NOT FOR PUBLIC USE

MASTER FILES

ROOM C-120

04

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 85/95

10:00 a.m., June 14, 1985

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

Executive Directors	Alternate Executive Directors
	A. K. Diaby, Temporary
	D. C. Templeman, Temporary
	P. Pêterfalvy, Temporary
	X. Blandin
	M. Z. M. Qureshi, Temporary
H. Fujino	M. Sugita
	B. Goos
J. E. Ismael	
R. K. Joyce	
	J. Hospedales, Temporary
	A. K. Juusela, Temporary
E. I. M. Mtei	A. Abdallah
	B. Jensen
	E. M. Ainley, Temporary
	G. Ortiz
	J. de Beaufort Wijnholds
	A. V. Romuáldez
G. Salehkhou	
	A. Vasudevan, Temporary
N. Wicks	
	N. Coumbis
Zhang Z.	Wang E.

L. Van Houtven, Secretary
V. C. Wall, Assistant

Also Present

IBRD: A. Cole, East Asia and Pacific Regional Office. African Department: J. M. Jiménez. Asian Department: Tun Thin, Director; B. B. Aghevli, J. R. Márquez-Ruarte, A. K. McGuirk, S. M. Schadler, J. Schulz, D. A. Scott. Exchange and Trade Relations Department: E. H. Brau, S. Kanesa-Thasan, K. M. Meesook, B. J. Nivollet. Fiscal Affairs Department: P. S. Heller. Legal Department: W. E. Holder. Research Department: W. C. Hood, Economic Counsellor and Director; L. Alexander, D. J. Andrews, K.-Y. Chu, T. K. Morrison, B. E. Rourke. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: A. A. Agah, S. M. Hassan, G. Nguyen, T. Sirivedhin. Assistants to Executive Directors: W.-R. Bengs, Chen J., J. de la Herrán, R. Fox, V. Govindarajan, N. Haque, G. D. Hodgson, Z. b. Ismail, J. M. Jones. H. Kobayashi, R. Msadek, J. A. K. Munthali, K. Murakami, E. Olsen, W. K. Parmena, M. Rasyid, J. Reddy, D. J. Robinson, J. E. Rodríguez, C. A. Salinas, M. Sarenac, A. A. Scholten, L. Tornetta, Yang W.-M.

1. THAILAND - 1985 ARTICLE IV CONSULTATION, REQUEST FOR STAND-BY ARRANGEMENT, AND USE OF FUND RESOURCES - COMPENSATORY FINANCING FACILITY

The Executive Directors considered the staff report for the 1985 Article IV consultation with Thailand, together with a proposed decision concluding the 1985 Article XIV consultation and a request for a stand-by arrangement for the period June 14, 1985-March 31, 1987 in an amount equivalent to SDR 400 million (EBS/85/128, 5/15/85), a request for purchase under the compensatory financing facility in an amount equivalent to SDR 185 million (EBS/85/129, 5/15/85; and Sup. 1, 6/12/85). They also had before them a paper on recent economic developments in Thailand (SM/85/154, 5/30/85).

Mr. Ismael made the following statement:

As a result of strong demand management policies, the Thai economy in 1984 continued to show improvement over the previous year. The real rate of economic growth improved moderately to 6.3 percent while inflation was reduced substantially to near zero. The fiscal position continued to improve and the current account gap narrowed significantly.

The current account deficit rose to a record level in 1983, owing to both a strong economic recovery that was associated with a surge of domestic demand, particularly in the second half of the year, and a contraction of export volume arising from the lagged impact of a bad harvest and from protectionism abroad. In response to this unexpected development, the Government decided in early 1984 to intensify its stabilization policy, in particular by severely limiting credit expansion and following a moderately restrictive fiscal policy. Consequently, the growth of domestic demand decelerated significantly from almost 11 percent per annum in 1983 to slightly above 2 percent per annum in 1984. However, the growth performance remained strong because of an impressive expansion of exports following a strong recovery in external demand and a sufficient supply response. An equally encouraging development also occurred on the price front. The rate of inflation, which had been declining continuously since 1980, maintained its downward momentum and neared zero in 1984. The slowdown in inflation could in large part be explained by relatively weak domestic demand and cautious wage policy, as well as low commodity prices.

Progress toward greater fiscal discipline continued in 1983/84. A sizable tax package introduced in early 1983/84 resulted in a reduction of the cash deficit of the Central Government from 4.1 percent of GDP in 1982/83 to 3.8 percent of GDP in 1983/84. The financial position of the state enterprises also improved because of higher savings in a number of key enterprises, particularly in the energy sector, which recorded higher profits owing to increased domestic production of oil and natural gas; and the downward trend of oil prices in the world market contributed substantially to the surplus of the Oil Fund.

As a result of higher export earnings and a slowdown in import demand, the trade deficit in 1984 showed a remarkable improvement. The current account deficit fell from $2.9 billion--7 percent of GDP--in 1983 to $2.1 billion--5 percent of GDP--in 1984. Despite the improvement in the current account position in 1984, it was feared that uncertainties in the global economic environment could still adversely affect the country's external stability. The authorities therefore decided to devalue the currency by 14.8 percent in November 1984 so as to correct the past distortions arising from the effective appreciation of the currency since the previous devaluation in mid-1981. The value of the baht was henceforth pegged to a basket of currencies of Thailand's major trading partners rather than to the U.S. dollar.

The improvements in the economic situation in 1984 were achieved at substantial cost to the Government. The intensification of the adjustment measures in 1984 generated great public outcries and constant political tension. Because of the uncertain global environment, however, the authorities feel that they need to exert further strong efforts to make the external payment position sustainable in the medium term. In their view, Thailand's underlying payments situation remains rather weak. Gross official reserves, which amount to about three months of imports, are considered by the authorities to be somewhat low in the present circumstances, particularly for an open economy with no restrictions on current international transactions. To facilitate their further adjustment efforts, my authorities are therefore seeking the Fund's support. It is their firm intention and commitment to reduce further the current account gap from 5 percent of GDP in 1984 to 4 percent in 1985 and 3 percent in 1986, while maintaining price stability and a growth rate of 5 percent to 6 percent per annum.

The thrust of the adjustment policy adopted by the authorities for 1985 and 1986 is to further strengthen fiscal discipline so as to achieve a better balance in the financial position of the public sector. The increased emphasis on fiscal discipline is expected to accelerate the momentum of adjustment efforts made in the past few years, including improvement in tax administration. The authorities firmly believe that without greater fiscal balance, the external payments problem cannot be eliminated.

Specifically, a fiscal package was introduced in April 1985. An expenditure reduction of B 4 billion was made in the already austere budget of the current fiscal year 1984/85. Current expenditure, excluding debt service, will decline by 2 percent in real terms, while capital expenditure will increase by only

2 percent in real terms. For FY 1985/86, an equally austere budget has been adopted by the Government, with no increase in real terms. On the revenue side, to compensate for an expected shortfall, a tax package was introduced in April, which is expected to raise additional revenue equivalent to 1 percent of GDP on an annual basis. As a result, the fiscal deficit of the Central Government is expected to decline from about 4 percent of GDP to about 3 percent in 1984/85 and to below 2 percent in 1985/86. The fiscal position could be further improved as a result of improved tax administration efforts currently being supported by the Fund's technical assistance program. The authorities also intend to review the tax on interest from fixed deposits, as well as tax privileges granted by the Board of Investment.

Improvement in the financial position of the public enterprises continues to be the biggest challenge to the authorities. Tariff adjustments have been made in the public utility and transportation sectors, in particular the substantial adjustment of the water rates and the minimum bus fare. Investment outlays of the public enterprises for the current and forthcoming fiscal year will be highly restrictive. The investment programs, even of high-priority projects, including the Eastern Seaboard Development Program, will be substantially scaled down and rephased. In addition, in March 1985, a high-level committee chaired by a Deputy Prime Minister was set up to monitor the operations of the public enterprises with a view to strengthening their financial position and to consider guidelines for the privatization of some enterprises. As a result of these measures, the overall deficit of the public enterprise sector in 1984/85 will be contained to slightly over 1 percent of GDP, despite a weakening in the financial position of the Oil Fund arising from subsidies on certain categories of petroleum products. The rationalization of petroleum pricing is under active consideration by the authorities. With further tariff adjustments expected, the financial position of the public enterprise sector will be bolstered in 1985/86.

Other key elements of the program include continued monetary restraint to ensure full benefits of the recent devaluation as well as to mobilize more domestic savings, and a flexible management of the exchange rate to maintain export competitiveness. Expansion of domestic credit has been set at 19 percent for 1985, an increase of less than 10 percent in real terms or just half of the increase in the recent past. And if in the course of the year it appears that the objective of the external payments position would not be attainable, credit expansion would be further restrained. In the area of interest rates, the authorities have reiterated their intention to continue with the development begun in early 1980 when the ramewor; was set to permit interest rates to move in accordance with market forces. In addition, the increase in net bank credit to the Central Government in 1985 will be limited to only about 7 percent.

Early in June 1985, in an effort to promote developments that will generate lasting benefit to the economy, the authorities introduced a new scheme to encourage commercial banks to allocate a larger proportion of credit to the five priority sectors--namely, agriculture, mining, industry, export, and trade in agricultural commodities.

