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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 85/183

10:00 a.m., December 18, 1985

R. D. Erb, Acting Chairman

Executive Directors	Alternate Executive Directors
	Mawakani Samba
	M. K. Bush
	M. Lundsager, Temporary
	S. Kolb, Temporary
	S. de Forges
	G. Nguyen, Temporary
	M. B. Chatah, Temporary
	M. Sugita
	B. Goos
	Jiang H.
J. E. Ismael	Jaafar A.
	H. A. Arias
	M. Foot
	O. Isleifsson, Temporary
	L. Leonard
E. I. M. Mtei	
	B. Jensen
	J. E. Suraisry
	J. de la Herrán, Temporary
	H. van der Burg, Temporary
	A. V. Romuáldez
G. Salehkhou	O. Kabbaj
	V. Govindarajan, Temporary
	L. Tornetta, Temporary

J. W. Lang, Jr., Acting Secretary
J. K. Bungay, Assistant

Also Present

IBRD: N. Ramachandran, Latin America and Caribbean Regional Office. African Department: A. Tahari. Asian Department: I.-S. Kim, K. Saito. Exchange and Trade Relations Department: S. Kanesa-Thasan. IMF Institute: M. G. Martin. Legal Department: Ph. Lachman, J. K. Oh. Middle Eastern Department: E. J. Bell. Treasurer's Department: T. Leddy, Deputy Treasurer; D. Williams, Deputy Treasurer; J. E. Blalock, W. L. Coats, Jr., D. Gupta, F. J. Lin, A. F. Moustapha, T. M. Tran. Western Hemisphere Department: E. Wiesner, Director; J.-P. Amselle, M. Caiola, M. A. Da Costa, A. C. A. R. Furtado, J. E. Sundgren, G. Yadav. Bureau of Statistics: R. V. Kennedy. Personal Assistant to the Managing Director: R. M. G. Brown. Advisors to Executive Directors: P. E. Archibong, W.-R. Bengs, L. P. Ebrill, G. W. K. Pickering. Assistants to Executive Directors: J. R. N. Almeida, R. Fox, L. Hubloue, W. K. Parmena, A. J. Tregilgas.

1. DESIGNATION PLAN AND OPERATIONAL BUDGET FOR DECEMBER 1985-FEBRUARY 1986

The Executive Directors considered the designation plan (EBS/85/266, 12/5/85; Sup. 1, 12/16/85; and Cor. 1, 12/18/85) and the operational budget (EBS/85/267, 12/9/85; and Cor. 1, 12/9/85) for the quarterly period December 1985-February 1986.

The Acting Chairman said that a revised designation plan had been presented in Supplement 1 of EBS/85/266, which provided an option with respect to the decision to adopt either the revised plan or the designation plan originally proposed in EBS/85/266 on the understanding that the latter would be superseded by the revised plan to be approved by a lapse of time decision as of noon on December 30, 1985. He asked which option Directors preferred.

The staff representative from the Treasurer's Department explained that large additional amounts of SDRs had been used with designation after the issuance of EBS/85/266 on December 5, 1985. Those additional designations had significantly altered the excess holdings of SDRs of many members in the plan. Therefore, the staff had issued a revised plan on December 16, 1985. Unfortunately, an error had been made in adjusting the figures on excess holdings used in the recalculation of plan amounts, and accordingly, a correction to Supplement 1 had been issued. The revision as corrected had reduced the amounts of designation assigned to all but one of the members in the plan although the aggregate amount of the plan was unchanged. The staff recognized that it had not been feasible for Executive Directors to consult with their authorities with regard to the revised amounts, and therefore suggested that the Board adopt the original plan, as it had been issued on December 5, and approve the revised plan, as corrected, on a lapse of time basis.

Mr. Goos said that he could go along with the proposal that the Board adopt the designation plan as it had been originally proposed. After having had some time to look at the latest revised plan, the Board would then adopt the revision on a lapse of time basis. He assumed that in executing the plan until the end of the year, the staff would stay within the limits foreseen in the original plan.

The Executive Directors agreed to adopt the original designation plan and to approve its revision by a lapse of time decision.

