04

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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 83/46

10:00 a.m., March 11, 1983

J. de Larosière, Chairman
W. B. Dale, Deputy Managing Director

Executive Directors	Alternate Executive Directors
	W. B. Tshishimbi
	M. K. Diallo, Temporary
	C. Taylor
	P. Péterfalvy, Temporary
B. de Maulde	A. Le Lorier
	J. Delgadillo, Temporary
R. D. Erb	
M. Finaish	
A. Habib	Jaafar A.
T. Hirao	T. Yamashita
	M. Casey
	D. I. S. Shaw, Temporary
	C. Robalino
G. Laske	G. Grosche
	C. P. Caranicas
	L. Barbone, Temporary
R. N. Malhotra	A. S. Jayawardena
	J. E. Suraisry
	T. de Vries
	K. G. Morrell
G. Salehkhou	O. Kabbaj
	E. I. M. Mtei
	S. E. Conrado, Temporary
J. Tvedt	A. Lindå
Zhang Z.	Wang E.

J. W. Lang, Jr., Acting Secretary
J. C. Corr, Assistant

Also Present

R. Sapunxhiu, Alternate Executive Director, IBRD. African Department: M. G. Gilman, S. Schiavo-Campo. Asian Department: N. N. Choudhry, S. Ishii, S. P. O. Itam, S. Kashiwagi, F. Le Gall, K. Saito, D. A. Scott. European Department: L. A. Whittome, Counsellor and Director; B. Christensen, H. B. Junz, W. E. Lewis, B. J. Nivolett. Exchange and Trade Relations Department: S. Mookerjee, Deputy Director; N. Kirmani, A. B. Petersen, R. Pownall. External Relations Department: N. K. Humphreys. Fiscal Affairs Department: R. D. Kibuka. Legal Department: J. G. Evans, Jr., Deputy General Counsel; W. E. Holder. Middle Eastern Department: A. S. Shaalan, Director; R. K. Basanti, F. Drees, S. Geadah, H. E. Jakubiak, S. Kawar, K. Nashashibi, M. Yaqub. Research Department: G. I. Brown, K.-Y. Chu, L. U. Ecevit, T. Gudac, N. M. Kaibni, E. C. Meldau-Womack, P. R. Menon, A. Salehizadeh. Secretary's Department: A. P. Bhagwat. Treasurer's Department: D. Williams, Deputy Treasurer; A. M. Al-Samarrie, D. Berthet, K. Boese, W. L. Coats, D. S. Cutler, L. E. Escobar, D. Gupta, A. F. Moustapha, M. Sami, T. M. Tran, G. Wittich. Personal Assistant to the Managing Director: N. Carter. Advisors to Executive Directors: S. R. Abiad, E. A. Ajayi, C. J. Batliwalla, S. El-Khouri, I. R. Panday, P. D. Péroz. Assistants to Executive Directors: H. Alaoui-Abdallaoui, H. Arias, R. Bernardo, J. Bulloch, M. Camara, L. E. J. Coene, R. J. J. Costa, C. Flamant, I. Fridriksson, G. Gomel, M. Hull, J. M. Jones, M. J. Kooymans, P. Leeahtam, W. Moerke, V. K. S. Nair, K. Okma, Y. Okubo, J. K. Orleans-Lindsay, J. G. Pedersen, G. W. K. Pickering, J. Reddy, C. A. Salinas, H. Suzuki, M. Toro, J. C. Williams, A. Yasseri.

1. EXECUTIVE DIRECTOR

The Chairman welcomed Mr. Arne Lindø, Alternate Executive Director to Mr. Tevdt, to the Executive Board.

2. DESIGNATION PLAN AND OPERATIONAL BUDGET FOR MARCH-MAY 1983

The Executive Directors considered the proposed designation plan for March-May 1983 (EBS/83/48, 2/28/83; and Sup. 1, 3/10/83) together with the proposed operational budget for March-May 1983 (EBS/83/49, 2/28/83; and Sup. 1, 3/10/83).

Mr. Grosche commented that the data for several countries had not been updated. In addition, data on gross reserves, gold, and foreign exchange for several countries, such as Iran and Iraq, had not been included.

Mr. Casey said that he understood the reasons behind the removal of Australia from the designation plan. He wondered whether, if its reserves were to improve following the recent devaluation, Australia would agree to be designated and to be included in the operational budget, even if to do so necessitated an accelerated repurchase of the drawing under the buffer stock financing facility. In addition, his Jamaican authorities might wish to substitute resources under the supplementary financing facility for enlarged access resources at a later date.

Mr. Barbone stated that his Maltese authorities could agree to inclusion in the operational budget for the period March-May 1983. However, he regretted that the proposed changes in EBS/83/48, Supplement 1 had been issued only on the previous evening. It had therefore been impossible to report them to his Maltese authorities. He joined Mr. Casey in seeking further information on Australia. According to the available data, Australia's reserves had increased through March 1983. Again according to the data available, Malta had suffered a reserve loss in January 1983.

Mr. Finaish noted that four countries in his constituency were included in the designation plan and operational budget. His Kuwaiti authorities consented, but he had not received confirmation from his authorities in Qatar and Oman. His authorities in Bahrain had indicated that, in view of the difficulties facing the oil industry and the decline in their reserves, they were finding it increasingly difficult to contribute to the usable resources of the Fund. He hoped that it would be possible to exclude Bahrain from the designation plan and the budget.

Mr. de Vries suggested that, in light of the lateness of the receipt of the documents, discussion should be postponed until Directors could give them adequate consideration.

The staff representative from the Treasurer's Department apologized for the late circulation. The papers had required changes in light of the devaluation announced a few days earlier by Australia. At the time of the devaluation statement, the Australian authorities had also announced that they had suffered reserve losses of over SDR 2 billion since the end of January. As far as possible, the staff sought to avoid amending the papers once the designation plan and operational budget had been circulated.

The Executive Directors agreed to resume their discussion of the designation plan and operational budget in the afternoon.

3. SUDAN - PURCHASE TRANSACTION - COMPENSATORY FINANCING FACILITY

The Executive Directors considered a request by Sudan for a purchase equivalent to SDR 39.1 million under the compensatory financing facility (EBS/83/34, 2/11/83; Sup. 1, 3/2/83; and Sup. 2, 3/8/83).

Mr. Mtei made the following statement:

As the Board will recall, Sudan's economic and financial problems were discussed as recently as last January when approval was given for a stand-by arrangement which became effective on February 23, 1983 after agreement had been reached with members of the Paris Club for a satisfactory rescheduling of Sudan's external debt. The paper before the Board today on the request for a purchase under the compensatory financing facility would have been discussed concurrently with the paper on the stand-by arrangement but for the fact that the staff needed more time to examine the data on exports and to make the necessary projections. I therefore do not need to highlight the problems and the background to them, as they remain basically the same as in January.

The shortfall in Sudan's export earnings for the year ended June 1982 is estimated at SDR 95.1 million, and is accounted for almost entirely by a shortfall in cotton exports. The cotton industry was affected by a combination of factors that were largely beyond the control of the authorities, including, among others, the recession in the world textile industry, which reduced demand for cotton; high interest rates in industrial countries, which discouraged the accumulation of stocks; competition from other cotton producers; and a decline in international prices. As a result, earnings from cotton exports fell by 58 per cent in 1981/82 and accounted for only 18 per cent of total exports in the shortfall year compared with more than 50 per cent in earlier years.

For the two postshortfall years, it is expected that earnings from cotton would increase substantially, mainly on account of a recovery in export volume. With the recent fall in interest rates, buyers are expected to ship their purchases of cotton abroad rather

than maintain them in Sudan. Exports are expected to be stimulated also by the recovery in the world textile industry during the course of the year. Meanwhile, the export unit value of Sudan's cotton is projected to increase by about 19 per cent in the post-shortfall period.

The authorities are continuing their efforts to correct the structural imbalances in the economy that have a bearing on the longer-term viability of Sudan's balance of payments position, as evidenced by the adjustment program now being implemented and supported by a stand-by arrangement with the Fund.

In sum, all the requirements for a drawing under the compensatory financing facility are met. Sudan has a balance of payments need. The shortfalls in export earnings are due to factors that are largely beyond the control of the authorities. The staff agrees that these factors are temporary and reversible. The test of cooperation is also amply satisfied. I therefore urge the Board to approve the draft decision in EBS/83/34, Supplement 1.

Mr. Taylor commented that it was clear that two of the conditions for approval of the proposed purchase had been met. There was a clear balance of payments need, and the authorities were willing to cooperate with the Fund. However, he had reservations about three aspects of the estimated shortfall; the first two were general in nature.

It was surprising that the request related to a shortfall period ended more than 8 months previously, Mr. Taylor continued. In an earlier case the staff had stated that the decision required only that the shortfall year should be the latest 12-month period for which data were available, of which up to 6 months could be estimated. Was it really true that in Sudan's case there had been no actual data later than June 1982? In previous requests by Sudan the export data lags had been only about 4 or 5 months. While he recognized that there was no strict rule, it had been the practice for the time lag not to exceed 6 months. If the lag should turn out to be longer than 6 months, an explanation should be provided in the staff paper. The compensatory financing facility was designed to finance short-term export shortfalls; if compensation did not take place until after export earnings had substantially recovered, much of the rationale for making the drawing might be said to have disappeared. If a statistical lag generally exceeded 6 months, it could indicate a need for improved monitoring and control procedures; if relevant, that aspect should be brought out in the staff paper.

The treatment of unrecorded exports was an issue that his chair and others had raised on previous occasions, Mr. Taylor noted. In Sudan's case, the staff had estimated unrecorded exports in establishing the balance of payments need. However, the export shortfall appeared to have been calculated without reference to unrecorded trade. The issue was not a major one in Sudan's case, but it might be important in other cases to

make whatever effort seemed possible to take account of unrecorded exports in calculating the shortfall, particularly if the results could significantly affect the size of the drawings. A clear and more consistent method of dealing with the issue in the staff papers would be welcome.