A major shift has taken place in the management of exchange rate policy. Concurrently with the 14.8 percent devaluation of the baht in early November 1984, the authorities abandoned the de facto peg to the U.S. dollar that had resulted in continuous exchange rate stability against the intervention currency for over three decades. The exchange rate is now managed flexibly to reflect fully the basket of currencies. To facilitate orderly exchange rate management as well as to control external liabilities, the authorities have imposed a limit on net open positions of all commercial banks, and recently required the registration of foreign borrowing by the private sector.

Other efforts have also been made toward improving the external debt profile. The working of the high-level Debt Policy Committee has been considerably strengthened. The annual external debt commitment ceiling of the public sector was reduced substantially to $1.3 billion in 1985. And to take full advantage of a well-established credit rating, a portion of the public sector's external debt has been refinanced, while more refinancing is being planned to alleviate the effect of the bunching of debt service payments occurring in the next few years.

My authorities are confident that, notwithstanding deterioration in the external environment, the adjustment policies set forth in support of their request for a stand-by arrangement would be adequate to reach the program objectives. Adjustment measures will be intensified if needed. In this connection, I am pleased to inform the Board that during the Parliamentary debate of no-confidence on the economic ministers, which was called for by the opposition on June 5, 1985, the Minister of Finance received an overwhelming vote of support for the strong stabilization policies he has been pursuing. He also reiterated the need to continue such a cautious stance until the country's external payments position becomes sustainable. On the basis of strong policies already implemented and the policies set forth in the letter of intent and reiterated in Parliament by the Minister of Finance, I would like to recommend to the Board that strong support be given to the requested stand-by arrangement, as well as the purchase under the compensatory financing facility.

> The Thai authorities are generally in broad agreement with the appraisal and the thrust of policy recommendations contained in the staff report. They wish to express their gratitude for the frank discussion and the close collaboration they have continued to enjoy with the Fund staff over the years. Technical assistance extended to them through the IMF Institute, the Bureau of Statistics, and the Fiscal Affairs Department is also deeply appreciated.

Thailand's timely request to use Fund resources was a classic case of a member voluntarily acknowledging a serious problem of adjustment at an early stage, Mr. Ismael stated. By supporting the proposed decisions the Executive Board would encourage other members to make necessary policy adjustments before their economic situations turned into crises. Approval of the proposed decisions would provide the financial underpinning Thailand needed to undertake required adjustment measures.

Mr. Blandin remarked that he agreed with the thrust of the staff appraisal, and he supported the proposed decision. However, since every economic indicator other than the external current account was favorable, did Thailand really need the Fund's resources? The rate of inflation had been reduced to nearly zero, and real growth had reached 6 percent. Nevertheless, because they were taking strong corrective measures in good time, the authorities' request deserved praise. Indeed, the case of Thailand differed from the usual cases the Executive Board considered in that it illustrated the application of one of the basic principles contained in the Articles of Agreement--namely, that the Fund would financially support a member's temporary maladjustment in its balance of payments in order to protect that country's credibility on the international financial markets.

The specific target of the Fund-supported program was to bring down the current account deficit from 5 percent of GDP in 1984 to 3 percent in 1986, Mr. Blandin continued. That objective was to be accomplished while maintaining noninflationary growth. To that end, restrictive demand management should be coupled with structural price and wage measures.

Domestically, the adjustment would focus on public finances by raising additional tax revenues and cutting expenditures, Mr. Blandin indicated. Indeed, the fiscal system presented some weaknesses, relying as it did to a large extent on taxes from business imports and duties for revenues. Therefore, efforts should be directed toward widening the tax base and improving tax administration and collection, especially tax arrears of businesses. Also, public enterprises continued to face a deficit; obviously their pricing and investment strategies should be assessed carefully, a process in which the World Bank was currently involved.

Monetary and credit policies should be restrictive, Mr. Blandin noted. A more active interest rate policy could raise domestic savings, which had been declining in previous years. In sum, the demand management policies were appropriate for tackling the balance of payments imbalance.

Although the current account deficit was manageable for the time being, it could be sustained in the long run only at the cost of a deterioration in Thailand's creditworthiness--an outcome the authorities were trying to avoid, Mr. Blandin went on. Furthermore, the rapid buildup of external debt in the beginning of the 1980s had put more pressure on the balance of payments. The authorities should establish a better equilibrium between imports and exports, particularly by developing nontraditional exports such as electronics, in which Thailand enjoyed a comparative advantage, one that a firm wage policy was essential to preserve. A flexible exchange rate policy also would help to promote exports.

The authorities were right to emphasize the development of the manufacturing industries, Mr. Blandin commented. Domestic production of oil and gas had allowed Thailand's external petroleum bill to decline in recent years. In the future, gas might overtake oil in domestic consumption, a development that would affect the medium-term scenario.

Mr. Goos considered that the proposed drawings were in effect a refinancing operation for maturing Fund credit of SDR 400 million and provided SDR 185 million in new money. In comparison, the balance of payments deficit was projected at less than $100 million during the program period--an extremely conservative projection that was based on the assumption that the strong improvement of private capital inflows of 1984 would be completely reversed. However, according to the staff, those inflows had been induced by "tight domestic credit conditions and continued strong growth of economic activity"--conditions that were expected to prevail in 1985 and 1986 because they were central elements of the adjustment program. Therefore, a partial reversal of the 1984 improvement might have been a more realistic assumption than the projected drop in capital inflows. Of course, acceptance of that assumption would wipe out the projected balance of payments deficit during the period of the program. Likewise, a third structural adjustment loan, which was currently being considered by the World Bank, could affect the balance of payments projections. Hence, he would have been more at ease with a significantly smaller amount of Fund financing, which also appeared more consistent with Thailand's continued favorable credit standing in the international capital markets and the Fund's catalytic role and the revolving nature of its resources.

He was in broad agreement with the staff's analysis and recommendations regarding the proposed adjustment program, Mr. Goos continued. In particular, he shared the view that Thailand's external debt had grown in recent years at an unsustainable pace that called for adjustment within the framework of the program that would reduce the resource gap by increasing domestic savings while at the same time maintaining growth of output at a relatively high level. The proposed strategy closely paralleled the adjustment strategy pursued in 1981-83--a strategy that had produced only mixed results, despite "almost continuous efforts" to bring the government deficit down to a sustainable level. Of course, at that time adjustment had been hampered by adverse exogenous developments and a lack of consistent monetary restraint. Nevertheless, the lesson to be drawn from the 1981-83 experience was that it would probably be more advisable to tackle the resource gap on both fronts--namely, by both increasing domestic savings and lowering the output target during the adjustment period. Such an evenhanded approach could withstand external shocks, an important point in view of the high sensitivity of the medium-term projections to exogenous factors--projections that provided little margin for error. Under those circumstances, priority should be given within the framework of the program to the efficient use of resources both in the private and public sectors. Thus, the World Bank's recommendations to improve investment strategy in a number of areas should be implemented without delay, especially in the telecommunications sector.

The further efforts to reduce the central government deficit, including the tax package adopted in April 1984, were commendable, Mr. Goos maintained. However, could those measures lead to a lasting improvement? The higher taxes and import duties on consumer goods might provide an additional incentive to smuggling and black market transactions--long-established features of Thailand's economy. Because the regular base of taxpayers was presumably only 10 percent of the population, a comprehensive reform of the tax system could make an important contribution to improving the fiscal situation. Equally important was the staff recommendation to contain government spending, especially wage outlays. The Government's intention not to grant a general wage increase for the third consecutive year was commendable. However, even more should be done to contain the significant wage drift that had led to an increase of 22 percent in the wage bill over the last three fiscal years. Also, it appeared that subsidies and current transfers should be reduced further, particularly to those public enterprises that had received a strong increase in such payments in recent years.

Indeed, the financial situation of public enterprises remained one of the weaker spots in the Government's adjustment efforts, notwithstanding the improvements achieved in recent years, Mr. Goos indicated. The authorities still were unable to come to a clear picture of the overall deficit of those enterprises, and he shared the staff's concern about the projected widening of that deficit in the current fiscal year. Against that background, he welcomed the enhanced role of the Debt Policy Committee, and the intention to review and monitor the operations of public enterprises by a newly established committee. Of course, the fiscal losses owing to the oil subsidy must be eliminated.

Although the proposed amounts of Fund financing raised some questions, he could support the proposed decisions, Mr. Goos remarked. The support was facilitated by Thailand's excellent adjustment record under previous Fund-supported programs and the authorities' commitment, mentioned by Mr. Ismael, to intensify their adjustment effort if the need should arise. That commitment was particularly important because he was not sure that the program provided for a sufficient degree of monetary restraint; domestic credit expansion was targeted at 19 percent in 1985. Finally, he welcomed the fact that Thailand was approaching the Fund at an early stage to correct its internal and external imbalances and not at a time when those imbalances had reached crisis dimensions.

Mr. Fujino said that after two decades of impressive growth--roughly 7 percent per annum--the rate of inflation in Thailand had accelerated, and the balance of payments position had weakened during the late 1970s. The acceleration in the rate of inflation during 1979-81 was largely a result of unfavorable price developments abroad, but the main cause for the deterioration in the underlying balance of payments position was the acceleration of public sector investment during a time of declining domestic saving. However, the adjustment effort, together with favorable external developments, had brought about a significant improvement in the economy in 1984: there had been a slowdown in private investment and a drawing down of inventories, but the increased contribution by the foreign balance had kept real growth at about 6 percent; the rate of inflation had fallen to almost zero; and the external current account deficit had been reduced.