The Executive Directors then took the following decisions:

SDR Department - Designation Plan for December 1985-February 1986

The Executive Board approves the designation plan for the quarterly period beginning December 18, 1985 as set out in EBS/85/266 (12/5/85). 1/

Decision No. 8151-(85/183) S, adopted
December 18, 1985

Operational Budget for December 1985-February 1986

The Executive Board approves the list of members considered sufficiently strong as set out in EBS/85/267, page 3, footnote 1, and the operational budget for the quarterly period beginning December 18, 1985, as set out in EBS/85/267 (12/9/85).

Decision No. 8152-(85/183), adopted
December 18, 1985

2. GRENADA - 1985 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1985 Article IV consultation with Grenada (SM/85/313, 11/25/85). They also had before them a report on recent economic developments in Grenada (SM/85/317, 12/4/85).

Mr. Leonard made the following statement:

Since the previous Board discussion of Grenada in November 1984, management of the island's affairs has moved from the interim administration to an elected Government. The new Government has continued the process of economic stabilization initiated in 1984 and further opened up the economy to the operation of market forces.

In 1985, the growth of real GDP quickened to 3 percent from 2 percent in 1984, mainly because of more buoyant manufacturing, construction, and tourism. Inflation slowed further, the rise in consumer prices being estimated at 3 1/2 percent for the year as a whole, compared with 5 3/4 percent in 1984. During the year, exports and tourism both did well but there was also an appreciable rise in imports of investment goods and consumer durables. As a result, the current and overall balances on

1/ Decision approving revised plan adopted on December 30, 1985. (Decision No. 8170-(86/1) S) external account, though remaining positive, were markedly below those of the previous year. The unemployment rate, as far as it can be established, remained high at 25-30 percent.

The Grenadian authorities recognize that the progress that has been made in part depended on temporary factors and that future growth will require more secure foundations. They continue, therefore, to be concerned by the need to foster productive investment, to reduce the extent of fiscal dependence on external financing, and to strengthen the external accounts over the medium term.

Additional measures, as noted in the staff report, were put into operation in 1984/85 to encourage private enterprise. Taxes have been lowered, price controls on certain goods removed, foreign exchange restrictions relaxed, a more flexible regime of interest rates introduced, bank liquidity improved and a program of public sector investment initiated, to remove in the period 1985-87 deficiencies of infrastructure that at present constrain investment. Guidelines for investment that will smooth the processing of investment applications and expedite project realization have also been put into operation.

The response to the Government's measures has yet to develop fully. Domestic private capital formation has increased and there are hopeful prospects for new investment in hotels and tourist amenities by outside interests. Nevertheless, a much greater inflow of investment funds and associated productive capital projects is required to generate the increase in foreign earnings that will maintain external balance in the medium term and offset any downturn in the present level of official transfer. The authorities, therefore, feel that an intensive development effort will have to be maintained for some time to come and will need the support of all major groupings in the economy for its success. It is hoped that the recently established National Economic Council will provide a means of engaging this support and responding optimally to the needs of private enterprise.

The favorable fiscal outturn in 1984 and as estimated in 1985--overall budget surpluses of Central Government of nearly 2 percent and 3 percent, respectively, of GDP were generated in these years--was largely the result of external current and capital grants. In 1985 such inflows were the equivalent of 78 percent of total domestic revenue and in 1985 were even higher, at nearly 90 percent. Without these subventions, capital expenditure would have had to be drastically reduced or substantial foreign borrowing incurred.

The authorities recognize that grants of that order are exceptional and that provision needs to be made against their future reduction. Current expenditure of Central Government is, therefore, being closely contained and a reduction of seven points in the percentage of such expenditure in GDP is planned over the next five years. There is an immediate problem for 1986 with a prospective fiscal gap in the public sector overall of 6-7 percent of GDP. Failure to bridge the gap through donor grants and debt rescheduling, which the authorities are seeking, would mean an extremely tight budgetary position and could have implications for the pace of tax reform to which the Government is committed and which is a key element in promoting the economic role of the private sector. The authorities are, therefore, prepared to cut planned expenditure if they are unable to secure the necessary bridging finance. Over the medium term a more systematic approach to dealing with shortfalls in grants and concessionary finance will be required. In this regard the authorities have noted the staff recommendation of contingency planning but have not yet come to a decision on the measures that should be taken.

