had been exceptionally high in the previous year owing to drought conditions, had been reduced to more normal levels. Once those price developments were halted or reversed, within the framework of the current exchange rate policy, the real effective exchange rate might again appreciate.

The staff had not presented global consolidated figures for the public sector as the data were unavailable for all public enterprises, the staff representative explained. Progress was needed in that area. However, some indication of the importance of the public enterprises had been given in Table 42 of SM/85/112; while 40 percent of industrial production was accounted for by the public sector enterprises, they represented a rate of return on capital of only 8 percent, indicating the relatively poor performance of the sector. The capital structure of the public enterprises was weak, and there were, therefore, few buyers willing to take them over. In addition, entrepreneurial capital in Sri Lanka was relatively scarce. Efforts to encourage nontraditional exports, apart from exchange rate action, should be directed toward the private sector. The emphasis of the Government on privatization was a step in the right direction.

As to the effect of a decline in tea prices on the medium-term balance of payments scenarios, if the shortfall in export earnings from tea were to be made up entirely from official reserves, they would fall to one month's imports in 1988 and would be virtually exhausted in 1989, the staff representative stated. On the other hand, if a shortfall in tea export earnings were made up entirely from higher foreign borrowing, the debt service ratio would increase to 19 percent in 1990, rather than the 14 percent forecast under Scenario A in Table 6 of SM/85/101. Finally, if the shortfall in tea export earnings were made up entirely from an increase in nontraditional exports--the most ideal outcome--such exports would have to grow by 19 percent a year instead of 10 percent a year as assumed by the staff in the medium-term scenarios.

The interval between the 1984 and 1985 Article IV consultations had been short because the authorities had requested that the consultation be held soon after the introduction of the 1985 budget so that the staff could give its assessment of the budgetary measures, the staff representative from the Asian Department commented. If corrective measures were needed, the authorities could have introduced them on time, as had happened in 1984. Indeed, in 1984, following the recommendations of the staff and the Executive Board, the authorities had undertaken additional expenditure restraint measures after the budget had been introduced.

Mr. Jayawardena remarked that foreign savings as a percent of GDP had declined from 15 percent in 1983 to 5.5 percent in 1984. The domestic savings ratio in Sri Lanka in 1984 had not been low compared with that in countries with similar incomes. Domestic savings had declined substantially in 1983 and 1984 when Sri Lanka's terms of trade had fallen sharply. The role of interest rate policy in mobilizing domestic savings at a time when the terms of trade were moving substantially against Sri Lanka was a matter that could be debated extensively. The authorities had been able to mobilize a large volume of foreign resources through some highly imaginative and publicized projects, even at a time when they had changed economic policy substantially. As the aid climate had not been favorable in recent years, considerable amounts of foreign resources had been utilized. His authorities were aware that the recent high level of foreign resource utilization could not be sustained in the future and were, therefore, adjusting their objectives accordingly.

The liberalization reforms of 1977-78 had led to a rise in foreign savings, which, in turn, had induced an ambitious public investment program, Mr. Jayawardena indicated. It had been argued that that investment program had overheated the economy. However, the Government viewed that program as a trade-off against long-standing consumer subsidization in Sri Lanka. A kind of social consensus had been reached for the elimination of the consumer subsidies; the Government had convinced the population that its current hardships were temporary and that the resources that had been directed toward subsidies would be used for capital development. In addition, the negative effects on the economy of the adjustment measures had been somewhat ameliorated by the enhanced public investment program.

The continuous appreciation of the rupee in real terms over the past several years had been reversed in a matter of a few months by the domestic inflation rate and investment of foreign currencies, Mr. Jayawardena stated. Caution must be applied when measuring the relative appreciation of a currency in real terms. There were certain benefits to frequent and small adjustments in the exchange rate in terms of the effects on domestic prices. Large, discrete exchange rate changes would have a strong impact on domestic prices, which, by fueling domestic inflation, would negate the exchange rate adjustment, particularly in a small economy. The country's price indices were strongly influenced by seasonal factors, especially the weather. His authorities would prefer more stability in the exchange rate than would be the case if it were adjusted according to cost-price indices.

Of the 125 public enterprises in Sri Lanka, most were small welfare agencies, Mr. Jayawardena indicated, and there were about 20-25 industries. The authorities had experienced problems in reforming the public sector; it had been difficult to identify the capital base of many enterprises and to determine the terms under which the shares in those enterprises should be sold to the public.