Nevertheless, Thailand's underlying external position had remained weak in 1984, Mr. Fujino noted. External debt had increased rapidly in recent years, and that debt had to be reduced significantly if the present favorable reception of Thailand in the international capital markets was to be preserved. Therefore, the primary objective of the adjustment program was to reduce the current account deficit from 5 percent of GDP in 1984 to 4 percent in 1985 and 3 percent in 1986, while maintaining output growth at a rate of about 6 percent a year.

In early 1985 the authorities had adopted a comprehensive package of fiscal measures, Mr. Fujino commented. The cornerstone of the adjustment program was the further improvement in the financial position of the Central Government. Budget expenditures for the current fiscal year had been cut by about 2 percent, and for the next fiscal year expenditure growth would be limited to no increase in real terms. The tax package adopted in April 1985 was expected to generate additional revenues equivalent to about 0.5 percent of GDP in the present fiscal year and about 1 percent of GDP in subsequent years. Therefore, the central government deficit was expected to decline further to about 3 percent of GDP in the current fiscal year and to below 2 percent in the next fiscal year. In addition, the authorities intended to strengthen the elasticity of the tax system over the medium term by rationalizing its structure and administration.

During the past five years, the overall deficit of the public enterprises had declined substantially, and the present deficit was not large, Mr. Fujino stated. However, the deficit would increase in the current fiscal year because of the impact of the devaluation of the baht on oil prices, and an upward adjustment of domestic prices for petroleum would be necessary to reduce that deficit. Monitoring the authorities' progress with the deficit would be an important part of the first review under the stand-by arrangement.

The World Bank's detailed assessment of the public investment program was important because the present procedures for monitoring public enterprises were not sufficient to enable the authorities to set a ceiling on their borrowing from the banking system, Mr. Fujino continued. The authorities should strengthen their capability to monitor public enterprise operations.

The adjustment program called for continued monetary restraint, and during 1985 the expansion of domestic credit of the banking system would be limited to 19 percent, a figure that included a small adjustment for the recent devaluation, Mr. Fujino added. Interest rate policy would play an important role in promoting the desired increase of domestic savings, and the authorities were committed to preserve flexibility in their policy management and to monitor credit conditions closely to ensure the attainment of the balance of payments target.

Although it had had some impact on the rate of domestic inflation, the substantial devaluation of the baht in November 1984 was necessary to restore Thailand's external competitiveness and to ensure the projected rapid growth of exports, Mr. Fujino remarked. Since the devaluation, the value of the baht had remained stable in effective terms because it had been pegged to a basket of currencies rather than to the dollar. Furthermore, the authorities intended to maintain flexibility in the exchange rate policy.

He would like some information about the new scheme to encourage Thailand's commercial banks to allocate larger proportions of credit to high-priority areas, Mr. Fujino said.

He supported the compensatory financing purchase, Mr. Fujino stated in concluding.

Mr. Templeman commented that at the previous Article IV consultation with Thailand (EBM/84/24, 2/15/84) concerns had been expressed about economic developments in Thailand in 1983--particularly regarding the overheating of the economy, the saving/investment relationship, the suppression of inflation by maintaining an overvalued exchange rate, the overshooting of the target for the current account deficit of the balance of payments, the overdependence on revenue increases to limit the fiscal deficit, and the overexpansion of credit to the private sector. However, in 1984 performance had improved in all of those areas. Real growth had exceeded 6 percent in 1984, following an average growth of 5 1/2 percent over the previous three years. Furthermore, overheating of domestic demand had slackened, and foreign demand had grown.

However, the investment ratio had fallen by more than 3 percentage points, and national savings had declined from over 19 percent in 1981 to less than 17 percent in 1984, Mr. Templeman continued, and he wondered what explained that trend. Nevertheless, the inflation picture looked good in general, the consumer price index having fallen slightly in 1984 after having grown by less than 3 percent and 4 percent, respectively, in the two previous years. Admittedly, the effects of the 1984 devaluation might increase the rate of inflation in 1985, although he wondered if that could explain fully the current 9 percent inflation rate. In any event, the current account deficit had fallen from 7.2 percent of GDP in 1983 to 5.0 percent of GDP in 1984, and the volume of exports and imports had reversed the adverse pattern of 1983.

Reference had been made in the staff paper (EBS/85/128, 5/15/85) to the desire to effect some structural reforms, although it was not clear what reforms were being considered nor the extent to which the justification for the stand-by request was based on them, Mr. Templeman maintained. He supported the authorities' intention to reduce the central government deficit to 3 percent of GDP in 1984/85 and to 2 percent in 1985/86 by cutting both current and capital expenditures, forgoing any general wage increase, delaying hiring, rephasing capital expenditures, increasing some taxes and public tariffs, and streamlining investment by public enterprises. The April 1985 tax package was designed to offset some revenue losses while avoiding undesirable tax disincentives. However, the increases in customs duties would cover nearly two thirds of Thai imports, and some rates had been raised by as much as 200 percent. Although that was essentially a revenue measure, he was also concerned about the possible impact of protectionism on the Thai economy and trade relations. Among possible additional revenue measures, one which was worth serious consideration was to increase the tax on interest income to finance a cut in marginal tax rates on personal income. He supported the various measures that had been designed to strengthen the public enterprises financially and control their operations effectively. In addition, the World Bank was playing a useful role in connection with possible tax reforms, the assessment of public investment programs, and tariffs on public enterprises.

Even if the velocity of money continued to decline, the 19 percent limit on domestic credit expansion was rather high, Mr. Templeman considered. However, if money demand proved to be less than expected, he was glad that the authorities intended to tighten credit further, and he also welcomed the commitment to maintain interest rate flexibility. With the November 1984 devaluation and the adoption of adequate interest rates and a flexible exchange rate policy, such an administrative measure as registering foreign borrowing did not appear to be needed to avoid capital flight.

He was pleased that according to the medium-term scenario, the debt and debt service ratios could be reduced from 37 percent and 24 percent, respectively, to about 27 percent and 19 percent, respectively, by 1990, even in the context of continued 6 percent rate of real economic growth, Mr. Templeman added.

He had had some initial doubts that Thailand's balance of payments problems justified a new stand-by arrangement, Mr. Templeman maintained. The external current account deficit was not large; the country still had good access to credit markets; and Thailand's debt, debt service ratios, and gross international reserves in relation to imports were about average for the indebted developing countries. Thus, staff arguments did not add up to an overwhelming case for an arrangement amounting to SDR 400 million. Nevertheless, on balance, the request could be supported. Thailand had not been a prolonged user of Fund resources. It had an open economy, no restrictions on current transactions, and in the absence of Fund credit, reserves would be drawn down to a low level. Completion of the proposed arrangement, however, would move Thailand into the prolonged-user category. Consequently, the authorities should take advantage of their access to private capital markets and, if possible, should not use the full amount of resources available under the stand-by arrangement.

The request for a purchase under the compensatory financing facility was acceptable, Mr. Templeman stated. The estimated shortfall might have been overstated significantly; the price assumptions for sugar, corn, rice, tapioca, and, possibly, integrated circuits seemed too optimistic. Nevertheless, accurately forecasting commodity prices was difficult, and he believed that, overall, the request met all the necessary requirements.

Mr. Joyce indicated that Thailand had made substantial progress on a number of fronts in 1984, and the firm policies for 1985 should permit that adjustment to continue. Real economic growth had reached 6 percent, and the rate of inflation was held to under 1 percent. The rate of inflation was expected to worsen considerably during the current year as the effects of the November 1984 devaluation were fed through the system; nevertheless, the projected figure of 9 percent, up from 1 percent in 1984, appeared to be too large.

In 1984 the external current account deficit had been reduced from 7 percent of GNP to 5 percent, Mr. Joyce commented. Although the authorities had tightened demand management policies and had devalued the baht, the current account position had improved owing to stronger foreign demand. Continued improvement would strengthen Thailand's international competitiveness and its balance of payments position.

Given Thailand's recent economic performance and the strength of its international creditworthiness, some Directors had questioned its need for further Fund financial assistance, Mr. Joyce pointed out. In spite of the improved performance in 1984, however, the external current account deficit was still unsustainable over the longer term. The debt service ratio was uncomfortably high, and the economy remained vulnerable to changes in international market conditions as well as climatic conditions. Under those circumstances, the authorities should improve the external accounts, an area in which the Fund could offer assistance; however, they should consider forgoing purchases under the arrangement if developments were better than expected.

The 1985 adjustment program clearly met the criterion for cooperation under the compensatory finances facility, Mr. Joyce remarked. Thailand had experienced an export shortfall of SDR 199 million in 1984. However, the 17 percent growth in export earnings projected for 1985 and 1986 might have given the calculations, and hence the shortfall, an upward bias. Indeed, since actual export earnings had increased by some 21 percent, it was curious that a shortfall had been calculated for 1984.

The authorities planned to tighten fiscal policy even further in 1985 in order to reduce the deficit and increase the public sector savings ratio, Mr. Joyce stated. Monetary policy and the restrained public sector wage policy had been geared appropriately to meet the inflation and balance of payments goals. Also, the baht was no longer pegged to the U.S. dollar, and the exchange rate was being managed flexibly--a development that would protect the country's competitiveness and bring about the needed balance of payments adjustment. In addition, structural policies planned for 1985 should improve producer incentives through a reduction in export taxes and should provide financing rather than subsidies to rice producers.