Two notable features of the staff medium-term scenario for the balance of payments are the falloff in official transfers envisaged from 1985 onward and the buildup in merchandise exports, tourism receipts and, on the capital side, private investment that is projected to replace it. These data underline the uncertain nature of Grenada's prospects over the remainder of the decade at least. It is apparent from the staff report that the authorities have done much in a short space of time to reorient domestic policies in directions that should help realize the progress toward sustainable balance set out in the projections. A successful outcome, however, will depend on domestic action being complemented in the period up to 1990 by adequate access to external markets and the ability of the Government to borrow on concessionary terms. For the more immediate future a smooth progression in the tapering off of external transfers is also desirable to enable the Government's domestic measures to come to fruition. This progression, as already mentioned, the authorities are endeavoring to secure.

The issue of flexibility in the exchange rate of the Eastern Caribbean dollar, which is the currency of Grenada, has become less acute with the recent depreciation of the U.S. dollar but has yet to be resolved. Pending a resolution, which is impeded by differences of view on the need for a change among the other countries using the currency, the authorities have brought the operation of the economy closer into line with the needs of the present fixed rate.

Mr. Mtei said that he welcomed the authorities' efforts over the past two years to liberalize the economy and improve resource allocation through, inter alia, the promotion of private investment, and the scaling down of the size of the public sector. A number of enterprises had been turned over to the private sector, and the establishment of the Working Group on State Enterprises in May 1985 should speed up the privatization process. The success of those policies in attracting higher levels of official transfers and concessionary financing had facilitated the completion of major infrastructural projects in the past two years, which must have contributed to the upturn in the rate of growth of GDP in 1984 and the acceleration of the rate to 3 percent in 1985; the real rate was projected at 4 percent per year until 1990. A major underlying factor of the growth performance was the completion of the erstwhile controversial airport toward the end of 1984 and associated investments, which had accounted for the high levels of investment and had considerably expanded potential earnings from tourism, which were expected to increase steadily in the medium term.

The authorities should be assisted to maintain the improved performance of the public sector, which had turned from large overall deficits in the early 1980s to surpluses in recent years--more than 6 percent of GDP in 1985--despite continuing high levels of capital expenditure and tax reductions to encourage private investment and exports, Mr. Mtei indicated. The staff was worried that in 1986 there would be a sharp reduction in the level of official transfers, leading to the re-emergence of an overall deficit equivalent to 8.7 percent of GDP. While he was more optimistic than the staff, he would nevertheless appreciate any explanation by the staff of the basis for its estimate. He was, however, pleased to learn that the authorities were considering the introduction in the 1986 budget of a comprehensive fiscal reform along the lines recommended by a mission from the Fiscal Affairs Department, which would aim at the introduction of indirect taxes and user charges to compensate for the revenue loss indicated earlier and to reduce central government current expenditure steadily in coming years. Indeed, strict current expenditure control appeared necessary in view of the substantial planned public sector investment program through 1987, which should exert an upward pressure on current expenditure. He hoped that Grenada's aid donors would provide adequate budgetary support.

In the external sector, despite noticeable improvements in the past two years, future prospects would depend heavily on transfers in the short run and on earnings from tourism in the long run, although commodity exports might increase considerably, Mr. Mtei noted. In the past two years, for example, the balance of payments had benefited tremendously from the improved terms of trade. However, he wondered whether continued expansion of export earnings was not being hampered by the appreciation of the Eastern Caribbean dollar; the staff should comment on the status on the review of the exchange rate. Finally, the liberalization of the foreign exchange and trade system of Grenada should be instrumental in attracting foreign investment.

Ms. Lundsager observed that the authorities were continuing their broad effort to expand the role of the private sector in their economy, an effort that she supported. In particular, some price controls had been removed, foreign exchange restrictions had been relaxed, and increased credit had been provided to the private sector during the year. In addition, the authorities had begun to implement their divestiture plan, and she hoped that they would proceed expeditiously. Furthermore, the authorities had apparently taken heed of the concerns voiced at the previous Board discussion on Grenada (EBM/84/168, 11/21/84) and had not increased public sector wages during the year.

