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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 83/74

3:00 p.m., May 20, 1983

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

Executive Directors	Alternate Executive Directors
	L. K. Doe, Temporary
	G. Ercel, Temporary
	P. D. Péroz, Temporary
A. Donoso	
R. D. Erb	
	S. R. Abiad, Temporary
	Jaafar A.
	T. Yamashita
	G. W. K. Pickering, Temporary
	C. Robalino
	G. Grosche
	C. P. Caranicas
R. N. Malhotra	
	J. E. Suraisry
J. J. Polak	
	K. G. Morrell
	O. Kabbaj
	J. M. Jones, Temporary
M. A. Senior	
J. Tvedt	
	C. Taylor
	Wang E.

L. Van Houtven, Secretary
R. S. Franklin, Assistant

Also Present

Asian Department: F. Le Gall, H. C. Kim. Central Banking Department: L. M. Koenig, Deputy Director. Exchange and Trade Relations Department: M. Guitian. Fiscal Affairs Department: M. I. Blejer. IMF Institute: E. Merino, Participant. Legal Department: H. Elizalde. Western Hemisphere Department: E. Wiesner, Director; H. Arbulu-Neira, J. O. Bonvicini, C. Cha, J. Jaramillo, G. Oliveros, F. Rubli-Kaiser, J. F. van Houten. Personal Assistant to the Managing Director: N. Carter. Advisors to Executive Directors: J. R. N. Almeida, S. E. Conrado, J. Delgadillo, S. M. Hassan, P. Kohnert, H.-S. Lee. Assistants to Executive Directors: H. Alaoui-Abdallaoui, H. Arias, J. Bulloch, T. A. Connors, G. Gomel, M. Hull, P. Leeahtam, V. K. S. Nair, J, G. Pedersen, J. Reddy, J. Schuijer, Shao Z., H. Suzuki, P. S. Tjokronegoro.

1. PERU - REVIEW OF EXTENDED ARRANGEMENT

The Executive Directors considered a staff paper on a review of the first year of the extended arrangement for Peru and the program for the second year (EBS/83/85, 4/27/83; Sup. 1, 5/18/83; and Cor. 1, 5/18/83).

The staff representative from the Western Hemisphere Department remarked that the Chairman of the Peru Advisory Committee on the renegotiation of Peru's foreign debt to banks had indicated by telex that commitments had been received from the banking community substantially covering the $770 million medium-term financing requested by the Peruvian authorities for the 12-month period ending March 1984 and providing for the maintenance of short-term exposure in Peru. The new money tranche of the medium-term loan had been oversubscribed by $38 million, while $28 million was still needed to reach the refinancing tranche of the loan. The commitments made by the foreign banking community were fully consistent with the capital flows from the foreign banks assumed in the balance of payments projection presented in Table 10 of EBS/83/85, Supplement 1.

Mr. Donoso made the following statement:

The Peruvian authorities are keenly aware of the need to obtain a fast reduction in the current account deficit to face the increased difficulties in world capital markets.

Their exchange rate policies have already brought about some restoration of the competitiveness of the Peruvian economy since the beginning of the program, so that most of the future efforts will have to come from reductions in expenditures.

The program for the second year of the arrangement as defined in February 1983 reflected the importance given by the authorities to improve the external balance of the economy. In short, the program contained a reduction in total consumption of about 3 percent in real terms so as to allow a rate of investment equivalent to 20 percent of GDP at the same time as a reduction in the current account deficit to 4.5 percent of GDP. To achieve this, a reduction of the overall deficit of the public sector to 3.8 percent of GDP was agreed in the context of continued flexibility in interest rate and exchange rate management. A reduction in the rate of inflation of 55 percent for the year 1983 was considered attainable and desirable, and credit policies were defined to make possible this lower rate of inflation together with losses of international reserves limited to $100 million.

The main problem in the implementation of the program during 1982 was excess expenditure by public enterprises and decentralized agencies of the public sector. To help control public spending in 1983, a coordinating group representing the Central Reserve

Bank, the Banco de la Nación, and the Ministry of Economy, Finance, and Commerce has been empowered this year to monitor the financial situation of the public sector and authorize the spending on a monthly basis.

Representatives of the Ministry of Economy, Finance, and Commerce have been designated in the principal public enterprises with authority to adopt measures regarding spending. The General Directorate of Public Credit was given the supervision of public external borrowing, aiming especially at increasing control over short-term borrowing.

Another important characteristic of the Peruvian economy which the authorities are determined to change relates to the high degree of dollarization. Being aware of the potential instability that dollarization entails, they raised the rates of interest on deposits denominated in soles by 22 percent and have stated their commitment to take additional measures if the behavior of dollar deposits makes it necessary.

Unfavorable external conditions indicated that the rate of growth could reasonably be expected to be 0.5 percent of GDP. The events that took place during the first quarter have drastically altered the performance of the Peruvian economy during this period and also the outlook for the year.

The damage from flooding and drought in the country has been enormously costly, as reported by the staff. Instead of a positive rate of growth of 0.5 percent of GDP for the year, a negative rate of 4 percent is envisaged; a rate of inflation above 70 percent is also expected. The need to cope with the effects of the disaster has determined changes in the program. Increased public expenditure for reconstruction programs and reduced revenue will increase the overall deficit of the Central Government by 0.5 percent of GDP. With a reduction equivalent to 1.2 percent of GDP in investment of the rest of the public sector, its overall deficit will be reduced to 1.5 percent of GDP to limit the increase in the overall deficit of the public sector.