The projected upturn of Sudan's earnings from cotton in fiscal years 1982/83 and 1983/84 was not entirely convincing, Mr. Taylor considered. Although cotton prices had recently strengthened, there was evidence of increased crop production from a number of African producers in direct competition with Sudan. Moreover, several of the factors that had contributed to Sudan's poor export record seemed likely to persist, such as the expansion in the Egyptian crop, increased Chinese production for the domestic market, and reduced demand from Eastern Europe. He invited the staff to comment on the factors that had influenced its projections of export recovery in cotton. Notwithstanding his reservations, he could support Sudan's request. The requested drawing was much less than the shortfall. It appeared possible that the calculations would not have been significantly different if a later shortfall year had been taken, since the weakness in cotton exports had been concentrated in the first half of 1982.

Mr. Suraisry stated that Sudan's request for a purchase met all the requirements of the compensatory financing decision. The request was based on actual data for the whole shortfall year. It was for an amount less than one half of the estimated shortfall. Even if its exports were to increase only slightly in the two postshortfall years, Sudan would still qualify for the proposed purchase. The sharp increase in Sudan's cotton production during the 1981/82 crop season had been encouraging. He hoped that production would return to its long-term level.

Mr. Salehkhou remarked that Sudanese exports had been adversely affected in 1981/82, mainly by a sharp decline in cotton exports. Worldwide recession, high interest rates prevailing at that time in the major industrial countries, a bumper cotton crop, and the resulting stiff competition from other cotton producers had all contributed to the dismal export performance. Although the staff projected a substantial recovery in cotton earnings for the two postshortfall years, the authorities should continue to implement important internal measures to set the stage for the emergence of a viable external sector.

The measures had been fully discussed at the time of the Executive Board's consideration of Sudan's request for a stand-by arrangement (EBM/83/21, 1/28/83), Mr. Salehkhou recalled. In particular, continued shortages of agricultural equipment and infrastructural weaknesses, as well as cost-price distortions, could undermine the potential benefits arising from an improvement in international markets as a result of the economic recovery in the industrial countries. Structural imbalances and other constraints remained prevalent; continued adjustment policies were needed to restructure the economy and to redirect manpower and other resources toward exports and productive investments. He welcomed Sudan's efforts in negotiating with creditors regarding repayment of loans. He

hoped that Sudan would undertake to honor all its commitments in a non-discriminatory manner, particularly a long-overdue loan contracted with another Fund member.

Mr. Malhotra said that the request met all the necessary requirements. He could support it.

Mr. Erb commented that the points made by Mr. Taylor were worthy of consideration. He shared his concern about the cotton export projections. However, given that the shortfall based on those projections was significantly higher than the proposed purchase, there was room for some overestimation of exports.

Mr. Tvedt stated that he could support the requested purchase, although he had problems with the methods used by the staff to calculate the shortfall. On page 10 of EBS/83/34, the staff explained that a large part of the decline in shipments of cotton exports in 1981/82 reflected an increase in cotton stocks sold but not shipped because of the relatively lower inventory costs in Sudan. For the two postshortfall years, a substantial recovery in export volume was projected, because the fall in international interest rates was expected to reduce the incentive of buyers to retain their cotton purchases in Sudan. That outcome seemed likely. However, it was puzzling that, in Table 5 on page 9, the staff provided only the gross figure of total exports of cotton, showing almost a doubling between the previous and the current financial year. Without information on how much of the increase was accounted for by the decrease in cotton stocks sold but not shipped, it was difficult to grasp what was happening to the underlying trends in cotton exports.

Miss Le Lorier remarked that she supported the proposed decision. However, she was concerned about the suggestion by Mr. Taylor that it might be possible to take into account unrecorded exports when estimating a shortfall. In many cases the data for recorded exports, let alone the data for unrecorded exports, were very fragile. She would be most reluctant to include unrecorded trade in the calculations for a compensatory financing facility request.

Mr. Casey said that he could support the request. However, he share the concerns of Mr. Taylor and some other speakers. In light of Mr. Taylor's observations, was it true that the 6-month rule had been breached? He had understood that the rule was fairly rigid; indeed, one of the countries in his constituency had suffered from its strict application. He invited the staff to comment on the flexibility of the 6-month rule.

The question of whether the shortfall was largely beyond the authorities' control was always difficult to assess precisely, Mr. Casey continued. In the present case, some of the causes of the cotton shortfall were related to such factors as labor shortages, deterioration of physical capital, transport difficulties, and the like. There had been a very large increase in cotton stocks, and the authorities had, in a sense,

encouraged the stockpiling by subsidizing carrying charges. He invited the staff to comment further on the question of whether the shortfall had, indeed, been largely beyond the control of the authorities.

Mr. Zhang said that he supported the request.

Miss Diallo commented that the economic and financial problems facing Sudan were well known to Executive Directors. It was clear that the country had experienced a sharp fall in export earnings for the year ended June 1982 as a result of external factors largely beyond the authorities' control. Since all the conditions required for a drawing were met, she had no difficulty in supporting the present request, which was, indeed, overdue. Although the Board was discussing the request in March 1983, the year ended June 1982 was being considered the shortfall year. In the prevailing world economic and financial situation, such understanding on the part of the Board was appropriate; it should be applied as often as necessary.

Mr. Finaish stated that he supported the proposed decision.

Mr. Habib said that he also supported the proposed decision in accordance with the conditions set out in EBS/83/34. The staff had established that a shortfall existed, and the Sudanese authorities had always cooperated with the Fund in trying to find solutions to their difficulties, and they had reiterated their willingness to cooperate further.

The staff representative from the Middle Eastern Department noted that one Director had referred to Sudan's payments to Fund members. Sudan continued to owe about $50 million to some oil exporting countries other than Saudi Arabia and Kuwait. The authorities were expected to seek a rescheduling of those loans in 1983 along lines similar to those agreed with members of the Paris Club.

The staff representative from the Research Department commented that the compensatory financing decision itself did not set a limit to the lag between the end of the shortfall year and the date of Board consideration of the request. Since the establishment of the facility, however, the normal practice had been to allow a lag of up to about 6 months, but the limit had not been applied rigidly. From time to time, delays had been unavoidable, making strict adherence to the 6-month convention impracticable. Of 177 cases discussed by the Board since 1975, the lag between the end of the shortfall year and the time of the request had been 6 months or less in 154 cases. In only one case had the lag been 8 months. Thus, the present case, with a lag of slightly more than 8 months, was exceptional.

In the present instance, the staff representative continued, information to support the request had been collected in October and November 1982, but the staff had had to request further information from the authorities, and it had therefore been impossible to prepare the compensatory financing facility paper for consideration at the same time as the stand-by arrangement paper in January 1983. The staff's understanding

was that data beyond June 1982 in the form required for the compensatory financing calculation did not exist on an actual basis at present. If a staff mission were to go to Sudan, it might be possible to collect export data for 1 or 2 later months. Experience suggested that, in Sudan's case, the most efficient way to obtain statistics was through a mission to the country that could work with the authorities to gather data in the appropriate form.

Mr. Erb commented that it was unsatisfactory that a mission was required to produce timely statistics. A procedure should be in place so that the statistics could be produced within a reasonable period. The lag in reporting the export data was particularly surprising given the close involvement of the Fund staff with the Sudanese authorities in working out the recent stand-by program.

The staff representative from the Middle Eastern Department said that there was little difficulty in obtaining data for cotton. However, it was much more difficult to have a comprehensive set of export data that included items such as livestock, hides, skins, and certain smaller exports. The Fund had a resident representative in Khartoum working with the authorities and doing his best to obtain the necessary data. However, it often required a long time to receive information from the outlying areas in Sudan.

The Chairman stated that the resident representative should be informed of the Board's concerns.

The staff representative from the Research Department, continuing his response to Directors' questions, observed that the issue of the treatment of unrecorded trade had been raised on previous occasions. It had been standard practice not to take account of unrecorded trade in calculating the shortfall. For some unrecorded activities, such as border trade in live animals, it was extremely difficult to make reasonable estimates.

The staff's projections of the upturn in cotton exports had been based on crops already harvested, the staff representative continued. The 1981/82 crop, which would be available for shipment during the first postshortfall year, had been 44 per cent higher than the crop available for export during the shortfall year. The 1982/83 crop, being harvested at present, would be available for shipment in the second postshortfall year; the indications were that it would increase from 784,000 bales to 912,000 bales. The projections could, therefore, be made with a reasonable degree of certainty, at least with regard to export availabilities.

Actual shipments of cotton were more difficult to project, the staff representative observed, and the timing of a world economic recovery was extremely important in that regard. The decline in interest rates that had already taken place in industrial countries should encourage importers to rebuild their stocks, which had fallen to very low levels during 1981

and 1982. Furthermore, a recovery in world textile activity was expected, perhaps later in 1983, a development that should benefit Sudan's cotton exports during the two postshortfall years. In addition, cotton acreage in the United States was expected to decline by about 19 per cent in 1983/84 because of the new payment-in-kind program initiated by the U.S. Government. Prices should, therefore, be strengthened later in the postshortfall period. The projected increase of 19 per cent a year in the price of cotton took account of improvements in the supply and demand balance as well as of the fact that the quality of Sudan's cotton was expected to recover.

One Director had wondered whether the shortfall had been largely beyond the control of the authorities, the staff representative from the Research Department went on. The Sudanese policy of exempting from storage charges purchasers' supplies of cotton held in the country had been in effect for a number of years; its main purpose was to encourage exports, not to withhold supplies from the export market. The dominant factor in 1981/82 had been a depressed world demand for cotton, which had reduced shipments significantly. Considering all the factors involved, the staff considered the shortfall to have been largely outside the control of the member.

The staff representative from the Middle Eastern Department added that the latest information from the World Bank suggested that the 1982/83 cotton crop in Sudan would be about 970,000 bales, that is, somewhat higher than the 912,000 bales mentioned in EBS/83/34. Furthermore, the Sudanese authorities intended to price their cotton at the same levels as in 1982 in order to sell as much of the crop as they could as fast as possible.

Mr. Barbone asked why, if the Sudanese intended to maintain the same price for cotton, an increase in 25 per cent in unit value was projected for 1983 in Table 4 of EBS/83/34.

The staff representative from the Middle Eastern Department replied that the prices set by the authorities were minimum prices and the realized prices could be substantially higher, depending on the prices offered by buyers.