Nonetheless, she was concerned that some inconsistency might remain in the economic policy stance, Ms. Lundsager indicated. In particular, with Grenada's membership in the Eastern Caribbean Central Bank, independent exchange rate actions were impossible, which implied that the effort to maintain international competitiveness must be based on responsible fiscal and monetary policies that restrained inflationary tendencies while maintaining equilibrium in the external sector. Thus, she was discouraged to see that the past high wage settlements in the public sector were still having a spillover effect in the private sector: even though there had been no public sector wage increase during the past year, the average private sector wage increase had been 10 percent, while consumer prices had increased by only an estimated 3.5 percent. For five years in a row, private sector wage increases had exceeded 10 percent, much in excess of inflation and probably of productivity increases as well. The effect of those developments was shown clearly in Chart 1 of the staff report: since 1980, the real effective exchange rate had appreciated significantly and even though some depreciation had occurred in 1985, the currency appeared to remain substantially overvalued. While Grenada clearly benefited from membership in the currency union, the ongoing study of the exchange rate probably was not going to lead to an exchange adjustment sufficient to offset Grenada's real effective appreciation because other members of the currency union were doing well with the exchange rate as it was, and a unanimous decision was required to change the rate. Given Grenada's size, the adoption of a national currency was inappropriate, but the economy was suffering from high unemployment and growth that was below potential, problems that frequently could be alleviated somewhat by an exchange rate adjustment. Given limited scope for exchange rate action, public sector policies, especially wage policies, were especially important.

The overall fiscal stance, while having improved in 1985, was still not reassuring, especially since it was projected to move from a sizable surplus in 1985 to a rather large deficit equivalent to 8.7 percent of GDP in 1986, with an unfinanced gap of about 6 percent of GDP, due mainly to the projected sharp drop in net external financing, Ms. Lundsager remarked. Those fluctuations underscored the vulnerability of Grenada to changes in the external environment and the need to increase domestic savings rapidly. For instance, public sector savings were only expected to rise slightly to 3.9 percent of GDP in 1986. With total expenditures remaining over 60 percent of GDP, and current expenditures over 30 percent, there was some room for adjustment. She would be interested in hearing if the authorities had specific plans for restructuring the civil service. In particular, the authorities apparently planned to contain the wage bill, but in view of past wage settlements, it might be wise to contain the increase in public sector wages specifically, given its demonstration effects on the rest of the economy. In addition, a scaling down of the size of the civil service could mesh well with the emphasis on increased private sector activity, including both domestic and foreign investment.

The fiscal reform package aimed generally at stimulating private sector activity, which could improve the employment situation, Ms. Lundsager mentioned. In particular, the disincentive effects of the large tax burden were being reduced, as the proportion of taxes to GDP was projected to fall by some 2.5 percentage points in 1986. The reduction in the export tax was welcome. Nonetheless, the tax burden remained high, at some 30 percent of GDP, and further reductions in both expenditures and taxes should be considered.

Cost competitiveness should be stressed because of the unemployment problem and the present and projected medium-term overall current account position, Ms. Lundsager stated. Grenada was such a small country that it was almost certain that any increased production of exports could be absorbed by its main export markets, and the authorities should stimulate domestic supply to gain that advantage. Even with Grenada's openness, foreign investment would not occur in the traded goods sector unless production could be competitive with other Caribbean exporters to the same markets. For example, it was not clear that foreign investors' interest in sectors outside the tourism sector, such as the light assembly sector, would pick up over the medium term. Thus, wage trends in the public and private sectors should be kept in mind by the authorities as they formulated their 1986 budget and wage policies. Finally, she supported the proposed decision.

Mr. Arias said that Grenada, like many other small island developing countries, suffered from certain basic structural weaknesses--an insufficiently developed structure of production and exports as well as structural deficits in the government accounts and balance of payments. Foreign exchange and internal savings constraints associated with those general economic characteristics had tended to limit the capacity of such countries to achieve the long-term growth and structural transformation--key conditions to reduce and ultimately to eliminate the high degree of vulnerability to external shocks. However, the recent economic performance of Grenada had provided ample evidence of the importance of external capital flows for overcoming such disadvantages and laying the basis for sound and sustainable growth rates. Mr. Leonard's remarks had provided instructive insights into the process of development in Grenada, and the staff report had furnished a sound and technical analysis of the special problems facing Grenada as well as the efforts of the authorities to tackle them.