Steps had been taken to monitor the public enterprises in order to strengthen their financial position, Mr. Joyce added, and there were plans to increase the tariffs charged by those enterprises. However, because of lack of information on the parastatals' dealings with banks, no performance criteria could be devised to set an effective ceiling on the credit they received--a small gap in the program. In addition, the authorities' decision not to pass through immediately to petroleum prices the cost of the 1984 devaluation had ameliorated the devaluation's impact. Hence, losses probably would be incurred by the Oil Fund, thereby weakening the overall financial position of the public sector. Therefore, the authorities should adjust consumer energy prices quickly and should meet their commitment to allow prices to be determined by the market.

Mr. Ortiz remarked that unlike most other Asian countries, Thailand had weathered well the recent episodes of world recession, high interest rates, and growing protectionism. In spite of the significant deterioration in the terms of trade since 1980, the imbalances in the economy were moderate compared with those in other developing countries, especially in the Western Hemisphere. The authorities had managed to absorb the effects of the unfavorable developments by temporarily running larger current account deficits without causing a significant deterioration in the fiscal accounts. During the previous four years, the fiscal deficit had fluctuated within a range of less than 3 percentage points of GDP and had been declining for the previous three years.

Economic performance in Thailand during 1984 had been quite satisfactory, Mr. Ortiz continued. The solid growth momentum initiated in 1983 had been maintained; the rate of inflation had been brought down to practically zero; and the current account deficit had been reduced. Those developments had been made possible by the application of effective demand management policies and strong export performance. In addition, the central government deficit had been reduced, the financial position of state enterprises had been improved, and international reserves had increased moderately from their 1983 level. Given the very favorable economic performance and the fact that the internal and external imbalances had been prevented from escalating to unmanageable proportions, it was questionable whether Thailand's program needed Fund support. In fact, economic performance during 1984 had been even better than in 1983, a year in which a Fund-supported program had been implemented.

The argument for a stand-by arrangement was that although substantial improvement had been registered in Thailand's overall external position in 1984, the current account situation remained unsustainable and the rising external debt burden had become a source of concern, Mr. Ortiz commented. However, while the 1984 current account deficit was still large in relation to GDP, export performance had been encouraging, and imports had risen only marginally from the 1983 level.

In fact, he questioned whether the debt was truly worrisome, Mr. Ortiz said. Even though external debt had increased substantially since 1980, public sector debt as a share of total debt outstanding had actually decreased slightly over the last four years. Moreover, debt owed to foreign banks had increased proportionately less than that owed to international institutions. The share of concessional loans in total commitments of the public sector had increased from 50 percent in 1980 to 55 percent in 1983, and most of those loans had been in the 25-year to 30-year maturity range. That picture indicated that public debt had been managed with great care; and while private debt had grown substantially, it was not a source for excessive concern because it was project-oriented and not government-guaranteed.

Another positive development concerning external policies was the management of the exchange rate, Mr. Ortiz went on. During 1984 the real appreciation of the baht had resulted exclusively from the appreciation of the dollar; consequently, the Thai authorities had abandoned the peg to the dollar in favor of a basket of currencies.

In spite of those favorable developments, the contemplated repurchases in respect of purchases under other stand-by arrangements would make the foreign exchange reserve position rather weak, Mr. Ortiz noted. The proposed program would reduce the external imbalance by reducing the public sector deficit and strengthening the state enterprises. Although private saving and investment had remained roughly in balance, the drop in the overall savings ratio was puzzling. Furthermore, the greater proportion of that drop was explained by the steady decline in household savings. Whereas in 1983 the ratio of private household savings to GDP had fallen by nearly 2 percentage points because of a sharp rise in the purchase of consumer durables, the largest drop had taken place in 1981 when household savings fell 2.6 percentage points. Such a strong fall was difficult to explain; after all, incomes and real wages had been rising.

Mr. Wijnholds commented that he supported the proposed decisions. The current and planned adjustment efforts under the proposed program justified the level of Fund assistance requested.

The economic performance of Thailand had been generally satisfactory over the past years, Mr. Wijnholds continued. There had been some deviations from sound macroeconomic policies, but the authorities had corrected those before serious damage had been done. In addition, cooperation between the Fund and Thailand had been good, and a number of stand-by arrangements had been successfully concluded in recent years. The proposed stand-by arrangement had become necessary because Thailand's reliance on external borrowing had threatened its international credit-worthiness. The program was sufficiently stringent to bring about the projected decline in the current account deficit in 1985 and 1986.

Monetary policy would be restrained, Mr. Wijnholds pointed out. The expansion of domestic bank credit was to be limited to about 10 percent in real terms--half the rate of increase in recent years. Consequently, credit conditions would become considerably tighter in 1985. However, too much emphasis should not be put on the expansion of domestic credit in real terms. Nominal credit expansion would increase somewhat, but because of the increase in the rate of inflation brought about by the devaluation in November 1984, the projected real increase would be considerably smaller. Besides providing for enough credit to finance real growth, there was a need to accommodate inevitable price increases--for example, those stemming from higher import prices. However, since the task of monetary policy was to contain or bring down the rate of inflation, monetary and credit aggregates should be assessed in real terms. In retrospect, the Board's flexible attitude on credit expansion in Thailand was unfortunate. The authorities should restrain credit expansion if the external payments objective appeared to be in danger.

A considerable degree of flexibility was available to the Thai authorities in that "performance criteria would be tested on the last day of any month in each three-month period, at the option of the Thai authorities"--an unusual, if not unique, provision in stand-by arrangements, Mr. Wijnholds indicated, and he would like a clarification by the staff. The targets for gross official reserves of $2.6 billion in 1985 and $2.7 billion in 1986 involved a decline to 2.7 months of imports in 1986. The authorities considered a level of reserves equivalent to three months of imports to be somewhat low. Furthermore, the proposed purchases, totaling nearly SDR 600 million, were to be used mainly to finance the external deficit and not to strengthen reserves.

The adjustment of the baht in November 1984 had been warranted in order to retain sufficient export competitiveness, Mr. Wijnholds pointed out. At that time the baht had been pegged to a basket of currencies, and the import surcharge had been lifted. In addition, taxes on rice and rubber had been reduced. Added to those positive developments was the fact that in 1984 exports had actually increased by 21 percent; therefore, it was somewhat awkward to talk about an export shortfall. In fact, it was really the 1983 fall in exports for which the current request was being made, a request which could have been made in 1984, had the authorities implemented their adjustment policies at that time.

Mr. Wicks said that the recent performance of the Thai economy had been impressive. Indeed, few requests for Fund assistance on so large a scale were based on so favorable a performance. That was a tribute to the authorities' determined adjustment efforts. However, it was one thing to agree that an economy needed adjustment and another to conclude that that adjustment should be supported by the use Fund resources. Thailand's overall balance of payments deficit in 1985 was projected at only $200 million, and even that assessment might be pessimistic. Moreover, the balance of payments was expected to move into surplus in 1986; Thailand's reception in the capital markets remained favorable; and it had a projected annual growth rate of 6 percent. Consequently, he doubted whether the authorities would have much difficulty in finding alternative sources of finance. Instead, the country intended to become more deeply committed to the Fund: the proposed purchases substantially exceeded the repurchases due over the next two years.

Nevertheless, by coming to the Fund at an early stage of a difficult adjustment effort, Thailand was doing precisely what the Board had urged members to do, Mr. Wicks remarked. And, Thailand was not a prolonged user of Fund resources. Furthermore, if a country were undertaking strong adjustment measures and felt that it needed the support of an arrangement with the Fund, then the Fund, as a cooperative institution, ought to do all it could to help. Arguments could therefore be made for and against a stand-by arrangement for Thailand. He could support the proposed arrangement, but it approached the outer boundaries of what was justifiable and it raised some important points of general principle which should be considered when the Executive Board discussed enhanced surveillance.

Further adjustment by Thailand was necessary, Mr. Wicks stated. The increase in the national savings ratio from 15 percent of GDP to 25 percent of GDP between 1960 and 1974 had been completely reversed over the subsequent decade. Increasing that ratio substantially must be a central aim. The latest adjustment program projected an increase of 2 percentage points in the savings ratio in the next two years. However, history indicated that there was still a long way to go before the saving-investment balance would become sustainable.

The public sector deficit since 1982 had been reduced by 2 1/2 percent of GDP, Mr. Wicks added. However, the 1985 public sector deficit had worsened owing to the devaluation of the baht in 1984. The fiscal measures announced in April should at least contain the situation, but more ambitious adjustment was needed. For instance, even if the projections for 1985 proved to be accurate, central government expenditure and net lending would have remained at 19 percent of GDP for five consecutive years. And although revenues had been increasing since 1982, the projected rise during the program was little more than one half percent of GDP, and it was partly due to an acceleration of transfers from public enterprises to the Central Government and improvements in tax administration brought about by Fund technical assistance. The authorities should give the closest attention to the advice of the World Bank on public investment.

Public sector finances would be weakened by not allowing the devaluation to affect domestic petroleum prices until later in 1985--a delay that would make the devaluation less effective, Mr. Wicks explained. It would have been better to get all price shocks over at once rather than adding to inflationary pressures at the end of 1985 when prices would already be rising faster as a result of the devaluation. The devaluation, coming on top of significant price liberalization, made it even more vital to restrain wages and inflationary expectations. Wage increases should be limited in the private sector to productivity growth.