Mr. Mtei observed that data for the estimation of the shortfall had not been available at the time of the staff's discussions with the authorities with regard to the stand-by arrangement. Moreover, the requested drawing was less than half of the estimated shortfall. Even if the data turned out to have been somewhat inaccurate, it was almost inconceivable that the shortfall would turn out to have been lower than the requested drawing. His Sudanese authorities were demonstrating their commitment to cooperate with the Fund through the implementation of the stand-by arrangement. He would bring to their attention the point made by one Director with regard to nondiscrimination in loan repayments.

The Executive Directors then took the following decision:

1. The Fund has received a request by the Government of Sudan for a purchase equivalent to SDR 39.1 million under the Decision on Compensatory Financing of Export Fluctuations (Executive Board Decision No. 6224-(79/135), adopted August 2, 1979).

2. The Fund notes the representation of Sudan and approves the purchase in accordance with the request.

3. The Fund waives the limitation in Article V, Section 3(b)(iii).

Decision No. 7359-(83/46), adopted
March 11, 1983

4. MALAYSIA - PURCHASE TRANSACTIONS - BUFFER STOCK FINANCING FACILITY - SIXTH INTERNATIONAL TIN AGREEMENT, AND INTERNATIONAL NATURAL RUBBER AGREEMENT

The Executive Directors considered a request by Malaysia for a purchase equivalent to SDR 45.2 million in connection with Malaysia's contributions to the buffer stock of the Sixth International Tin Agreement (EBS/83/36, 2/16/83; and Sup. 1, 2/24/83) together with a request for a purchase equivalent to SDR 67.8 million in connection with Malaysia's contributions to the buffer stock of the International Natural Rubber Agreement (EBS/83/37, 2/16/83; and Sup. 1, 2/24/83).

Mr. Jaafar stated that the requests related to Malaysia's compulsory contributions to the buffer stock of the Sixth International Tin Agreement, and to its contributions in response to four call-ups under the International Natural Rubber Agreement. The request amounted in total to SDR 113 million, equivalent to about 30 per cent of Malaysia's quota with the Fund. The staff had clearly established that there was a balance of payments need and that the test of cooperation with the Fund had been met.

As a result of the slowdown in the world economy, Mr. Jaafar continued, Malaysia's exports since 1980 had been adversely affected following record surpluses in the previous four years. The trade balance had first been in deficit in 1981; the deficit was estimated to have worsened to SDR 953 million in 1982. The adverse impact of a deterioration in the terms of trade for primary export commodities and a slowdown in export volume had contributed to the current account deficit of SDR 3,361 million in 1982, equivalent to 15 per cent of GNP. The prospects for 1983 were expected to be similar, although a moderate recovery in exports was projected in anticipation of a recovery in world trade.

The requests also met the test of cooperation with the Fund, that the authorities should seek ways to improve Malaysia's balance of payments problems, Mr. Jaafar added. Directors would recall that the authorities had been urged to curb public expenditure at the time of the previous Article IV consultation. In June 1982, they had taken measures to reduce the level of public expenditure in view of the external performance of that year.

Mr. Hirao noted that Malaysia's overall balance of payments was estimated to have recorded a deficit of SDR 234 million in 1982 and that gross international reserves at the end of November 1982 had been equivalent to 3.9 months of imports, compared with 4.3 months of imports at the end of 1981. The current account deficit had widened from 1 per cent of GNP to 15 per cent of GNP in 1982. Malaysia's balance of payments need was clear; it justified the proposed purchase.

While Malaysia's record of economic growth and financial stability was good, Mr. Hirao continued, its open economy was susceptible to cyclical external conditions. The estimated current account deficit in 1982 suggested an urgent need for adjustment by the authorities. The staff indicated in the papers that the authorities had taken measures to reduce the level of public expenditure and that they planned to limit the growth of their expenditure to 1 per cent in the 1983 budget. The staff had made it clear that Malaysia's requests in connection with their contributions to the buffer stocks of the Sixth International Tin Agreement and of the International Natural Rubber Agreement met all the requirements set forth in the relevant decisions. He supported each of the proposed decisions.

Mr. Suraisry agreed that the two requests by Malaysia met all the requirements for a drawing under the buffer stock financing facility. Malaysia's balance of payments need was well established, as was its record of cooperation with the Fund. The more restrictive fiscal stance adopted by the authorities was very much in line with the Board's advice at the time of the Article IV consultation discussion in June 1982. Both requests were consistent with the decision to allow drawings from the buffer stock financing facility to finance compulsory contributions under the Sixth International Tin Agreement and the International Natural Rubber Agreement. The amounts requested were small relative to quota; he noted that the purchase covering Malaysia's contributions under the Sixth International Tin Agreement was contingent upon a repurchase of the same amount that had been used to finance an earlier contribution to the buffer stock of the Fifth International Tin Agreement.

Mr. Delgadillo commented that he was in general agreement with the staff appraisal and that he strongly supported each of the proposed decisions. For more than a year the international tin market had been weak, reflecting the conditions prevailing in the world economy as a result of the recession and the sluggish demand for metals and other primary commodities. Under the circumstances, the International Tin Council (ITC) had sought to prevent prices from falling below the floor price so as to

avoid further disruptions in the market and in the economies of the main exporters of the metal. In the absence of clear indications of recovery in the world economy, particularly in the economies of major users of metals as raw materials, the outlook for the producer countries would remain uncertain and the work of the ITC would continue to be important in endeavoring to avoid further detrimental effects on market prices.

In Malaysia's case, Mr. Delgadillo continued, the test of cooperation had been met and the authorities had adopted a number of corrective measures in July 1982 to reduce the fiscal imbalances. In view of recent developments on the external front, the widening of the overall balance of payments deficit at the end of 1982, and the deterioration in the level of international reserves, he expressed confidence that the authorities would continue to cooperate closely with the Fund in finding appropriate and timely solutions to those problems. The requests met all the requirements established under the pertinent decisions.

Mr. Morrell remarked that he also supported the proposed decisions; the requests met all the relevant requirements. Malaysia had been particularly adversely affected by the continued depressed commodity markets; it had obviously been vulnerable in view of its position as the world's largest exporter of natural rubber and of tin. He noted that the country had played a leading role in the cooperative efforts to establish the commodity agreements, as evidenced by its leading position and by the amount of the drawings.

Mr. Salehkhou commented that he agreed with the thrust of the staff appraisals and that he supported the two decisions. Malaysia's balance of payments position had sharply deteriorated in the previous two years, concurrently with the unfavorable development of its external terms of trade. The result had been a substantial increase in the current account deficit from 1 per cent of GDP in 1980 to 15 per cent in 1982. The development was clearly a consequence of the world recession that had adversely affected Malaysia's main exports in terms of both prices and volume. After sizable surpluses in 1979 and 1980, the balance of payments had recorded large deficits in 1981 and 1982, accompanied by substantial foreign borrowing and a severe drain on international reserves.

Malaysia's record of cooperation with the Fund was largely satisfactory, Mr. Salehkhou continued, as could be seen from the important measures introduced in July 1982 aimed at reducing the level of public expenditure and increasing government revenues in line with the Executive Board's recommendations at the time of the 1982 Article IV consultation. The two requested purchases met all the requirements of the decisions relating to the corresponding buffer stock agreements. Both the International Tin Agreement and the International Natural Rubber Agreement had recently played important roles in limiting the deterioration of the two commodities' international prices and in reducing the impact of such deterioration on the exporting countries.

Mr. Malhotra, Mr. Zhang, Mr. Finaish, Mr. Taylor, Mr. Erb, and Mr. de Vries, Miss Le Lorier, and Miss Diallo each stated that they supported the proposed decisions.

Mr. Casey said that, while he also supported the proposed decisions, one aspect of the request with regard to the International Tin Agreement remained puzzling. The Malaysian authorities had informed the International Tin Council on July 19, 1982 that they would make their contribution to the Sixth International Tin Agreement by transfer from the buffer stock of the Fifth Agreement with effect from July 1, 1982. Such action presumably gave rise to a repurchase obligation to the Fund. However, the staff's explanation was unclear; it noted on page 5 of EBS/83/36 that the staff had been able to clarify Malaysia's contribution to the Sixth International Tin Agreement only very recently. What was the precise meaning of paragraph 1(b) in the relevant decision when it referred to the member being expected to make a repurchase at an earlier date when such a development occurred? The language did not include the word "prompt" as it did in some other decisions. Had the staff notified Malaysia that the country had to make the expected repurchase? Why had the Executive Board not been informed of the delay, as would have occurred in the case of an overcompensation under the compensatory financing facility?

Mr. Grosche said that, while he also supported the proposed decisions, he shared the concern expressed by Mr. Casey.

The staff representative from the Research Department observed that the transfer of tin from the assets of the Fifth International Tin Agreement to meet Malaysia's contribution under the Sixth Agreement was regarded by the Fund as a distribution; it was, therefore, subject to the expectation of an early repurchase. However, there had been a good deal of confusion with regard to Malaysia's communications with the International Tin Council. The staff had only learned of Malaysia's notification to the Council in July that it wished to meet its contribution by a transfer when the Malaysian authorities had expressed interest in a purchase under the buffer stock financing facility. Although it had been notified by the Malaysian authorities, the Council had postponed taking a decision on when to effect the transfer in its books; in fact, the matter still remained undecided. After a series of communications among the staff of the Fund, the Malaysian authorities, and the staff of the Council, it became clear that there had been a misunderstanding as to when the expectation of repurchase applied. If the Malaysian authorities themselves had known the position precisely, they would certainly have informed the Fund earlier. With regard to the difference between the wording of the compensatory financing facility decision, which referred to "prompt" repurchase, and the wording of the decision dealing with repurchases in the event of a distribution to members by the buffer stock (Paragraph 1(b) of Decision No. 5703-(78/39), as amended), which referred to repurchase "at an earlier date," the staff had used language appropriate to the latter decision in the documents before the Board.

The Chairman stated that the staff should comment, at an appropriate time, on the reasons for different language in the buffer stock decisions and in the compensatory financing facility decision.