After two years of virtual stagnation, the Grenadian economy had picked up in the context of an appropriately financed adjustment program together with external grants averaging approximately 30 percent of GDP in the two-year period 1984/85; real GDP had risen by 2.5 percent in 1984 and was projected to increase by a further 3 percent in 1985, Mr. Arias stated. Moreover, the rate of inflation had decelerated to 2 percent, despite the substantial liberalization of domestic pricing policies; the public sector was running a current account surplus, which had averaged 3.8 percent of GDP in 1984/85; the domestic banking system had adequate liquidity; and the current account of the balance of payments had improved dramatically, reflecting a sharp decline in project-related imports, an expansion of tourism, and a marked increase in external grants. Despite that satisfactory performance, certain worrisome features had emerged. In particular, the unemployment rate was estimated at 25-30 percent, and its reduction was crucially dependent on the mobilization of domestic resources to maintain current investment levels, as the continuation of the present level of external flows was not assured. He wondered whether the staff could shed some light on current and prospective domestic savings levels.

He welcomed the priority accorded by the authorities to the implementation of the public sector investment program--prepared in collaboration with the Interagency Resident Mission--which envisaged capital expenditures averaging 28.6 percent of GDP per year in 1984-86, Mr. Arias added. It was worth noting that that average was still below the 43.9 percent recorded in the three years up to 1984. The emphasis placed on the strengthening and revitalization of the food and agricultural sectors as well as on improving the supporting economic infrastructure was welcome. However, the authorities should follow the World Bank staff's recommendations to make a more determined effort to improve domestic resource mobilization as a source of counterpart funding, particularly in the light of the projected unfinanced gaps in coming years. He would appreciate comments from the staff on the present effort to expand private sector investment at a rate consistent with the needs of Grenada.

He encouraged the authorities to pursue their commitment to strengthen public finances over the medium term, thereby making optimal use of the breathing space provided by the period of sustained capital inflows, Mr. Arias commented. The comprehensive fiscal reform being formulated in collaboration with the Fund, which was expected to be implemented early in 1986, represented an essential step forward. However, the authorities should ensure that the fiscal reform did not lead to an erosion of public revenues; therefore, their efforts to achieve fiscal equilibrium through expenditure restraint were well placed. Their commitment to restrict wage and salary increases as well as to improve the efficiency and financial performance of the public enterprise sector would not only serve to contain current expenditures but would also contribute to the long-term competitiveness of the Grenadian economy.

Grenada had relied extensively on official external concessional assistance to finance the current account deficit of the balance of payments, Mr. Arias concluded. Given the expected decline in such assistance, it was critically important for the authorities to implement their public sector investment program, which was geared to strengthening and diversifying the economic base and, thereby to promoting exports.

Mr. Foot said that the Government had achieved a great deal in the past few years. However, the authorities still needed to make progress in several areas. First, Grenada needed to continue looking for increased private investment. The climate for that could only be helped by the measures taken thus far and by the authorities' continued commitment to privatization and liberalization of policies. The second need was to exercise restraint in public expenditure, especially with respect to the civil service, and to adopt contingency plans in the event that external grants were not forthcoming on the scale envisaged. Third, the authorities needed to boost tax revenue without undermining the effort to achieve development objectives and while continuing the highly desirable policy of fiscal reform. Fourth, the review of the exchange rate position should be confirmed. The real exchange rate still appeared high, and it was far from clear that the current exchange rate policy was in Grenada's long-term interests. Finally, the authorities needed to continue to deal with the problem of external arrears. The staff assumed that arrears would continue at their 1985 level, but he was not convinced that that outcome would be desirable. He urged the authorities to tackle the problem and not to assume that the current level of arrears could be maintained indefinitely.

The staff representative from the Western Hemisphere Department said that the projected decline in external grants in 1986 was based on preliminary official data, which had been made available to the staff on its recent visit to Grenada; however, the projection was subject to change as the authorities were currently seeking additional aid.

The Governor of the Eastern Caribbean Central Bank (ECCB) had informed the staff that field work on the exchange rate study had just been completed for Grenada and St. Vincent, and that the ECCB would prepare a report and forward recommendations on a common exchange rate policy to the member governments for their review, the staff representative noted. After that review, a final set of recommendations would be sent to the Monetary Council of the ECCB for approval sometime in March 1986. As had been mentioned by some Executive Directors, several member governments had expressed their reservations on the need for exchange rate action, thus making it difficult to reach any unanimous agreement on an exchange rate adjustment.