He endorsed the authorities' attempt to tighten monetary policy in 1985, Mr. Wicks said. But given the outlook for nominal GDP, the estimates of the income elasticity of money would have to be high to justify the projected rapid monetary growth. The authorities should maintain a flexible interest rate policy. However, oligopolistic practices in the banking sector traditionally had inhibited such flexibility, and while the decline in the rate of inflation in 1984 had raised real interest rates, the reverse would occur in 1985 unless nominal interest rates were increased.

The request for compensatory financing was based on a 20 percent increase in the value of exports in 1984, the shortfall year, and the request had come when Thailand's export market shares had been increasing, Mr. Wicks remarked. Also, some manufactured exports might have been held back owing to a lack of competitiveness--in which case the shortfall would not have been beyond the authorities' control. The request should more appropriately have been for a smaller proportion of the calculated net shortfall than was actually proposed.

Mr. Coumbis stated that Thailand's economic performance had improved significantly in 1984 because of effective demand management. During the previous Article IV consultation with Thailand, many Directors had expressed concern about the current account of the balance of payments and the expansion of credit. However, the external account deficit had declined substantially in 1984, the rate of inflation had fallen to nearly zero, and the rate of growth of real GDP had been maintained at 6 percent. Because of the short- and medium-term objectives of the authorities, the proposed decisions were acceptable. However, the extent of the proposed use of Fund resources was questionable.

Mr. Ainley indicated that he could support both requests by Thailand. The authorities' performance under the two recent stand-by arrangements had been good in general. However, despite impressive achievements--rapid growth of real GDP and a low rate of inflation--they had recognized the need to strengthen the external position in a fundamental way. Also, the main elements of the adjustment program were firmly in place--tighter fiscal policy, credit control, and a competitive trade stance. In addition to supporting the large devaluation in November 1984, the program focused on past weaknesses, especially the public enterprises, the public investment program, and the tax system. Furthermore, the program combined demand restraint with structural reforms designed to improve production incentives and promote domestic savings. The World Bank was closely involved in the authorities' long-range planning.

The proposed stand-by arrangement was the fourth for Thailand in the past seven years, Mr. Ainley noted. The proposed access was relatively large; the level of the Fund's holdings of Thailand's currency was already quite high. In addition, there was no real balance of payments crisis in Thailand. Nevertheless, in accepting Thailand's request for assistance, the Fund would strike an appropriate balance between adjustment and financing. Despite domestic pressures to relax the policy stance, the timely and voluntary request for a stand-by arrangement indicated that the authorities intended to continue adjustment and represented precisely the sort of early approach to the Fund specifically encouraged in the 1979 guidelines on conditionality. The program was strong; the member's record was good; and there was also close Fund-Bank collaboration in key areas. Therefore, the amount requested could be justified. However, Thailand must succeed in establishing a viable balance of payments. If that happened sooner than expected, then the authorities should not draw down the full SDR 400 million. In any event, sustained adjustment efforts were needed in the short and medium term if the external current account was to be balanced.

Mr. Zhang said that he agreed with Thailand's request for a stand-by arrangement because of the continuing adjustment program that had been started in the early 1980s. Since then, Thailand's external current account position had progressively worsened, and the rate of inflation had accelerated because of the drastically changed external situation and delays in adopting appropriate adjustment measures. External debt had grown at an annual rate of 45 percent in the early 1980s. However, the situation had improved substantially after the authorities implemented programs under stand-by arrangements with the Fund in 1981 and 1983, followed in 1984 by prudent demand management policies. In 1984, under difficult conditions, the external deficit had declined markedly; the rate of domestic inflation had fallen to near zero; and the growth of real GDP had been maintained.

The authorities recognized that the country's external position remained rather weak, Mr. Zhang stated. Although Thailand's current account deficit amounted to only 5 percent of GDP in 1984--a significant part of which had been financed by inflows of capital--that deficit would not be sustainable in the medium term, particularly with a low level of official reserves and a rising external debt. The timely adjustment program proposed by the authorities was comprehensive and strong. It aimed to reduce the government deficit and the current account deficit to

3 percent of GDP while seeking to achieve a projected 6 percent growth of GDP and a low rate of inflation. The proposed targets and the adjustment measures constituted a well-balanced program.

Thailand was coming to the Fund for a new stand-by arrangement at a time when its balance of payments position was not as weak as that of many other developing countries; its international reserves were not depleted; and its creditworthiness in the international financial markets was high, Mr. Zhang added. The authorities were cautious because the economy was subject constantly to adverse external influences and frequent changes in weather conditions--factors beyond the authorities' control. In addition, external debt had been rising quickly, while reserves had been declining rapidly.

The calculated shortfall of SDR 44 million for "other exports" was puzzling, Mr. Zhang concluded. In contrast to the specific analysis of exports of manufactures, only general assertions were made in the staff paper (EBS/85/¿29, 5/15/85) regarding the causes for the shortfall of "other exports," such as the adverse influence of the appreciation of the exchange rate. What were the adverse factors beyond the control of the Government that were affecting individual exports? Why had a large number of products constituting only a very small percentage of total exports been studied? It seemed somewhat presumptious to provide a precise figure for the aggregate shortfall from that small share of exports.

Mr. Mtei stated that even though the Thai economy was basically sound, the authorities wanted to correct existing distortions while they were still manageable. The satisfactory performance was due to prudent and flexible policies. For example, the Government's diversification program, its commitment to a liberal economic system, and its efforts aimed at maintaining a favorable climate for private enterprise had contributed to economic growth since the 1960s.

Thailand had contained the growth of its population, Mr. Mtei commented. Whereas the population had been increasing at the rate of 3.4 percent yearly in the 1950s, the annual growth rate had fallen to less than 2 percent in the 1980s. Apart from making it easier to plan for new generations of workers, the slower population growth had raised the standard of living, a development that could be expected to continue if economic growth was maintained.

Because of increased foreign borrowing in the past four years and the consequent rise in the debt service, a high priority was to improve the external payments position, Mr. Mtei noted. Although at present the balance of payments position was not critical, it could become more problematic if exports slipped--a possibility, given that agricultural exports were vulnerable to poor weather and that global economic recovery might not be as robust as expected.

The program emphasized adjustment and growth by balancing demand management policies with policies aimed at making the economy more productive, Mr. Mtei indicated. Price adjustments had removed distortions; agricultural development had been emphasized; and export promotion had been given added attention: those developments should reinforce the role of the exchange rate in Thailand's adjustment, especially with its diversified export base.

Containing the budget deficit was an integral part of the adjustment strategy, Mr. Mtei continued. Steps were being taken to raise revenues while restraining expenditures and improving the finances of public enterprises. However, the increase in the duty rates on capital equipment was inconsistent with the promotion of private investment. An increase in the tax on interest from fixed-rate deposits--an issue presently under consideration--would be a disincentive to domestic resource mobilization. New tax measures would need to be buttressed by improvements in tax administration, and the Fund should offer technical assistance in that area.

The medium-term economic prospects were encouraging, Mr. Mtei went on. The current account deficit was projected to be at a sustainable level, the growth of output was expected to remain high, and prices were expected to be stable. Those projections, however, would depend on a favorable external environment, but at present, major trading partners had increased their protection against Thailand's exports of textiles, tapioca, and marine (fish) products. In addition, the outlook depended on good weather.

Mr. Salehkhou commented that since the previous Article IV consultation with Thailand, its economy had performed satisfactorily because of the authorities' adjustment policies under the 1983 stand-by arrangement. The 1983 program had ended impressively: real economic growth had rebounded to its traditionally high level; inflationary pressures had been contained further; and the deficit of the Central Government had declined. In 1984 the rate of real GDP growth had been 6.3 percent; the rate of inflation had dropped to 0.9 percent; and the fiscal deficit had been reduced to 3.8 percent of GDP. Furthermore, there had been a recovery of exports and a curtailment of the external current account deficit to 5 percent of GDP, compared with 7.2 percent in 1983. Exports had been particularly impressive, and external receipts had risen by 21 percent after dropping 6 percent in 1982 and 4 percent in 1983.

The containment of inflation had been mainly the result of the appreciation of the currency, which had also enabled the authorities to mitigate the impact on the price index of the relaxation of credit policy, particularly in 1983, Mr. Salehkhou said. Furthermore, while exogenous factors such as world economic recovery and favorable weather conditions had contributed to the strong rebound of exports in 1984, the performance of the Thai economy mostly reflected the authorities' cautious financial policies.

However, in view of the projected rate of inflation for 1985 brought on by the past year's steep devaluation, rising external debt both in terms of GDP and as a ratio of debt service to exports, and relatively high fiscal and external imbalances, further adjustment was clearly called for if Thailand was to maintain adequate reserves and a favorable standing in international capital markets, Mr. Salehkhou remarked. Although Thailand's balance of payments did not seem presently under excessive strain compared with that of most users of Fund resources, he welcomed the authorities' decision to seek the financial assistance of the Fund in support of an adjustment package that should accelerate the correction of remaining imbalances and introduce the needed structural reforms without adverse effects on the performance of the real sector.