The Acting Chairman made the following summing up:

Executive Directors commended the Sri Lanka authorities on the improvement in economic performance achieved in 1984. Prudent financial policies, combined with favorable external conditions--including relatively high international tea prices--had substantially reduced inflation and improved the balance of payments position, allowing a needed buildup of external reserves and reduction in external commercial indebtedness. However, Directors also noted that the gains achieved during the last year reflected to a large extent temporary factors and that much remained to be done to overcome the underlying structural problems.

Directors welcomed the sharp increase in domestic savings as a ratio to GDP recorded in 1984 but, noting that the contribution of favorable external developments was likely to be temporary, Directors encouraged the authorities to continue efforts to improve the domestic savings rate to offset the expected decline in net capital inflows in the coming years. As a substantial portion of the domestic savings effort would have to come from the government sector, Directors welcomed the significant improvement in the fiscal position during the past two years, but they expressed concern that the Government might not be able to meet its 1985 budget objectives without the introduction of additional measures.

On the expenditure side, control procedures would have to be improved to avoid the recurrence of the 1984 expenditure overruns. This was all the more important now that it appeared that tea prices would be significantly lower than forecast in the budget. Directors agreed with the staff that despite the good revenue performance in 1984, the elasticity of the Sri Lanka tax system was too low to sustain the required revenue effort during the years ahead. Tax efforts to improve private sector incentives should be combined with actions to broaden the tax base of the economy. The technical assistance requested from the Fund in this area could serve a useful function in designing measures to improve revenue performance and the expenditure control system.

With respect to public enterprises, Directors commented that better financial performance was essential to the achievement of fiscal discipline and monetary control. They urged the authorities to redouble their efforts to improve management techniques and economic incentives in the public enterprise sector, an area in which the World Bank was well placed to provide expert assistance.

Directors noted with satisfaction the contribution of tight monetary policy to the improvement in the internal and external balances of the economy in 1984. The authorities achieved a substantial increase in foreign reserves; at the same time, they reduced monetary expansion and inflation. Looking ahead, however, there was a clear danger that slippage in the government budget would make it difficult to maintain a stance on monetary policy consistent with the authorities' objectives of keeping inflation under control and improving the balance of payments. Directors therefore urged the authorities not to relax monetary policy and to take immediate measures to ensure the targeted improvement in the fiscal position. Several Directors also encouraged a reduced reliance on quantitative credit controls and a further reduction in concessional refinancing to the tree-crop sector.

In the area of economic incentives, Directors stressed the importance for future growth prospects of continued efforts to bring about an economic environment that was more conducive to export performance, in particular, through diversifying the export base, and to private sector initiatives. The recently implemented tariff reform designed to reduce the bias against exports was welcomed, and continued efforts in that area were recommended.

While welcoming the depreciation of the rupee in recent months, most Directors expressed concern about its real appreciation over the years because of the effects on export competitiveness and the climate for investment in the tradable goods sector. They stressed that the favorable balance of payments position in 1984 should not obscure the need for implementing a flexible exchange rate policy aimed at strengthening competitiveness and providing the correct signals to investors and producers.

Rapid growth of exports was essential, not only because debt service payments were rising, but also to ensure sustained economic growth in the medium term. It was also suggested that an improvement in the environment for foreign investment flows would be a positive step toward strengthening the balance of payments position.

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

The Executive Board then took the following decision:

1. The Fund takes this decision in concluding the 1985 Article XIV consultation with Sri Lanka, in the light of the 1985 Article IV consultation with Sri Lanka conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund notes with satisfaction that Sri Lanka continues to maintain an exchange system which, with the exception of certain limitations on the availability of foreign exchange for personal travel abroad, is free of restrictions on payments and transfers for current international transactions.

Decision No. 7984-(85/78), adopted
May 22, 1985

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/85/77 (5/22/85) and EBM/85/78 (5/22/85).

4. CHILE - 1985 ARTICLE IV CONSULTATION - POSTPONEMENT

Notwithstanding the period of three months specified in Procedure II of the document entitled "Surveillance Over Exchange Rate Policies" attached to Decision No. 5392-(77/63), adopted April 29, 1977, the Executive Board agrees to extend the period for completing the 1985 Article IV consultation with Chile to not later than June 28, 1985. (EBD/85/133, 5/20/85)

Decision No. 7985-(85/78), adopted
May 22, 1985

APPROVED: March 4, 1986

LEO VAN HOUTVEN
Secretary