The authorities had indicated that they would keep the wage bill constant in nominal terms over the medium term, the staff representative explained. At the same time, they had felt a need to raise wages in certain categories of the civil service, and they were looking at the size as well as the structure of the civil service. In that connection, the authorities were reviewing an organization and management study that had recently been completed, but no decisions had been made yet.

As data on savings were scarce, the staff had made some calculations of domestic savings, but they tended to be indicators rather than firm estimates, the staff representative from the Western Hemisphere Department commented. According to those indicators, the level of domestic savings in Grenada was negligible. Similarly, data on private investment were not currently being collected in Grenada; staff estimates, however, indicated that private investment had increased substantially in 1984 and 1985, and the staff expected it to rise considerably over the medium term, particularly foreign investment in tourism. In that context, it was noted that the climate for private investment had improved significantly, reflecting the measures taken by the new Government, such as the new investment guideline, expanded fiscal incentives, increased availability of bank credit, and a relatively successful ongoing effort to remove infrastructural bottlenecks.

The staff representative from the Exchange and Trade Relations Department said that in its appraisal the staff had clearly recommended that Grenada's arrears should be eliminated. However, that recommendation was not reflected in the balance of payments table because the staff did not know when the arrears would actually be eliminated.

Mr. Leonard observed that much interest had been shown in the fiscal management of Grenada during the past two years, especially in the past year when the new Government had come into office. As the staff had pointed out, expenditure as a percentage of GDP was expected to fall to 34 percent in 1986 and to be reduced further in subsequent years, which represented a great deal of fiscal compression. The authorities had taken and were continuing to take a number of factors into account in their fiscal management. Those included the need for a reduction in the relative size of the public sector; reform of the tax system, even though the reform might result in a loss of revenue, at least in the short term; generation of more savings to finance future public sector investment; observance of the discipline imposed by a fixed exchange rate system; and fostering the international competitiveness of the economy by avoiding excessive wage increases for civil servants which would give the wrong headline to the private sector. All those requirements added up to a formidable package that would make heavy demands on the authorities in managing the economy over the next few years. The authorities were striving to meet those demands; however, it was not clear how much additional fiscal compression would be possible. The best approach at the present juncture would appear to be to encourage the authorities to proceed in the directions in which they were going, to watch the situation closely and to support them in taking any corrective action needed in the light of particular contingencies that might arise, rather than to map out, at present, a long-term course of detailed action. The economy had to be given a chance to respond to the efforts that were being made, and time was needed for the private sector to evolve and provide more buoyancy to revenue and to expand the fiscal base as well. Too great a hurry might derail the entire process.

The exchange rate issue had bedeviled discussions among the Eastern Caribbean islands for a long time, Mr. Leonard recalled. Ms. Lundsager had rightly suggested that it was unlikely that there would be any major developments in the exchange rate as the result of the present studies, and that Grenada was too small to make exchange rate changes on its own.

The advantages to be gained from a stable exchange rate should not be overlooked. From the commercial point of view, it was attractive to have a reasonable assurance that at any time the value of the the Eastern Caribbean dollar would remain unchanged over the following six or twelve months. Moreover, Grenada's acceptance of the Eastern Caribbean dollar and membership in the ECCB represented a step toward the more concerted economic action in the region that appeared to be necessary for future regional prosperity. A fixed exchange rate did, of course, call for discipline on the part of the members of the system. The authorities in Grenada had demonstrated that they fully appreciated that restraint and were trying to move their economy in the right direction. If any unforeseen or unexpected developments arose, however, the overall stance would have to be reviewed more closely.

The Acting Chairman made the following summing up:

Executive Directors agreed with the basic thrust of the appraisal in the staff report for the 1985 Article IV consultation with Grenada.