Mr. Jaafar explained that his Malaysian authorities had written to the International Tin Council (ITC) in July expressing an intention to transfer, not an instruction to transfer. Following further communications with the ITC, as well as between the ITC and the staff of the Fund, it became clear that the ITC had not made a transfer and that it did not intend to do so until all members made their contributions. In the meantime, there had been confusion regarding Malaysia's obligation to repurchase under the Fifth International Tin Agreement.

The Executive Directors then took the following decisions:

Purchase Transaction - Buffer Stock Financing Facility - Sixth International Tin Agreement

1. The Fund has received a request by the Government of Malaysia for a purchase of SDR 45.2 million under the Decision on Buffer Stock Financing Facility: The Problem of Stabilization of Prices of Primary Products, Decision No. 2772-(69/47), June 25, 1969, as amended by Decision No. 4913-(75/207), December 24, 1975, and the Decision on Buffer Stock Financing Facility: Sixth International Tin Agreement, Decision No. 7247-(82/147), November 12, 1982.

2. The Fund determines that this purchase would be consistent with the decisions referred to in (1) above, notes the representations of Malaysia, and approves the purchase in accordance with the request.

Decision No. 7360-(83/46), adopted
March 11, 1983

Purchase Transaction - Buffer Stock Financing Facility - International Natural Rubber Agreement

1. The Fund has received a request by the Government of Malaysia for a purchase of SDR 67.8 million under the Decision on Buffer Stock Financing Facility: The Problem of Stabilization of Prices of Primary Products, Decision No. 2772-(69/47), June 25, 1969, as amended by Decision No. 4913-(75/207), December 24, 1975, and the Decision on Buffer Stock Financing Facility: International Natural Rubber Agreement, Decision No. 7246-(82/147), November 12, 1982.

2. The Fund determines that this purchase would be consistent with the decisions referred to in (1) above, notes the representations of Malaysia, and approves the purchase in accordance with the request.

Decision No. 7361-(83/46), adopted
March 11, 1983

5. YUGOSLAVIA - 1982 ARTICLE IV CONSULTATION, AND REVIEW UNDER STAND-BY ARRANGEMENT

The Executive Directors considered the staff report for the 1982 Article IV consultation with Yugoslavia and a review under the stand-by arrangement (EBS/83/46, 2/24/83; Sup. 1, 3/10/83; and Cor. 1, 3/10/83). They also had before them a report on recent economic developments in Yugoslavia (SM/83/40, 2/28/83).

Mr. de Vries expressed Mr. Polak's regrets that he was unable to attend the Executive Board meeting because of official commitments. He thanked the staff for its incisive analysis of the Yugoslav economy. On Mr. Polak's behalf, he made the following statement:

> It has been only four months since the Board last discussed the stand-by arrangement for Yugoslavia (on November 12, 1982), but a great deal has happened in these four months.
>
> It became clear, in the last months of 1982, that, in spite of additional adjustment measures taken since the new Government took office in mid-1982, there was no possible way in which, in the short run, compensation for a radical change in the capital account of the balance of payments could be found by an improvement in the current account. Moreover, the actual improvement over 1981 in the current account turned out to be much smaller than had been expected until close to the end of 1982: in transactions with the convertible currency area, although there was a satisfactory improvement of about $0.5 billion in the first half of the year, there was none in the seasonally more important second half, so that for the year as a whole the improvement was small (the deficit declined from $1.8 billion to $1.4 billion), nearly $1 billion less than had been expected.
>
> But even without this disappointing performance of the current account it became increasingly evident that it would be necessary to deal directly with the question of capital outflows as large-scale maturities occurred in the first half of 1983, short-term credits ran out rather than being rolled over, and new credits became increasingly difficult to negotiate.

The Yugoslav authorities were, and are, determined not to approach this situation by means of rescheduling of private credits or Paris Club arrangements for government or government-guaranteed debt, and to accept the sacrifices for the population that follow from this decision. This attitude of the Yugoslav authorities has been welcomed by the governments of friendly industrial countries, and in the last few months a major international effort has been mounted to make it possible for Yugoslavia to overcome the difficulties of its capital account for the next few years without the country taking recourse to the rescheduling route. This has involved interrelated actions on the part of the ministries of finance, the export credit agencies, and the central banks of a large number of countries; the Bank for International Settlements; the World Bank; and the commercial banks with large exposure in Yugoslavia. The Fund staff has played a key role in orchestrating the highly complex sets of negotiations that were necessary to bring this whole effort to a reasonably satisfactory conclusion. It has undertaken this extraordinary task with alacrity and has stuck with it in the face of disappointments and obstacles from many sides. On behalf of the Yugoslav authorities, I want to express deep appreciation for this major effort by the staff.

A key element in the network of financial arrangements that is now falling into place is, of course, the agreement with the Fund on the program for 1983 (the third year of Yugoslavia's three-year stand-by arrangement), which is also necessary to unlock the Fund's component in the supply of finance for 1983. At SDR 554 million (133 per cent of the present quota), this is by no means a negligible amount in the total financing program. In recognition of the greater seasonal need of Yugoslavia in the early part of the year, the quarterly distribution is slightly front-loaded, with SDR 325 million in the first, and SDR 229 million in the second half of the year.

Although strong efforts have been made to lighten Yugoslavia's immediate burden of debt repayment and to provide it with some fresh resources, it has to be acknowledged that the financing program is extraordinarily tight. Success will depend on full implementation by Yugoslavia of the measures announced, and on early reinforcement of any measures that prove not to be fully adequate to bring about the intended results.

With respect to the outcome of the program over the past two years, Chart 1 of the staff paper summarizes in a simple, telling way the areas where this program has, and those where it has not, come up to the targets and expectations. For credit and the federal budget, the objectives were achieved. The objective for the current account balance for the first year was approximately reached, but the much more ambitious one for the second year was not. The hope to bring inflation down sharply from the previous year's rate was frustrated in both 1981 and 1982. For 1983, the

chart shows an expected price rise of 30 per cent, which is only slightly below the experience of 1982. As the staff explains on page 26, their forecast is higher than the amended official price projections of some 25 per cent, and both are higher than the earlier figure of 20 per cent to take account of the effects of the important structural adjustments in certain prices recently introduced and the policy adopted with respect to the exchange rate. A final point that Chart 1 makes very clear is that the disappointments with respect to prices and the balance of payments cannot be attributed to excessive domestic absorption: on the contrary, the growth of the real social product declined in both 1981 and 1982, against a small programmed increase for each year. But for 1983, a radically more conservative stance has been adopted as inevitable, with real social product forecast by the staff to fall by 2.6 per cent (Table 5, EBS/83/46).

It is clear from these few indications of performance that, in spite of policy actions taken on many points in the past two years, and making full allowance for the unfavorable international climate in which the adjustment process had to operate, Yugoslavia had not yet put into place the full instrumentarium of policies required for noninflationary balanced growth with a satisfactory balance of payments. As the staff points out, part of the delays in this connection are related to the difficulties of policy implementation in a federal state.

In designing a program for 1983, the Yugoslav authorities and the staff have made a major effort to design additional measures of policy control to enhance incentives and productivity and to counteract certain built-in inflationary tendencies. In this context, the authorities are moving in the direction of greater emphasis on centralized control of a number of major variables, a point on which Directors laid stress during the previous discussion of Yugoslavia in the Board.

To deal with the inflation problem, the measures to control, on a decentralized basis, the level of nominal workers' incomes have been tightened and it has been accepted that centralized regulation will be introduced if these measures do not achieve the desired result promptly. On prices, further measures are being taken to weed out the remaining distorting effects of price controls, in spite of the short-run inflationary impact of such measures. In the area of credit policy--where end-of-period targets have, with one minor exception, consistently been met--a number of changes and refinements have been introduced. One of these is the adoption of ceilings based on the average of three end-of-month data for each quarter. A second is the substitution of "net domestic assets" of the banking system for the previously used "domestic credit expansion." A third is the control of excessive inter-enterprise credit by means of a priority system that would oblige an enterprise to pay its creditors before it

paid its workers more than the minimum guaranteed income. Credit in the form of unpaid bills had become a source of finance that permitted uneconomic enterprises to continue to operate unchecked by indirectly draining resources from the banking system. The control over credit expansion will also be assisted by further adjustment of interest rates, brought about largely by a significant increase in the cost of funds to the banking system. There has been a tendency in the past to pursue the objective of positive real interest rates on the basis of optimistic views as to the expected rate of inflation. The midyear review will serve to ensure that any possible tendency in that direction in 1983 will be quickly corrected.

In the case of fiscal policy the risk is not so much that expenditure will outrun receipts; the overall budgets of the federation and the other public sector entities are traditionally *in balance. Rather, the risk is that increases in receipts due* to inflation will be passed through into increased expenditure. The staff has devised an interesting technique (needed on account of the lag in data on government expenditure) to ensure that, in future, excess receipts will be frozen as an anti-inflationary measure.

Finally, substantial further modifications had to be introduced in the area of exchange and trade policies. Agreement has been reached on additional real depreciation of the dinar (see page 24 of the staff report). In addition, it was necessary to ensure that the regulations on the allocation of export proceeds were such as to give exporters access to foreign exchange to buy the necessary imported inputs and to maintain roughly the benefit they had derived previously from selling retained foreign exchange to importers.

The staff estimates that with this package of measures the current account deficit with the convertible area can be reduced by about $1 billion in 1983, to a figure of about $0.5 billion. With full realization of the plans for the financial flows, this would permit some buildup in reserves, which is absolutely necessary for the country to face the early part of 1984.

The close cooperation between the Fund and Yugoslavia is *beginning to show results, even if these results are not forth*coming as rapidly as the two partners had hoped. In the circumstances, there is much to be said for the decision that has already been taken by the Yugoslav Government that it will seek a new stand-by arrangement with the Fund for 1984 and beyond. The financing agreements with governments and banks are predicated on the continued existence of such arrangements; but it seems evident that their value to Yugoslavia extends well beyond these formal considerations.

Mr. Caranicas commented that, at the time of the Executive Board's previous discussion of Yugoslavia (EBM/82/146, 11/12/82), Directors had reviewed developments under the three-year stand-by arrangement and they had come to the conclusion that the adjustment under way was insufficient and that the situation in Yugoslavia remained critical. Directors had realized then, and they were discovering again, that the unfavorable outcome for both the external and internal balances in 1982 was not so much the result of unfavorable events--partly exogenous and uncontrollable, partly embedded in the policies of the authorities and their administrative controls--as of the very nature of the Yugoslav constitutional system and its degree of decentralization.