Fiscal policy was the centerpiece of the adjustment program for 1985-86, Mr. Salehkhou indicated. Despite the negative impact of the November 1984 devaluation on fiscal spending and revenues, the measures already implemented would reduce the central government deficit to 1.8 percent of GDP by 1986, compared with nearly 4 percent in 1984. That decline and an improvement in the finances of public enterprises--through increases in utility prices and scaling down of capital expenditures--should maintain credit restraint while ensuring adequate financing of the private sector.

External policy should contain the external current account deficit and halt the deterioration of Thailand's external debt situation, Mr. Salehkhou went on. Management of the exchange rate was expected to play a major role: the 1984 devaluation of the baht had restored external competitiveness and had offset the impact on exports of the decline in foreign demand in 1985. Also, pegging the exchange rate to a basket of currencies of major trading partners should ease political resistance to exchange rate adjustments. Those policies were to be supplemented by structural reform--phasing out price controls, linking wage increases to gains in productivity, promoting nontraditional exports, extending incentives for the development of the agricultural sector, and streamlining public enterprises in cooperation with the World Bank.

Despite those comprehensive policies and measures, the expected improvement in Thailand's external position in 1985-86 was due to strong export growth projected for both years, Mr. Salehkhou commented. Although increases of 17.7 percent and 16.3 percent for 1985 and 1986, respectively, might be unrealistic--especially in view of increased protectionism and the decelerated economic growth of major trading partners--such a projection was essential if the calculation of a shortfall for 1984 was to meet requirements for a purchase under the compensatory financing facility. However, the projection and the rebound in exports in the shortfall year were consistent with the medium-term trend. The balance of payments need and the test of cooperation with the Fund had been met. Furthermore, despite a possible negative impact of the strong appreciation of the baht on the expansion of exports in 1985, the shortfall had been due to a number of factors--protectionism; the drought, which had adversely affected the 1982-83 crop; and slow economic recovery among trading partners other than the United States.

Mr. Vasudevan said that Thailand had not requested the stand-by arrangement to fulfill the cooperation requirement for the proposed compensatory financing purchase in the upper credit tranches but to reduce its dependence on external borrowing and to safeguard its credit standing. Besides, the stand-by arrangement would reduce the imbalance in the external current account. The devaluation of the baht by 14.8 percent in November 1984 had prompted the stand-by arrangement because it had to be supported by monetary, fiscal, and structural adjustment policies. The absence of an adjustment program would have led to economic deterioration and serious external imbalances. The proposed stand-by arrangement was unusual in that it aimed at narrowing the external account deficit while maintaining a high growth rate of 6 percent a year. Thailand had had a fairly strong growth of the labor force, and the unemployment rate had risen in recent years.

Fiscal adjustment was the centerpiece of the program, Mr. Vasudevan maintained. In order to neutralize the adverse effects of the November 1984 devaluation of the baht, the authorities had adopted a policy package in April 1985 to reduce the Central Government's deficit by about 2 percent of GDP in 1985/86. In addition, the ratio of current and capital expenditures to GDP would fall during the program period. Also, the April tax package and the transfers from public enterprises were commendable fiscal actions.

Management of public enterprises posed the biggest challenge, Mr. Vasudevan indicated. Indeed, prices of public utilities and in the transportation sector had been raised while investment outlays had been restrained. Nevertheless, deficits would remain because the authorities did not intend to pass through the effects of the devaluation to the domestic prices of petroleum products until later in 1985, when the surpluses of the Oil Fund would be exhausted, because the domestic prices of petroleum products had been higher than international prices throughout 1983 and 1984. That decision, however, was under review. The authorities would consult with the World Bank on rationalizing the public investment program and the tariff structure.

To contain the inflationary effects of the devaluation and to ensure the realization of the external objectives, credit expansion was to be limited to 19 percent of GDP in 1985, Mr. Vasudevan noted, and that would be a challenge to the monetary authorities. The net credit expansion to the Central Government was also a performance criterion, and there was a possibility of setting a ceiling on credit expansion to public enterprises at the time of the first review of the program, depending upon the authorities' capacity to monitor such information. In his view, the authorities should not fix quantitative ceilings on credit expansion on the basis of ownership but rather should ensure that public enterprises functioned efficiently; in providing bank credits public enterprises should be accorded the same treatment as private enterprises.

The exchange rate policy was realistic, Mr. Vasudevan stated. The authorities would carefully monitor external debt and would limit new medium-term and long-term public debt. Medium-term projections showed that the debt service ratio would either decline or be stable by 1990.

Thailand had an excellent track record, Mr. Vasudevan commented, and the authorities were committed to intensifying adjustment if needed.

Mr. Romuâldez said that Thailand's proposed program was well designed and appropriately stressed achieving fiscal balance. However, Thailand's current problems derived not from a lack of adjustment policy but of perseverance and consistency in its implementation. The tendency was to negate the effects of restraint in one sector by accommodation in another. Therefore, the measures already taken--increases in the tariffs of key public enterprises, devaluation of the baht, and the tax package of April 1985--must be adhered to throughout the period of the stand-by arrangement.

The system to monitor borrowing by public enterprises from the banking sector was somewhat inadequate and should be strengthened, Mr. Romuâldez added, although such borrowing recently had been small. The Debt Policy Committee should be able to monitor the debts of the public enterprises, and an advisory group had been recently formed to review overall obligations. Given the magnitude of public enterprise operations, the authorities should be constantly aware of their finances.

Increases in the surplus of the Oil Fund and sizable reductions in power and transportation deficits had improved the finances of the public enterprises during the past few years, Mr. Romuâldez continued. However, because of the Government's decision not to pass through the effects of the devaluation to the domestic prices of petroleum products, the surplus of the Oil Fund was practically exhausted. In fact, an adjustment in the prices of petroleum products before the end of the year was essential to the program, and the authorities were considering it.

In the second half of the 1970s, Thailand had diversified the structure of its exports from a heavy dependence on rice to a variety of products such as rubber, tapioca, tin, sugar, fruits, vegetables, and manufactured items such as integrated circuits, canned goods, textiles, iron tubes and pipes, and wood products, Mr. Romuâldez noted. That success should contribute to a strong growth rate in spite of the constraints associated with the program. However, was a goal of 6 percent growth in terms of GDP consistent with the program as a whole? In addition, a flexible exchange rate was essential for Thailand to take advantage of strong external demand.

The authorities should streamline and rationalize the public investment program in consultation with the World Bank, Mr. Romuâldez went on. In addition, they should tighten credit in 1985 because the deterioration of the external position in 1983 had been caused by a weak credit policy. Furthermore, the authorities should maintain a flexible interest rate policy, which should succeed despite the oligopolistic character of the Thai banking system.

The Thai authorities had come to grips with the unsustainable debt buildup before it had gotten out of hand, Mr. Romuâldez commented. Furthermore, the proposed access to Fund resources was appropriate to the comprehensiveness of the program. The balance of payments outlook was still uncertain and vulnerable to exogenous developments. Also, Thailand's exports had been subject to its trading partners' restrictions that in 1983 affected 75 percent of traditional exports and 46 percent of total exports. Restrictions in industrial countries affected 40 percent of total 1983 exports. For example, the authorities estimated that $240 million per year would have been lost in export earnings during 1982-86 because of tapioca quotas alone. The international community should support Thailand's adjustment efforts and those of developing countries in general by liberalizing access to markets.

Although some export competitiveness had been lost because of the baht's appreciation in 1983-84, the compensatory financing request satisfied the requirements of balance of payments need, and exogeous cause of the export shortfall and met the test of cooperation with the Fund, Mr. Romuâldez stated. In addition, the shortfall was partly due to the effects of drought during 1982-83, from which recovery in 1984 was still weak, and to increased protectionism in industrial countries.

Mr. Qureshi remarked that Thailand had long enjoyed strong GDP growth and relatively low rates of inflation. However, a viable balance of payments position had remained somewhat elusive. Two previous adjustment programs supported by the Fund had improved the external sector. Those adjustment efforts were wide-ranging and had included tightened financial policies and structural reform measures designed to liberalize trade and rationalize tariffs, taxes, and prices. Nevertheless, the balance of payments remained weak, and the associated growth in external debt had been a cause for some concern. The adoption of a comprehensive adjustment program with the objective of bringing about a significant improvement in the external position was appropriate under the circumstances, and he could support the proposed program. Fiscal improvement was central to the program. It was necessary to control expenditures, raise tax revenues, improve the profitability of key public enterprises, and streamline the public investment program. The recent exchange reform and continued flexibility in managing the exchange rate, along with the structural adjustment measures envisaged in the program, should encourage the recovery of the export sector and strengthen the overall external position.

While the Thai economy was healthier than that of the average country requesting Fund assistance, it was advantageous for a member to come to the Fund prior to a stage in which payments difficulties had assumed serious proportions, thereby necessitating a remedy that was more in the nature of a rescue operation than a framework for orderly adjustment, Mr. Qureshi continued. In addition to controlling expenditures and raising additional revenues, the authorities also were contemplating, with assistance from the Bank and the Fund, a comprehensive medium-term reform for improving the elasticity of the tax system by rationalizing the structure and administration of direct and indirect taxes. Would part of that tax reform be implemented within the period of the proposed program and would progress on the matter be covered in program reviews? Also, while prospects for the Thai economy appeared favorable for the remainder of the decade, a cautious policy stance was needed. The sensitivity analysis prepared by the staff showed that relatively small deviations from the assumptions underlying the proposed program could have a significant adverse effect on the current account and the debt position. In reporting the results of the sensitivity exercise, the staff could also have reported the sensitivity of the projections to the individual assumptions relating to the terms of trade, export growth, and LIBOR.