Directors welcomed the authorities' efforts over the past two years to foster a more market-oriented economy and the emphasis given to creating conditions for the growth of the private sector. It was noted that the authorities had liberalized controls on domestic prices and on foreign exchange transactions, expanded incentives for private investment, and reduced public sector participation in production and commercial activities. Directors felt that those policies, along with the infrastructure investments that had been supported by external aid had contributed to the recovery of real GDP in 1984-85, and they noted that the continued pursuit of such policies should enhance the prospects for growth of output and employment over the medium term. In that context, they considered it important that Grenada continue to implement policies that would improve the mobilization and allocation of domestic resources as well as provide a basis for attracting foreign financial flows, including direct investment and foreign assistance.

Directors pointed out that the strength of Grenada's fiscal and external positions in the past two years largely reflected the high level of external grants. While noting the importance of continued external finance, Directors stressed the need for measures to raise public sector savings to offset the effects of the decline in grants that was expected to take place. Directors expressed particular concern about the projected unfinanced gaps in 1986-87 and encouraged the authorities to be prepared to scale down expenditure if the needed additional external assistance was not forthcoming in the amounts required to eliminate the gaps. Also, in that respect, while tax reform was necessary in order to encourage the efficient allocation of resources and to improve the structure of public finances over the medium term, Directors cautioned that tax reform measures should be accompanied by actions to offset its short-term adverse impact on public sector revenue.

As was noted in the staff report, Grenada's exchange rate had appreciated significantly in real terms over the past five years, notwithstanding some reversal since early 1985. The authorities were encouraged to continue to cooperate in the Eastern Caribbean Central Bank's current review of the exchange rate of the Eastern Caribbean dollar. However, it was recognized that Grenada had limited possibilities to use the exchange rate as a means of external adjustment. Directors stressed that there was a greater need for the authorities to ensure that fiscal and monetary policies were consistent with improving the competitive position of Grenada. It was noted that Grenada had taken certain measures to alleviate the adverse impact of the currency appreciation on the country's production and balance of payments. However, Directors drew attention to the rise in real wages in 1982-84 and urged the authorities to exercise strict restraint on public sector wages, not only to strengthen the public sector finances, but also to provide appropriate signals for wage settlements in the private sector as part of the overall effort to improve Grenada's international competitiveness and to raise the profitability of investment.

Directors encouraged the authorities to seek resolution of matters relating to the rescheduling of certain external debts and to strive toward becoming current in respect of all public debt obligations. The Grenadian authorities were also praised for the steps that had been taken to open up the economy and to establish a more liberal external trade regime.

It is expected that the next Article IV consultation with Grenada will be held on an 18-month cycle.

The Executive Directors then took the following decision:

Decision concluding Article XIV consultation

1. The Fund takes this decision relating to Grenada's exchange measures subject to Article VIII, Section 3, and in concluding the 1985 Article XIV consultation with Grenada, in the light of the 1985 Article IV consultation with Grenada conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. Grenada applies a tax of 5 percent on most purchases of foreign exchange, which gives rise to a multiple currency practice. In view of the circumstances of Grenada, the Fund approves the retention by Grenada of the multiple currency practice resulting from the tax on foreign exchange purchases until March 31, 1986.

Decision No. 8153-(85/183), adopted
December 18, 1985

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/85/182 (12/16/85) and EBM/85/183 (12/18/85).

3. TANZANIA - TECHNICAL ASSISTANCE

In response to a request from the Tanzanian authorities for technical assistance in studying the applicability of computers to the collection of monetary and economic statistics, financial analysis, and accounting practices, the Executive Board approves the proposal set forth in EBD/85/307 (12/10/85).

Adopted December 16, 1985

4. ANNUAL REPORT ON EXCHANGE ARRANGEMENTS AND EXCHANGE RESTRICTIONS, 1986 - PART ONE - OUTLINE

The Executive Board approves the proposed outline of Part One of the Annual Report on Exchange Arrangements and Exchange Restrictions, 1986, as set forth in EBD/85/306 (12/9/85).

Adopted December 16, 1985

5. APPROVAL OF MINUTES

The minutes of Executive Board Meeting 85/37 are approved. (EBD/85/310, 12/11/85)

Adopted December 17, 1985

6. EXECUTIVE BOARD TRAVEL

Travel by an Advisor to Executive Director as set forth in EBAP/85/310 (12/13/85) and by an Assistant to Executive Director as set forth in EBAP/85/309 (12/13/85) is approved.

APPROVED: AUGUST 12, 1986

JOSEPH W. LANG, JR.
Acting Secretary