It was not the first occasion on which the Executive Board had had to deal with a country that had observed all the performance criteria and understandings proposed by the Fund without being able to achieve the adjustment program targets, Mr. Caranicas continued. The current account and inflation targets were notable examples in the present case. The Yugoslav economy continued to stand at a critical juncture even after the extensive discussions and many difficult decisions involved in the intense international efforts of governments, central banks, and other institutions, including the Fund. The crisis persisted despite the appreciable resolve and great courage shown by the authorities throughout 1982 and the first two months of 1983. Immense difficulties lay ahead, as indicated in EBS/83/46, Supplement 1.

Commenting on credit policy, Mr. Caranicas noted that important measures had been implemented to strengthen the techniques of monetary control at the authorities' disposal. Both the increase in interest rates and the schedule of ceilings on net domestic assets of the banking system, coupled with new legislation to be introduced shortly to stem a swelling in the inter-enterprise credit market, ought to result in the desired degree of monetary stringency, reducing the leeway offered by continued unchecked increases in money velocity. With regard to incomes policy, an essential instrument for inflation control, he welcomed the suggestion made by the staff to monitor the developments in the growth of personal incomes on a quarterly basis; the intention of the authorities to reduce real earnings in 1983 was also appreciated.

The recurrence of a wage-price spiral and the disappointing outcome with regard to inflation were connected, to an important degree, with the workings of the self-managed economic system, Mr. Caranicas considered. The practice whereby enterprises raised prices and wages at the same time on the basis of the expected inflation rate led to inflation prone behavior. Institutional changes in the income determination mechanism were needed, therefore, to correct such a situation. The recently adopted decision to link wage growth to realized, rather than expected, enterprise earnings was important as a means of improving the implementation of incomes policies on a decentralized level. However, it appeared likely that more active centralized control might be required. He invited the staff to comment further on the issue and to indicate what measures might be envisaged.

Considerable uncertainty prevailed with regard to the outlook for external payments, Mr. Caranicas observed, as underlined by the particular caution with which the staff submitted the relevant projections. As pointed out in EBS/83/46, Supplement 1, "it is in the nature of such projections that these data remain relatively tenuous." Given the precarious situation of the trade and current accounts, it was imperative for the authorities to shift demand from domestic to foreign sources. It was equally important to shift resources, to the extent possible, to the tradable goods sector. The policies that had been put into place were steps in the right direction, that is, compressing domestic absorption and correcting relative prices via appropriate exchange rate adjustments. Nevertheless, exports had declined in volume in 1982 in the face of a sluggishly growing export market, and the sizable drop in imports had been forced mainly by a shortage of foreign exchange and declining domestic demand, rather than through favorable relative price changes. The disappointing performance on the export front was attributed by the staff to some degree to reduced incentives available to exporters from the operation of the revised system of foreign exchange allocation. The lower incentives to producers provided by that mechanism were, presumably, less than offset by the incentives gained through a lower exchange rate for the dinar. Exporters appeared to have largely reaped the benefits stemming from the devaluation by raising prices, thereby choosing to increase their profit margins rather than their market shares.

It could be argued that a larger depreciation was necessary if Yugoslav export industries were to improve their competitiveness, Mr. Caranicas suggested. The staff's description on page 24 of EBS/83/46 of the exchange rate rule chosen by the authorities was somewhat obscure. If he understood it correctly, the dinar was supposed to depreciate steadily, in real effective terms, during 1983. In Yugoslavia's case, given past pricing behavior and the institutional setting of the economy, there was no certainty that such a real depreciation could actually be achieved, since any nominal devaluation might be fully passed through onto domestic and export prices. Even if that development did not occur, the increases in export volumes predicted by the authorities--20 per cent--or by the staff--8 per cent--did not seem reasonable, as they implied a strong upsurge in market shares; such a prospect was difficult to believe, in light of the existing commodity and geographic composition of Yugoslavia's exports.

He warmly supported the proposed decision, Mr. Caranicas added, and he welcomed the financing package worked out through elaborate and highly complex negotiations in which the Fund had been deeply involved. Responding positively to the commendable decision of the Yugoslav authorities not to request a rescheduling of their external debt, creditor countries had provided extra finances and they had mobilized the international effort to help Yugoslavia in its hour of need. It was a clear demonstration that adjustment could succeed, if the necessary sacrifices by the population were combined with the cooperation and assistance of the entire international financial community.

Mr. Laske recalled that, at the Executive Board's discussion of the three-year stand-by arrangement with Yugoslavia in November 1982, two points had become obvious: first, developments in the second year of the program had not been satisfactory, and second, policies in Yugoslavia had not been dealing adequately with the major problems. The staff reports before Directors confirmed those findings; they brought out very clearly the maladjustments and the problems in economic policy and in the economic institutional framework in Yugoslavia. Two developments were particularly disappointing. First, the deficit in the external current account had been reduced only marginally from the previous year's record deficit, and, as a result, the outcome for 1982 had fallen far short of the program's objectives. Second, the rate of inflation, although significantly lower than in 1981, remained as high as it had been in 1980, when it had been considered excessive.

Both those developments were primarily due to an overabsorption of resources by domestic demand, especially for consumption purposes, Mr. Laske suggested. In 1982, the Yugoslav authorities had not been successful in sufficiently containing wage increases and the expansion of credit. Although the program's ceilings for domestic credit expansion had been observed, the enterprise sector had managed to evade the restriction by extending nonbank credit in an unorganized way. Further shortcomings in the general policy framework, for example, the inefficient allocation system for foreign exchange, could be cited, but the developments in the current account and in inflation were the most important. The program for the third year of the arrangement focused appropriately on corrections in those two areas.

Commenting on wages policy, Mr. Laske observed that the outstanding feature of the program was the objective of a decline of 7.5 per cent in real incomes. Following a cumulative decline of 15 per cent over the previous two years, the 1983 objective certainly amounted to a bleak prospect for the Yugoslav population. However, it was difficult, if not impossible, to envisage other ways in which the necessary and urgent reduction of the striking imbalance between demand and supply could be overcome. In order to realize that objective of the program, the authorities had decided that nominal incomes should not rise between the last quarter of 1982 and the first quarter of 1983. That wage freeze looked impressive, but it raised two questions. First, would it suffice to achieve the projected reduction in real incomes if, after the first quarter, nominal wages were to rise in line with the rate of inflation? Second, what legal powers would be at the disposal of the federal authorities when the agreed initial wage freeze was not observed and nominal incomes again began to overshoot the limits set by the requirement to cut personal consumption effectively?

The wages policy, with all its uncertainties, was buttressed by a priority scale for the payments obligations of enterprises, Mr. Laske added. The scale accorded a very low priority to wage payments and it could, if an enterprise failed to generate sufficient revenue, lead to additional wage cuts down to the guaranteed minimum wage. In its

appraisal, the staff concluded that the safeguard mechanism for the achievement of reasonable wage developments was an important improvement, but that it did not necessarily eliminate the central weakness of the wage determination process. That weakness had been the enterprises' practice of basing wage awards on prospective earnings, and therefore on anticipated price increases, rather than on realized earnings. It appeared likely that such habitual behavior would continue, although circumscribed by the priority scale for payments obligations and by incentives to redress financial disintermediation, that is, by increased interest rates. The situation involved an intricate net of regulation and potential pecuniary gain. He shared the staff's lack of conviction that the new tightened system would achieve the desired results. The disadvantage of maintaining enterprise liquidity outside the banking system had not yet been made sufficiently painful. Collusion among enterprises to choose the easy way to meet their high priority obligations might continue to be attractive.

In the area of monetary policy, the most important subjects were interest rates and unsecured inter-enterprise credits, Mr. Laske continued. In both areas the authorities had taken some measures, but they might turn out to be insufficient. He was confident that such a conclusion would be reached with regard to interest rates when the mid-term review was conducted. Table 9 of EBS/83/46 indicated the rather substantial increases in interest rates that had taken place between the end of 1981 and the end of February 1983. In evaluating those increases, however, Directors should bear in mind that interest rates had been little more than notional two years previously, and that little incentive had been provided to hold dinar balances with the banking system. At present, the cost of money to the banking community continued to be well below the expected rate of inflation, about 30 per cent, even at the longer end of the maturity range. Although the cost of credit for nonpriority borrowers might rise significantly above the likely rate of inflation, the extensive use of priority credit at artificially nominal and negative real rates of interest did not appear to make the extension of inter-enterprise credit much less attractive than it had been hitherto. What kind of penalty might be applied if the existing volume of unsecured credit was not reduced significantly within the forseeable future? In that context, it was somewhat surprising that a judgment regarding whether those accounts had been reduced satisfactorily might be postponed to as late as September 1983.

The performance criterion relating to monetary developments was formulated in terms of the net domestic assets of the banking system, Mr. Laske noted, instead of domestic credit expansion, as had been the case previously. Furthermore, the authorities were formulating their credit ceilings on the basis of three-month averages instead of end-of-quarter amounts. Both changes had been mentioned in the Executive Board's discussion in November as worthy of consideration; they represented a distinct improvement in the monitoring mechanism.

An interesting feature of the fiscal system in Yugoslavia was the practice of returning surplus revenues to the taxpayer in the form of tax rebates or through another mechanism, Mr. Laske continued. It appeared to be a sensible arrangement for normal circumstances when the economy was broadly in equilibrium. Such was obviously not the case at present; revenue targets were likely to be surpassed because of the expected high rate of inflation. Under such circumstances, the customary practice of rechanneling surplus revenues into the economy should be suspended temporarily, and all such excess revenues should be transferred to a blocked account in the National Bank until better times had returned. A freezing of surplus revenues in that way was, indeed, envisaged by the authorities, but only after revenues exceeded those of the previous year's corresponding period for three months. It was doubtful whether such an arrangement could effectively stop excess expenditure. Skilled accountants might be imaginative enough to arrange that, every two months, the flow of excess revenues was disrupted for one month, so that the legislation needed to effect the blockage was never triggered.