The national savings rate had been falling more or less continuously since the early 1970s, Mr. Qureshi pointed out. Some fall in savings since 1980 could be due to terms of trade movements; however, that explained more the year-to-year changes in the savings rate than the trend. Furthermore, whereas the decline in savings in the public and corporate sectors had been explained to some extent, the decline in household savings remained a puzzle. Nevertheless, the drop in savings was the largest in the household sector. The staff had mentioned rising expenditures on consumer durables as an explanation, but that itself needed to be explained.

The figures on the unemployment situation in Thailand were appreciated, Mr. Qureshi continued. It was rare to see unemployment figures in staff reports on developing countries, because usually no data were available, especially regarding underemployment or disguised unemployment. However, to the extent that data were available it should be provided.

He supported the compensatory financing request, Mr. Qureshi said. It was noteworthy that protectionism, in addition to adverse weather, had been mentioned in the staff paper as a significant cause of the export shortfall. Not only could protectionism create short-term balance of payments problems for a country, but over the medium term it also could obstruct the achievement of the objective of balance of payments viability that was envisaged in the proposed stand-by arrangement.

The staff representative from the Asian Department said that the target for the inflation rate was formulated on the basis of a 20 percent increase in the price of tradables--17 percent owing to the direct impact of the devaluation and 3 percent owing to world inflation. Assuming that tradables were 50 percent of the economy and that the prices of nontradables would remain stable, the domestic rate of inflation would reach 10 percent. Consequently, the target for the domestic rate of inflation implied a small decline in the prices of nontradables. Of course, the rate of inflation could be reduced below that target if tightened policies substantially lowered the prices of nontradables. Such policies, however, would adversely affect domestic growth. In that light, the envisaged small decline in nontradable prices would be adequate because when the impact of devaluation on prices had been dissipated, the domestic rate of inflation would be lowered to the foreign rate. Developments so far in 1985 indicated that the inflation rate was only 6 percent, reflecting weaker than anticipated foreign prices and tight credit conditions. Some of the latest information indicated that the credit increase had been within the program ceiling. Domestic credit had been rising at an annual rate of less than 14 percent compared with the ceiling of 19 percent. Nevertheless, there would be other adjustments in prices later in 1985, notably increases in public enterprise tariffs and petroleum prices. In the end, the rate of inflation for 1985 might be somewhat below projections.

Whether credit targets should be expressed in real or nominal terms was an interesting point, the staff representative went on. In general, it was not possible to talk in terms of real credit. For example, a large increase in nominal credit might be small in real terms if it led to a high rate of inflation. However, after a sharp adjustment in the exchange rate, some increase in the inflation rate was unavoidable. Because a moderate decline in the prices of nontraded goods was envisaged in the program, there would be a minimal rise in the rate of inflation. Also, the 1984 credit policy had been quite tight and had contributed to the improved current account.

The commercial banks in Thailand were reluctant to base interest rates on credit conditions, the staff representative indicated. Instead, they relied on the Bank of Thailand to adjust the ceiling. Recently, however, to encourage the banks to adjust the interest rate themselves, the Bank of Thailand had stopped setting the rates. That action had caused a temporary stalemate, although there were indications that the banks might become more flexible.

Early in 1985 interest rates had risen because bank liquidity had been tight owing partly to the outflow of capital, the staff representative noted. The trend had been reversed, however, and by April there had been a substantial inflow of capital, making the banks more liquid and easing the pressure on interest rates. Nevertheless, real interest rates in Thailand were quite high--not an unusual circumstance for developing countries in Asia--reflecting the high rate of productivity of capital. However, borrowers with good credit standing always had access to foreign credit. For them, the nominal rate tended to be equal to the foreign rate. The authorities should refrain from adjusting the interest rates and encourage the banks to do it.

The preliminary data for the first four months of 1985 indicated that export performance had been strong in terms of volume but somewhat weaker in terms of value, the staff representative said. However, by April 1985, prices had started to pick up again. Consequently, for the year as a whole, the external current account was expected to be close to the target, particularly since imports had been weaker than anticipated. Because the data on volume and prices were seasonal and preliminary, it was difficult to be more precise at present.

Capital flows were volatile, the staff representative continued. The tightening of credit conditions partially explained the sharp increase in inflows in 1984. A number of other factors had also contributed to the inflows, including the anticipation that the tax exemption for interest payable on foreign loans would be lifted in June 1985, and the political events following the November 1984 devaluation, which had given rise to strong speculation that the exchange rate action might be reversed. Data for the first five months of 1985 indicated that private capital inflows had been $347 million, or $830 million on an annualized basis, compared with $800 million projected under the program. The public debt was $350 million in the period January-May, or $847 million on an annualized basis, compared with $700 million projected under the program, and was not a cause for concern. The picture could, of course, change, and the balance of payments could conceivably strengthen considerably for some unforeseen reason. However, Thailand would have to have a balance of payments need to make each of the scheduled purchases.

Thailand had considerable access to capital markets, the staff representative commented. Loans from the Fund, including compensatory financing, would amount to 12 percent of overall borrowing in 1985 and 7 percent in 1986, equivalent to 10 percent of net borrowings in 1985 and a negative 3 percent in 1986. Without Fund assistance, reserves would fall $250 million in each of the two years 1985-86, to well below the current level. The authorities would ideally like to maintain reserves equivalent to three months of imports, but they would not seek to achieve that target at the cost of even tighter policies.

In the absence of Fund resources, the Bank of Thailand could turn to credit markets, the staff representative noted. In the past, the Bank had refrained from borrowing from the market and had borrowed only from the Fund when it had had balance of payments problems. The authorities were concerned that turning to the credit markets for the first time on the scale of the Fund loan would adversely affect their credit standing.

The external debt had not reached a crisis stage, the staff representative pointed out. However, the debt had doubled in the past four years. Also, the debt service ratio had increased rapidly, a trend that could not continue. Early in 1983 the Thai authorities realized the need to address the deteriorating external situation, but they could not implement a program because of political considerations. Late in 1984, those constraints had eased, and the authorities had devalued the baht, and in early 1985 they had implemented a fiscal adjustment package. Access to Fund resources under a stand-by arrangement had considerably strengthened the hand of economic policymakers.

Fiscal adjustment had been slow in the first part of the fiscal year, the staff representative noted, because the fiscal year ended in September and the adjustment effort had begun only in April. Consequently, the decline of 0.7 percent of GDP in the fiscal deficit of the Central Government in the remaining part of the current fiscal year was not small, and the full impact of the program would occur in the fiscal year beginning in October 1985.

The tax package had been formulated quickly to improve the external position and did not deal with some of the underlying weaknesses of the tax system, the staff representative stated. As pointed out by some Directors, the increase in import tariffs was disturbing, but the high rate of 200 percent applied only to a few luxury items such as cars. A comprehensive tax reform was still needed, and that would be examined in the context of the structural adjustment loan of the World Bank and the reviews of the Fund-supported program. In fact, there was the possibility of a joint Fund-Bank effort, with the Fund providing technical assistance for improving Thailand's tax system in the context of a structural adjustment loan with the Bank.

A number of improvements were needed in the tax system, which had been studied by the Fiscal Affairs Department, the staff representative said. For example, a review of the tax exemptions granted by the Board of Investment revealed that those exemptions were too high. Also, the rates for direct taxes were excessive, resulting in tax avoidance. Tax receipts could be increased if tax rates were reduced and tax administration improved. Public enterprises could be taxed. In addition, a proposal had been made to completely eliminate the rubber and rice taxes, which had already been reduced substantially, and to raise the tax on petroleum products. Under discussion were new excise taxes, increases in business taxes, and a general sales tax to replace excise and business taxes. However, in the targets for the current and subsequent fiscal years, little allowance was made for those taxes because they had not been instituted.

Savings rates had been declining mainly because of a sharp deterioration in the terms of trade, the staff representative continued. Terms of trade had fallen from the peak of 116 in mid-1970 to about 100 in 1979-80 and had continued to slide to about 83 in 1984, an all-time low; in fact, the observed terms of trade during 1980-84 were the lowest since 1953. Although year-to-year fluctuations were difficult to interpret because data on savings were not very reliable, the declining trend in the savings rate was a cause of concern. In addition to the decline in the terms of trade, demand management policies in 1983 had also had some transitory impact on savings. Consumption had risen, partly due to expansionary credit policy, and the savings rate had fallen by 1 percent. However, more important was the continuous decline in the savings rate over the years. The program projected a gradual increase in the savings rate during the program period and over the medium term.

The main structural reforms to promote domestic saving would be in the areas of taxes and public enterprises, the staff representative added. Progress had been made in the public enterprise sector, especially on information gathering. In 1985, relatively reliable data on the public enterprise sector had become available for the first time, and it would allow the authorities to monitor developments in that sector more closely. Also, progress had been made on the formulation of policy affecting public enterprises, particularly through the formation of the new committee to scrutinize the investment program. The Fund would coordinate its efforts with the World Bank, particularly in the major investment programs such as telecommunications and the Eastern Seaboard projects.