The foreign exchange allocation system had been amended by replacing the retention scheme with a sectoral distribution system, Mr. Laske remarked. Both the old and the new systems appeared rather complex; it was questionable whether the new mechanism could be administered relatively more efficiently than the old. He remained unconvinced that more foreign exchange was likely to be available than hitherto, after credit obligations and essential import needs of the enterprises had been met. At present, only the quota for the federal level of the public sector had been set, while quotas for the regional and community levels remained undecided.

A more serious question was how to prevent all available foreign exchange being consumed by the high-priority sectors, Mr. Laske suggested, since no administrative procedure had ever succeeded in closing all loopholes and making the regulations absolutely watertight. In the end, it could well turn out that little foreign exchange would be channeled into the official market for acquisition by those enterprises that, for one reason or another, were not priority users. For the sake of a more rational and efficient resource allocation, the Yugoslav authorities would be well advised to move progressively away from allocating foreign exchange by administrative regulation and to allow the price mechanism to determine for which purposes foreign exchange should be used. Such a move would necessarily require a complementary exchange rate policy.

The authorities had commendably followed suggestions made by Executive Directors, Mr. Laske remarked. They had corrected the overvaluation of the dinar that had resulted from Yugoslavia's rate of inflation departing sharply from that of its major trading partners. International competitiveness appeared to have been restored to an earlier level. However, it was not clear whether that particular level was appropriate to the objectives of the program: to gain market shares in the convertible currency area, to redirect exports from the nonconvertible currency markets to convertible currency markets, and to make Yugoslavia more attractive to tourists and as a recipient of workers' remittances.

At the time of the initial discussion of the stand-by arrangement, Mr. Laske went on, the staff had pointed out that an increasing share of Yugoslavia's exports were being sold to the countries with nonconvertible currencies, presumably because they were easier to market in that area. The situation continued to prevail, since the staff mentioned that Yugoslavia had problems in Western markets as a result of quality and design inadequacies. He had doubts whether such marketing problems could be overcome by exchange rate adjustments alone, whatever their size might be. In the present highly competitive trade climate, deficiencies of that kind could not be eliminated by underpricing. The enterprises concerned, and the authorities, had to seek to improve quality and design. He fully agreed with the proposition that exchange rate policy had to be conducted in a manner that safeguarded the international competitiveness of the Yugoslav economy. However, priority should be given to appropriate demand management, supply, and structural policies. Continually correcting the shortcomings in those policies through subsequent exchange rate adjustment would not solve the economy's problems.

The program presented for the third year of the stand-by arrangement prompted a rhetorical question, Mr. Laske stated. Although the performance criteria had been met, except for one minor overshooting, the basic objectives of the adjustment effort had been missed by a substantial margin. The program for the third year was a valiant effort to catch up, and the Yugoslav authorities intended to request a follow-up arrangement when the present one expired. In such circumstances, he wondered whether it would not have been more advantageous to have canceled the present arrangement and to have concluded a new multiyear arrangement. The program under consideration would have been appropriate to the first year of a new two- or three-year stand-by arrangement that would have given the Yugoslav authorities, as well as their foreign creditors, both official and private, assurance of a continuous adjustment effort under Fund supervision.

He had not mentioned many aspects of the Yugoslav situation and of the program, Mr. Laske noted. He emphasized that in all those aspects he fully endorsed the staff's appraisal. He welcomed the progress that had been made in securing the financing of Yugoslavia's external deficit for 1983, and he thanked the staff and management for their energetic efforts in achieving that progress. He supported the draft decision as amended. Particular importance should be attached to the provision that the Fund staff would visit Yugoslavia at quarterly intervals to monitor developments, and to the mid-term review during which it would have to be determined whether additional measures or corrections to measures already taken would be necessary to keep developments in Yugoslavia on track.

Mr. Taylor noted that the process of negotiations that had led to agreement on the third year of Yugoslavia's stand-by arrangement had been highly complex; his authorities welcomed the key role that the Fund staff had played. Since the beginning of Yugoslavia's arrangement, a number of Directors had feared that there would be potential problems in securing adequate adjustment of the external position within the planned period.

As it had turned out, some progress in reducing the current account deficit had been achieved. However, progress had been concentrated in the first year of the arrangement. It had become clear from about the middle of 1982 that progress was insufficient, and that the capital outflows that had emerged in the second half of 1982 had added to the seriousness of the problem. To some extent those ouflows had reflected well-known exogenous developments, but it could also be said that the problem in the capital account might not have been so serious if more decisive progress had been made under the arrangement at an earlier stage.

The current task was to reinforce the adjustment effort in the period of respite offered by the cooperative financial package being put together with the help of friendly governments and with the cooperation of the commercial banks, Mr. Taylor continued. He welcomed the more realistic appraisal of Yugoslavia's economic situation in the staff report, and the commitment by the authorities to a series of measures that, if adopted, would go a long way toward rectifying the position.

The basic objective had to be to secure a large and sustainable improvement in the external current account, Mr. Taylor considered, in order to enable the economy to meet the heavy burden of debt service obligations that it would face for many years. Given the sluggish prospects for the world economy, it would be a far from easy task. A related objective had to be to reduce the considerable inflationary pressures and tendencies in the economy that, inter alia, greatly inhibited the effective working of the price mechanism upon which adjustment, even in a socially planned economy, had to depend heavily.

The thrust of the new program in terms of the objectives for real incomes, credit, domestic demand, and relative prices was probably adequate, perhaps even in some respects severe, Mr. Taylor added. However, he stressed that he had reservations regarding interest rates and monetary policy. The main question was whether the measures could be implemented to the extent necessary to secure those objectives. It would be vital that the authorities took all the necessary steps to fulfill their commitments under the program. At present, they appeared to be rather optimistic, trusting to the cooperation of the various economic sectors and regions, so that many of the tighter measures proposed were being introduced only provisionally and the supporting legislation in some important areas either had not been finalized or remained only in reserve.

The key elements of the program, Mr. Taylor observed, were the measures relating to personal income, the control of the growth of inter-enterprise credit, the control of public expenditure, the exchange rate, the question of export incentives within the complicated exchange allocation system, and, importantly, the use and the role of interest rates in the economy. The steps that had been taken to restrain personal incomes were welcome as far as they went, but their impact on the enterprise sector was questionable, given the apparent lack of an effective means of exerting financial pressure on enterprises. It remained to be seen whether the wage freeze in the first quarter could be achieved. Progress in that area would have to be monitored carefully.

The steps that had been taken to control inter-enterprise credit were also welcome, Mr. Taylor remarked. If successful, they would bear heavily on enterprises' ability to pay high wages. Their effectiveness remained to be seen. He would have preferred an approach that sought to raise the price of inter-enterprise credit to more realistic levels; it might be necessary to move in that direction if the present approach failed to yield the desired results. In the absence of up-to-date information on public sector expenditure, the proposed approach of monitoring and controlling expenditure through the revenue side appeared sensible, if it could be made to work, a possibility that had to be taken on faith, given the limits that had been agreed on government borrowing. The authorities intended to recycle excess revenues into the economy as they arose; presumably the excess revenues would not be left to accumulate in the National Bank. The process was intriguing; he associated himself with Mr. Laske's question on whether it might not have been better to freeze at least some of the revenues. The process by which the excess revenue would be distributed was also interesting. Was there an element of redistribution or were taxes simply returned to those who paid them?

The commitment to manage the exchange rate so as to assure continuing gradual improvement in export incentives was also welcome, Mr. Taylor went on. He noted the recent adjustment of about 6 per cent, an indication of the authorities' serious intentions to carry out their commitment. Perhaps the staff could specify the nature of the commitment in more detail. It was unfortunate that the assessment of the impact of the exchange rate policy was complicated by the recent change in the exchange rate law governing priorities in the system of allocating foreign exchange. The staff believed that some loss of export incentives appeared certain to result from the latter change, although it could not be quantified at present. The change removed some allocative distortions but it introduced others. Insofar as it would expand the role of the banks in unifying the foreign exchange market, it was an important step in the right direction. He joined Mr. Laske in urging the authorities to manage the system so that it allowed market-based signals to operate to the maximum extent possible.

Interest rate policy was the most worrisome area of the program, Mr. Taylor considered. The authorities had agreed that substantial moves toward a more rational interest rate structure were due, and bank deposit rates had been raised. However, even on the basis of, perhaps conservative, official forecasts, real rates on short-term deposits remained appreciably negative; in any case, priority lending would remain heavily subsidized. He urged the authorities to reconsider their policy in that area with a view to raising nominal rates further if inflation failed to improve to the extent hoped for and with a view to reducing the scale of subsidized credits in the economy. Adoption of more attractive interest rates on dinar deposits might help to bring about an orderly shift in the composition of household savings away from foreign currency holdings. At present, the domestic banking system was vulnerable to the overhang of liquid foreign currency liabilities; the existence of such holdings had to represent a potential source of instability in the stock of domestic liquidity.

In view of the various uncertainties attached to the implementation of policies, Mr. Taylor stated, it would be vital that the authorities and the staff cooperated fully to monitor progress in the coming months and that corrective actions should be taken speedily if the main objectives did not look like they would be achieved. The mid-term review would provide a vital opportunity to assess progress; at present, it seemed appropriate that credit ceilings should be set only for the first half of the year. Full implementation of the program would be essential to restore external confidence, without which the provision of financial assistance by the Fund and by Yugoslavia's creditors would be merely a temporary palliative. The momentum toward an improved current account with the convertible currency area would have to be sustained for a number of years. In that context, it would be helpful to have an indication, even if only approximate, of the profile of Yugoslavia's debt service in the period beyond 1985. Although it was perhaps early to assess the longer-term picture precisely, the staff would need to consider the question when the outcome of the arrangement involving the commercial banks was clear; in addition, it would be crucially relevant to the Board's consideration of any possible follow-on arrangement with Yugoslavia.

His authorities believed that confidence would be greatly helped by the provision of better publicly available information on the Yugoslav economy, Mr. Taylor remarked. The staff had indicated that it also strongly held the view that the analysis and management of the economy would be greatly enhanced by better and more current economic statistics. One important weakness appeared to be the use of statistical exchange rates in calculating the trade accounts and there also appeared to be weaknesses in the provision of adequately detailed, timely data on external debt, interest rates, the amount of foreign currency in circulation, and the amount and kind of inter-enterprise credit. He encouraged the staff to make every effort to ensure that the authorities had all the information and instruments available to avoid the re-emergence of arrears and the emergence of discriminatory payments arrangements. The authorities should be encouraged to devise proper arrangements for the monitoring and management of Yugoslavia's indebtedness and to maximize their efforts to reassure creditors that those Yugoslav banks that had borrowed internationally would honor their commitments under whatever arrangements needed to be devised.

He supported the proposed decision, including the waivers, Mr. Taylor said, and he accepted the modification to make the second drawing under the 1983 program conditional on satisfactory progress toward agreement with the commercial banks. He noted that the proposals concerning arrears permitted until August 1983 were practical in the circumstances; they would help to reassure creditors that the Fund program would not be prematurely terminated on technical grounds.

Mr. de Maulde commented that, since the Executive Board's previous discussion of the stand-by arrangement with Yugoslavia, a major comprehensive effort had been made by the international community in support of the adjustment effort undertaken by the authorities. He fully associated

himself with Mr. de Vries in commending the Fund management and staff for their active role in the negotiation process. The program for 1983 seemed well designed; he could support the proposed decision, as amended. However, the structure of external debt continued to make the situation precarious. The authorities had commited themselves to an ambitious strategy in order to avoid resort to rescheduling, and, as pointed out in EBS/83/46, Supplement 1, they had very little margin for error.

He fully shared the view that incomes policy remained vital, Mr. de Maulde went on, and he welcomed the intention of the Federal Government to enforce it if necessary through an adequate intervention mechanism. The targets set for the growth of nominal incomes were stringent. However, the size of the the so-called unallocated consumption aggregate, about 4.25 per cent of gross social product (GSP) in 1982, made it questionable whether incomes policy fully encompassed all household earnings. The choice of the last quarter of 1982 as a reference base for monitoring the change in incomes in 1983 was also questionable. In many countries, the last quarter of the year tended to be a seasonal peak in wage developments; he invited the staff or Mr. de Vries to provide additional information on the outcome in the last quarter of 1982. He agreed that the goal of minimizing unemployment, as well as the obvious need to curb inflation, called for the successful implementation not only of incomes policy, but also of supportive and consistent monetary and prices policies, so as to avoid the repetition of an upsurge in domestic demand similar to that experienced in 1981/82.

The Social Accounting Service would have a critical role in attempting effectively to disallow unreasonable payments to loss-making enterprises, Mr. de Maulde considered, and in enforcing the order in which enterprises would have to settle their various payments obligations so as to control the growth of inter-enterprise credit and of employee income. He hoped that the needed legislation would be adopted well before the end of May 1983. A significant effort had been made to bring a number of prices closer to international levels. However, centralized price control would remain in effect for a number of products until the end of June. That control had been used in October 1982 to limit the impact of the devaluation on the prices of industrial producer goods; he invited the staff to comment on the effect of that decision on the structure of relative prices and on whether it would be appropriate to renew the control during the course of 1983.

Commenting on fiscal policy, Mr. de Maulde welcomed the improvement represented by the monthly redistribution of excess revenues, as well as the freezing of the unredistributed surpluses. However, the system appeared to be a complex way of lowering the rate of taxation; perhaps, in the course of 1983, it would be worth considering an ex ante rather than an ex post reduction in the rate of taxation so as to eliminate the risk of an accumulation of excessive liquidity in the public sector.

The efficiency of monetary policy had been weakened by two factors: the growth in inter-enterprise credits and the large share of foreign currency deposits in M-2, Mr. de Maulde remarked. The latter characteristic of the Yugoslav monetary system could not be expected to disappear in 12 months. However, the authorities should consider the influence that positive real interest rates on local currency instruments might have in reducing the relative share of foreign currency deposits in monetary assets. Reduction in the subsidies to priority credits would also have to be pursued, although such a policy might be dependent upon the success achieved in controlling the growth of inter-enterprise credit. The future effects of the recent law on foreign exchange and credit transactions were not easy to assess; much would depend on how it was implemented. He welcomed the greater responsibility given to the banking system; a comprehensive discussion of the system should be included in the next staff report, since the system was not a perfect substitute for an exchange market.

He generally agreed with the staff's appraisal of the policies to be pursued, Mr. de Maulde continued, and he welcomed the pragmatic and flexible approach that it had taken. He had no difficulty with the two waivers proposed; however, he noted that the staff recommended approval of the existing arrears, which might increase after the Board's decision had been taken, and he wondered whether a similar decision had been taken in previous cases. The provision for quarterly staff visits was appropriate, given the uncertainties surrounding the pace of disbursement under the financial resource package and the difficulties in assessing the performance of the Yugoslav economy. He joined Mr. Taylor in urging the authorities to improve the timeliness and quality of their economic statistics. To some extent, there might be a trade-off between the rigidity of performance criteria and the frequency of staff visits. For example, the projected variation in the velocity of money, less than 14 per cent, had to have a significant bearing on the estimation of the ceilings on net domestic assets. The reviews would permit the Executive Board to correct those ceilings if the velocity of money turned out to be different from the current forecast. He could accept the amendment to the effect that the second purchase from the Fund was conditional upon sufficient progress in the provision of external bank financing.

The realism of the Fund's expectations when it was asking three neighboring countries--Yugoslavia, Hungary, and Romania--to expand their exports, to curtail their imports, and to redirect their trade from the Eastern bloc toward other markets was open to question, Mr. de Maulde commented. The staff itself expressed certain doubts when it stated on page 33 of EBS/83/46 that exports previously directed to CMEA countries might not be easily redirected to the convertible area because of quality and design difficulties. Directors could not overlook the fact that the Fund had expected Yugoslavia to increase the volume of its exports in 1982 and that the actual outturn had been a decline of 2.5 per cent. The shortfall could be attributed to a variety of factors, but he agreed with Mr. Polak that it could not be attributed to excessive domestic absorption.

The staff tended to consider that the lack of competitiveness was a major factor, appearing to justify an exchange rate depreciation supported by domestic adjustment measures, Mr. de Maulde said. To the extent that there was a need for a better balance between the incentives for export production and those for domestic production, exchange rate adjustment was appropriate. However, while he accepted the need for exchange rate adjustment in Yugoslavia's case, he wondered whether it would not be better to quantify the size of the adjustment in relation to the program target for exports rather than in relation to the various indicators of competitiveness. The latter were always difficult to calculate, but particularly so in the case of a socialist economy. In other words, was there not a risk that the Fund would be advocating a series of exchange rate adjustments in member countries that would be competing with each other? It might be worth reviewing, in the near future, the relationship between the design and the results of arrangements concluded with countries located in the same region.

Mr. Casey recalled that, at the previous Board discussion of Yugoslavia, his chair had suggested that the performance criteria had been too lax, particularly in relation to liquidity creation, and that the architecture of the program ought to be overhauled in the third year. Those suggestions had been followed in part, and the authorities were beginning to tackle the major structural problems in a more decisive way. The adjustments would need to be more painful than they would have been if the authorities had adequately addressed the issues at the start of the program two years earlier. A number of areas remained worrisome, however; he agreed with the proposed regular quarterly contacts and with the proposal to make the drawing in May 1983 contingent upon adequate external financing. He joined Mr. Taylor in seeking improved data on external debt, and he welcomed the provision of technical assistance by the Fund in that area.

There were wide differences of view between the staff and the authorities, Mr. Casey went on, not only with regard to the data but with regard to the effects of policy. It was clear from Table 1 in Appendix II of EBS/83/46 that the authorities expected a much greater shift of resources to the tradable sector in 1983, and that they were very optimistic with respect to export growth to the convertible currency area and also with respect to inflation. Referring to the overall thrust of the program, the staff stated that "the balance of risk is positive." It appeared that the staff was not entirely convinced that the program was sufficiently strong even in the third year, and that there might be doubts about the finely poised external financing package being negotiated. He invited the staff to clarify its overall judgment of the program and to address the question whether a full scale rescheduling exercise could be avoided at the present stage. The request by the authorities to commercial and official creditors for a 90-day moratorium on payments could be seen as a de facto rescheduling.

The Executive Board was being asked to approve two waivers ex post, Mr. Casey noted. He could accept the waiver on the monetary side, but the waiver for external arrears appeared to have been treated rather lightly

in the staff papers. If Yugoslavia's drawings from the Fund were suspended because of the build-up of arrears, the whole external financing package could be in jeopardy; therefore, the Board had little choice but to approve the waiver on arrears. However, a country in his constituency, Dominica, had breached a performance criterion largely as the result of a national disaster; in its case there had been no question of an ex post waiver--Dominica's subsequent drawing had been automatically suspended.

Policy improvements were under way in Yugoslavia in the areas of personal incomes, public finances, domestic liquidity, and the exchange rate, Mr. Casey considered. In some areas, the Government stood ready to use legal powers if necessary; nevertheless, slippages could continue to occur. Progress in adjusting relative prices appeared slow; the authorities planned to move toward international prices or market-clearing prices over a two-year period, an aspect of the program that needed to be accelerated. Prices had to be freed as soon as possible, first, to earn urgently needed hard currency, and second, to avoid domestic misallocation of resources, a situation that had resulted in a heavy burden of debt. If prices were not freed, the balance of payments would have to be protected by a severe compression of domestic demand and a reduction in needed imports, a development with adverse implications for future growth prospects.

Progress on interest rates also needed to be accelerated, Mr. Casey went on. Although legislation was being framed to control inter-enterprise credit, the best policy would be to allow interest rates to rise. Even if that policy put a strain on the liquidity position of enterprises, it might also have a beneficial effect on the quality of the investment by those enterprises. Higher domestic interest rates would also encourage workers' remittances and they would discourage domestic holding of foreign exchange. Priority lending would remain substantially subsidized, a situation that did not augur well for the conduct of monetary policies. Setting priorities outside the market mechanism indicated a certain ambivalence on the part of the authorities with respect to the type of economic system that they wished to have. While such an attitude was understandable, and while the difficulties were compounded by Yugoslavia's federal system, it was difficult to ascertain whether all policies were internally consistent and what the final outcomes were likely to be. Perhaps that situation explained why there was a difference of view between the staff and the authorities.