The credit ceilings were set as period ceilings, but they differed slightly from similar ceilings set in other cases, the staff representative from the Asian Department remarked. As in other cases, if the quarterly ceiling for, say, end-September were met, then the October and November ceilings, although provision was made for them, were actually irrelevant. However, if the September ceiling was missed--for a technical reason, perhaps--then the next month's ceiling would be the criterion for a drawing at that time. In other cases, the ceilings for October and November had been set at the level of the December ceiling. During the negotiations, however, it had become apparent that such a procedure did not allow adequate flexibility because either the December ceiling would have had to be set too tightly or, if it had been set appropriately, the October ceiling would have been too lax. Therefore, the staff and the authorities reached an agreement to set the ceilings for October and November along the trend line established for the period September-December.

The staff representative from the Exchange and Trade Relations Department stated that the method of formulating the credit ceiling was an interesting technical innovation. The Fund generally employed two types of ceilings in programs. The one most often used was a point ceiling. If at the end of December a country's outstanding credit was below a certain level, then it might make a drawing. The next drawing would depend on meeting a level specified for the end of March. In some other programs, period ceilings were used in which the level of the credit ceiling applied during each month of the quarter, and not only at the end of the quarter. The point ceiling allowed little flexibility because the member would have to wait until data for the end of the quarter was available. Under a period ceiling, a member could make a drawing after any month in the quarter that the member was below the ceiling. That method had the disadvantage that credit growth could exceed somewhat the intended target, especially in the first month of a quarter. Outstanding credit could be under the ceiling in the first month, hence allowing a drawing even though the underlying credit trend might subsequently go well beyond limits. The program for Thailand incorporated a new formulation of the period ceiling: the member would be allowed to draw provided credit was below a trend line between the end of the previous quarter and the end of the next quarter.

Consequently, the method used for Thailand was no more related to waivers than any standard period ceiling, the staff representative maintained. Under a period ceiling, the performance criterion specified that during any period that the member's outstanding credit was below the ceiling, the member could draw. If the ceiling were exceeded in the month of September, the member could not draw without a waiver. However, if the outstanding credit were below the ceiling in the month of October, the member could draw. In the standard period ceiling, a flat ceiling would be applicable during the entire quarter. In the case of Thailand, there was a trend line through the quarter and that was the only difference.

All the methods of specifying ceilings had advantages and disadvantages, and each could be manipulated, the staff representative from the Exchange and Trade Relations Department went on. The primary disadvantage of the flat period ceiling was that if the previous quarterly ceiling had been missed by a large amount, the ceiling specified for the following quarter would apply to the following month, and the member might be allowed to draw, even though the underlying credit growth was considerably larger than envisaged. Thus, notwithstanding a deviation in the intended credit growth, the country might still be below the new quarterly ceiling. That would not happen under the innovation used in the Thai case.

The staff representative from the Asian Department added that in the previous program, for example, if the September ceiling had been 100 and the December ceiling 150 and the September ceiling had been missed, then the country could still have drawn in October if the October credit had been below the ceiling for December. However, that method created a problem, because if credit had risen along a trend between 100 and 150 during September-December, and if the ceiling of 100 and 150 had been set appropriately, then a ceiling of 150 for October would have been too high.

Ultimately, whether a ceiling was lax or tight depended on the level of the ceiling rather than on the mechanics of how the ceiling was set, the staff representative indicated. In the case of Thailand, consideration was given to adopting a point ceiling. However, the Thai authorities were not happy with that procedure because it did not allow for any flexibility. Consequently, a compromise was reached based on what was a relevant level of credit between September and December. The ceiling would rise according to a trend rate of growth adjusted for seasonality. All methods were subject to manipulation, because any number could be adjusted for a given period. Even under a point ceiling, credit could go below the ceiling in September, rise in October, and come down in December. Manipulation was really a separate issue that was not relevant to the case of Thailand.

The borrowings of the public enterprises from the banks had not been large, the staff representative continued. Consideration had been given to setting a ceiling on such borrowings as a monitoring mechanism for the Government; that would be desirable because there was not an established data base. Work could be done to improve the mechanism for gathering data and, if necessary, a ceiling could be set at the time of the midterm review for borrowings of public enterprises from the banking system.

The production of natural gas had increased in recent years and was expected to rise further over the medium term, the staff representative stated. Production was projected to more than double from 2 billion liters in 1984 to about 4.8 billion liters by 1990. Thus, the share of natural gas in total energy consumption would rise from 9 percent in 1984 to about 14 percent in 1990, correspondingly reducing the share of imported oil from 53 percent to 45 percent. Because there were other sources of energy, the figures did not add up to 100.

A structural adjustment loan from the World Bank was under consideration, but it would not be finalized until the end of 1985 or early 1986, and consequently the Fund program had not allowed for any financing from that source, the staff representative indicated.

The terms of trade was probably the most important factor in the medium-term projections and the sensitivity analysis, the staff representative pointed out. However, what was really important was not so much those projections but the Government's commitment to adjust policies if developments turned out to be different than expected.

The Thai authorities were concerned about registration of foreign borrowing because of short-term speculative flows that created problems; consequently, they had considered imposing controls on those flows, the staff representative from the Asian Department said. However, they had refrained from doing so because they were concerned that controls would not be effective and would create other problems. The current procedure was designed to collect more information. All borrowing had to be registered within a week after it had arrived; there was no control because there was no permission required. However, the speculative short-term flow continued to be a source of problems for the Thai authorities, and they were in a quandary as to what to do about it.

The staff representative from the Research Department remarked that using underlying projections established in conjunction with the latest world economic outlook exercise, the staff had projected export growth for 1985 and 1986--the postshortfall years--at 17 percent per year in SDR terms. Also, the staff had taken into account Thailand's special marketing arrangements and the quality difference in Thailand's exports compared with similar commodities for which representative international prices were quoted. After the staff paper had been issued, more recent information had became available on the latest international prices of primary commodities. Prices of maize, rice, and sugar had been somewhat lower than anticipated, while others, particularly tin prices, had been on target. However, the prices Thailand would receive--the actual export unit values--were expected to be different from those that were being internationally quoted. For instance, the quality of Thailand's exported rubber was different from the quality of rubber for which the price was monitored. The same was true for sugar and integrated circuits as well; however, the quality of the latter was expected to improve in the postshortfall period.

It was too early to make a judgment on the implications of those price movements for exports during the rest of the postshortfall period, the staff representative continued, but some information had become available on the value of total merchandise exports for the first four months of 1985. In SDR terms, earnings had been about 16 percent higher than in the corresponding four months of 1984, compared with annual export growth of about 17 percent that had been projected for the postshortfall period in the staff paper. Therefore, based on preliminary information for the first four months of 1985, there was no reason to reduce the projections for the entire postshortfall period.

As for the beyond-the-control issue, the staff representative remarked, Thailand's exchange rate had been appreciating in real terms in recent years. However, that trend had been reversed in 1984, the shortfall year, and the real exchange rate had depreciated by about 1 percent from 1983. Moreover, in assessing the beyond-the-control issue, it was necessary to consider not only exchange rates but also other factors that could have affected exports during the five-year reference period; for example, in the shortfall year, the prices of Thailand's major primary exports had declined by 1 percent in SDR terms, and the price increase for manufactured exports had decelerated to 2 percent after reaching 6 percent in both 1982 and 1983. Therefore, by examining the effects of volume and price on the shortfall, it was possible to break down the value shortfall into price and volume components for the commodities that accounted for 75 percent of the total value of exports. On that basis, the value shortfall could be entirely attributed to the price shortfall of commodities over which Thailand had no control.

"Other exports" accounted for a sizable part of the shortfall in total value of exports, the staff representative continued. Although the values of the "other exports" were lumped together, the staff, in making projections and assessing the causes of the shortfall, had relied on information on the composition of the group, Thailand's recent investments in the relevant sectors, government policy, and demand outlook for those products. Under the present compensatory financing decision, a shortfall was defined as a downward deviation of exports from the medium-term trend and was not a decrease in absolute value of exports in the shortfall year. A shortfall could be estimated either as a result of a decline in exports or of a deceleration in export growth. Consequently, that Thailand had experienced an increase in exports--by 21 per cent--in the shortfall year was not unusual. A country could also experience a shortfall because export growth either decelerated or export value declined in the year immediately preceding the shortfall year. In such a case, the increase in exports in the shortfall year might not be sufficient to raise the level of exports in the shortfall year to the medium-term trend, which was calculated as the five-year geometric average of exports earnings centered on the shortfall year. Thailand's exports had declined by 4 percent in the year immediately preceding the shortfall year and, in spite of the 21 percent recovery in the shortfall year, the level of exports in that year was still below the medium-term trend. Although unusual, there had been other compensatory financing cases in which the value of exports had increased at similarly high rates in the shortfall year. Specifically, of 110 requests for compensatory financing purchases approved by the Executive Board since 1979, export increases in excess of 10 percent in the shortfall year had occurred in 11 cases. In 10 of those cases, a shortfall had been projected--in spite of the large increases in exports in the shortfall year--because there was either negative or low growth in exports in the year immediately preceding the shortfall year.

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

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/85/94 (6/12/85) and EBM/85/95 (6/14/85).

2. EXECUTIVE BOARD TRAVEL

Travel by an Executive Director as set forth in EBAP/85/153 (6/12/85) is approved.

APPROVED: April 1, 1986

JOSEPH W. LANG, JR.
Acting Secretary