The final year of the program was fairly well designed, Mr. Casey stated, although faster progress could have been expected in relation to the freeing of prices, interest rates, and the trade and payments system. He hoped that the external financing package would remain firm, not least because so many people had put so much effort into framing it. His chair had provided comments on the package direct to the staff. It appeared that Fund resources could fill the current financing gap but there might be little margin left for the rebuilding of severely depleted foreign exchange reserves with which to repay the loan from the Bank for International Settlements (BIS) later in 1983. If there was to be a new program, prior conditions should be considered. He invited the staff to comment on the reason for shortening the final year of the program to nine months.

Mr. Hirao commented that the staff presented a clear analysis of the current liquidity difficulties facing Yugoslavia. High growth policies in the second half of the 1970s, along with heavy reliance on foreign capital, had resulted in a large accumulation of foreign debts, while investment projects had not yet yielded sufficient foreign exchange earnings. At the same time, the growth of aggregate demand associated with the expansion in investments had triggered a wage-price spiral in the economy. He supported the strategy adopted by the authorities and endorsed by the staff to overcome the liquidity difficulties. It called for, first, strengthening the tradable goods sector, and second, restraining aggregate demand, particularly through wage moderation.

With regard to the strengthening of the tradable goods sector, Mr. Hirao continued, it was appropriate that the authorities had recently adopted a flexible exchange rate policy. He noted that monthly depreciation of the real effective rate was included in the performance criteria for the 1983 program. A similar criterion had been adopted in the 1983 program for the extended arrangement with Brazil. In Brazil's case, the letter of intent and the authorities' subsequent communication had specified the speed of depreciation, but the letter of intent from the Yugoslav authorities was rather more vague. In that regard, he noted the interesting observations made by Mr. de Maulde on the exchange rate, and he invited the staff to comment on the background to the different approaches used with regard to Brazil and Yugoslavia.

The depreciation of the effective exchange rate would bolster profit margins in the external sector, Mr. Hirao observed. However, improvement in the profit position would not necessarily result in an increase in the production of tradable goods, unless the necessary inputs were provided smoothly to the external sector. Concerning exporters' access to foreign exchange with which to buy imported inputs, he noted the staff's observation that the new mandatory foreign exchange allocation system implied some reduction in incentives to exporters who lost the use of the retention quota. He urged the authorities to ensure that the loss of export incentives would be more than compensated by other means of foreign exchange financing. It would also be desirable for the authorities to give similar consideration to a means of ensuring an adequate supply of domestic inputs to exporters.

Commenting on the other major aim of the adjustment strategy, namely, strict control of aggregate demand, Mr. Hirao remarked that wage restraint would play a crucial role. He noted that the mechanism for the implementation of wage restraint had been weak. He was encouraged by the authorities' determination to activate its legal powers, if necessary, to achieve the targeted reduction in real personal income per worker in 1983. He invited the staff to comment further on whether the Federal Government's legal power would be applied to both the enterprise sector and to the social sector in all the republics.

The Government had adopted tight expenditure ceilings, Mr. Hirao noted, and he supported the authorities' efforts to freeze excess revenues arising from inflation. Those responsible for credit policy in 1983 could

learn from the experience in 1982. Although the expansion of domestic banking credit had been held below the program ceiling in 1982 for the most part, the money supply had exceeded the level consistent with the stabilization program and the inflation rate had turned out to be more than double the target rate. That experience suggested that, in addition to control on domestic banking credit expansion, other measures were necessary to slow down liquidity growth in the economy. He attached great importance to the implementation of tight controls on credits extended outside the banking system, especially inter-enterprise credits. The midyear review would be a useful occasion to monitor improvements in the monetary aggregates and the effectiveness of the new legislation in bringing inter-enterprise credit under control.

The severe external liquidity crisis was partly due to the strong seasonality of Yugoslavia's external payments flows, Mr. Hirao observed. He strongly hoped that the special financing package would ease the current crisis, and that the same seasonal needs in the first halves of 1984 and 1985 would be adequately met without special arrangements.

Mr. Péterfalvy stated that he supported the proposed decision on Yugoslavia and that he welcomed the resolve of the international financial community to take another decisive step in dealing with the present crisis. The problems of Yugoslavia were no longer simply a consequence of adverse developments in the world economy; they had become one of the factors aggravating the crisis. Yugoslavia's liquidity situation and the relative tardiness of efforts to resolve it had already hurt those directly involved, as well as all countries affected by the world economic situation, particularly those that had been working hard to find a way out of the present difficulties. If problems such as Yugoslavia's remained unresolved, the potentially successful efforts and sacrifices of other countries could be rewarded with frustration and failure. In view of such considerations, the obligations that the Yugoslav authorities were about to take were timely; they required immediate implementation if they were to be successful. Yugoslavia had always played an important role in the development of its region, and its innovative spirit had long made itself felt beyond its political frontiers. He was convinced that the Yugoslav Government would again demonstrate the vitality of that traditional spirit.

In order to do so, Mr. Péterfalvy continued, the authorities would have to address decisively the centrifugal forces at work in their country. The Yugoslav authorities should dispense with the hesitation and half measures of the past, since they were clearly aware of the seriousness of their situation, of the disruptive effect it could have on other nations, and of the goodwill and willingness of the international community to come to their aid. He was pleased to note that they had begun taking steps in that direction. The tightness of the financial package required that the Yugoslav authorities should keep their promise and that they should immediately seek the legislative approval necessary to implement their program and to ensure that the necessary prerequisites to make the program work were in place at both the federal and regional levels. Nothing would be more dangerous at present than a collapse of the rapid implementation of the program.

The effects of the proposed measures should be rapid and adequate, Mr. Péterfalvy considered, while being consistent with the long-term trend in Yugoslav social and economic policy to rely on indirect and market-oriented instruments rather than on administrative measures. Unfortunately, many of the measures taken hitherto, and some of those proposed for the future, appeared to run counter to that well-established and well-managed policy tradition in Yugoslavia. While he understood that it might be necessary to introduce, temporarily, administrative restrictions that the Yugoslav authorities themselves would have considered "etatiste" a few years earlier, he emphasized that Yugoslavia's experience of the previous 30 years had convincingly demonstrated the viability of a market-oriented system of economic management in a socialist country. The failure of the program could put that very system into question.

An essential element, which had been missing so far, was a greater degree of integration at the federal level, Mr. Péterfalvy suggested. A firmer grip by the federal authorities on policy instruments, including, inter alia, greater centralization of credit and fiscal policies was also essential. He did not believe that a master plan at the federal level should make decisions for individual units, but the Federal Government had to take responsibility for decision making, for institutional arrangements in the administration of economic policy, for the handling of economic instruments, and the like.

He supported the program in the hope that the Yugoslav authorities would rapidly and firmly implement the various measures called for, Mr. Péterfalvy added. However, he was not entirely convinced that all those policy elements would achieve the desired results. His main concern was whether the measures would really succeed in imposing a greater degree of financial responsibility on enterprises, making them more responsive to policy initiatives undertaken at the federal level. While he welcomed the rise in interest rates, he was not sure how effective it would be, given that certain credits would remain heavily subsidized. Would those subsidies be correspondingly increased? He invited the staff to comment on what results might be expected from the authorities' interest rate policy.

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

6. AGENDA - RESCHEDULING

The Executive Directors considered proposed reschedulings of a number of agenda items.

Mr. de Vries suggested that the Board's discussion of Romania could be considered on March 30, 1983.

Mr. Malhotra asked that consideration of a request by Bangladesh for a stand-by arrangement be taken up on March 28, 1983.

Mr. de Maulde commented that he could accept the requests by Mr. de Vries and Mr. Malhotra. However, shortening the usual four-week period between the circulation of certain Board documents and their consideration by Executive Directors could create difficulties for their timely transmission to some authorities.

Mr. Shaw remarked that he also could accept the requests by Mr. de Vries and Mr. Malhotra, but it appeared that such requests were becoming increasingly frequent. Some of his authorities had become concerned about the timely reception of Board documents.

Mr. Tshishimbi stated that his Malagasy authorities would be grateful if the Executive Board's consideration of their request for the use of Fund resources could be brought forward to March 23 or March 28, 1983. Early consideration of their request would enable them to meet a performance criterion with regard to a reduction in arrears at the end of March.

The Chairman noted that consideration of the request on March 23 would result in a circulation period for the relevant documents of only two weeks.

Mr. de Maulde commented that, since shortening the period for the circulation of the documents might create difficulties, perhaps the Executive Board could decide to postpone the relevant performance criterion for a short period.

The Deputy Managing Director said that the Executive Board could decide to postpone the performance criterion relating to the reduction in external payments arrears other than dividends from the end of March to the end of April. In that way, consideration of Madagascar's request could be taken up by the Board in early April in accordance with the usual practice. The draft decision already circulated could be revised to that effect (EBS/83/55, 3/8/83).

The Executive Directors agreed to the proposed early scheduling of the agenda items on Romania and Bangladesh, and to follow the Deputy Managing Director's suggestion regarding changing the date of a performance criterion in order that the agenda item on Madagascar (EBS/83/55, Supplement 1, 3/25/83), could be discussed in accordance with the usual schedule.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/83/45 (3/8/83) and EBM/83/46 (3/11/83).

7. MADAGASCAR - TECHNICAL ASSISTANCE

In response to a request by the Central Bank of Madagascar for technical assistance, the Executive Board approves the proposal set forth in EBD/83/56 (3/4/83).

Adopted March 10, 1983

8. PUBLICATION OF "THE EUROPEAN MONETARY SYSTEM - THE EXPERIENCE, 1979-82"

The Executive Board approves the proposal set forth in EBD/83/57 (3/4/83).

Adopted March 10, 1983

9. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/83/76 (3/8/83) and EBAP/83/77 (3/9/83), by Advisors to Executive Directors as set forth in EBAP/83/46, Supplement 1 (3/7/83) and EBAP/83/76 (3/8/83), and by an Assistant to an Executive Director as set forth in EBAP/83/73 (3/4/83) is approved.

APPROVED: August 12, 1983

JOSEPH W. LANG, JR.
Acting Secretary