The authorities are strongly committed to their program for the year 1983 in spite of the difficulties. To attain the reduction in the current account deficit in the new conditions, investment and consumption are expected to decrease.

The expected lower level of activity will in itself reduce imports but not enough to offset a projected reduction in exports of about $470 million compared with the level contemplated in the program set up in February. The rest of the reduction in imports will come from the additional tightening of monetary and fiscal policies.

> Actions have already been taken in line with the program during the first quarter of 1983. The rate of depreciation of the sol was accelerated to follow the increase in the rate of inflation. Recently the effective interest rate on deposits denominated in soles was set at 98 percent a year. Public spending has been cut. With net capital inflows lower than expected during the first quarter, monetary policy was tightened to limit losses of international reserves. As of March 31, all performance criteria of the extended arrangement were being met.
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> Nonetheless, Peru is facing a difficult financial situation. The fast reduction in short-term credit experienced in the first months of the year and larger than expected payments to foreign official entities have made it necessary to request the refinancing of debt owed to participants in the Paris Club and to some socialist countries, in addition to the ongoing renegotiation of debts with banks.
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> The authorities are deeply grateful to the Fund management and staff for their support to obtain the financing required as well as for the excellent job that they have done in connection with defining the program for the second year of the extended arrangement.
>
> It remains for me to recommend that Executive Directors approve the continuation of the extended arrangement for Peru on the basis of the understandings that have been reached.

Mr. Caranicas observed that the economic situation in Peru had deteriorated following the recent natural disasters, making it difficult for the authorities to pursue desired economic policies. Against that background, any discussion of economic outcomes and policy prospects in the country should address two fundamental issues, namely, the country's experience with inflation and its balance of payments and external debt situation.

Peru's performance on the inflation front had been disappointing, Mr. Caranicas continued; and combating the persistently high rate of inflation should therefore be the most important medium-term policy aim of the authorities under the extended arrangement. The staff had clearly described the obstacles to reducing the rate of inflation in the short term, but it had failed to probe in detail the peculiarities of a high-inflation economy and to suggest corrective actions of a more structural nature that could usefully reinforce conventional demand restraining measures for controlling inflation. Fiscal, monetary, and wage policies seemed to be moving in the right direction; indeed, fiscal targets in the program were impressive. However, progress under incomes policy was uncertain, given the reliance on voluntary price-wage guidelines and modified automatic escalator schemes. In that connection, some clarifying comments by the staff or Mr. Donoso would be welcome.

The staff was also well aware of the inflation-feeding impact of the continuing depreciation of the sol, Mr. Caranicas said. There was admittedly some trade-off between balance of payments adjustment and inflation control, and the exchange rate approach chosen by the country apparently gave greater weight to the former. Some estimates about the likely effects of a different ranking of weights--one, for example, that assigned a higher priority value to disinflation--might have helped Directors better to understand the policy options available to the Peruvian authorities.

On the external side, the substantial improvement projected for the current account, if realized, would unfortunately be due to a sharp drop in imports resulting from declining activity and could therefore be quickly reversed by a cyclical upturn, Mr. Caranicas noted. More disturbing, however, were the recent unexplained developments in the capital account; in that regard, he would have appreciated some clarification of the factors that had led to the sizable short-term capital outflow in the first months of 1983, which was to be financed by a rescheduling of debt owed to official creditors. The calculations of the impact of the refinancing agreement in terms of debt relief--from which Peru's balance of payments would benefit--provided some useful information; presumably, however, the debt service profile described in Table 9 of EBS/83/85, when revised accordingly, would show higher debt service ratios in later years. That worrisome prospect deserved further consideration by the staff. Finally, he believed that Peru deserved Fund support in pursuing its financial program under the extended arrangement, and he could therefore agree to the proposed decision.

Mr. Robalino stated that he too could support the proposed decision relating to the second year of the extended arrangement for Peru. The authorities should be commended for the efforts that they had made during the first year of the arrangement since, despite a deterioration in the current account of the balance of payments and nearly zero growth in GDP, public sector savings had increased, and all performance criteria had been met, including the one relating to net domestic indebtedness of the nonfinancial public sector. He had been particularly impressed that domestic adjustment efforts had compensated for the reduction in the contracting of foreign debt.

For 1983, the government deficit was programmed to increase by 0.5 percent as a consequence of the national disasters that had occurred during the first quarter of the year, Mr. Robalino observed. Floods, landslides, and droughts over extensive areas of the country had also played a major role in the 15 percent deterioration in Peru's terms of trade in 1982; the very minor increase in expenditure during the year could not be assigned nearly as much blame for the poor performance of the economy. In fact, the authorities had acted with great courage in the circumstances and had employed good financial sense, financing most of the needed expenditures by issuing bonds to the private sector.

On more technical matters, he noted that the projection of a reduction in the current account deficit--from 8.3 percent of GDP to 4.5 percent of GDP--had been revised to show an even greater reduction, while no changes had been made in the ceilings under the performance criteria, Mr. Robalino said. It therefore appeared that the required adjustment effort would be even more burdensome than before, and he hoped that the banks would take a longer-term perspective in discussions about rescheduling Peru's external debt. Finally, while it was clear that the authorities were fighting the "dollarization" of domestic financial assets, he wondered whether they were relying exclusively on an acceleration in the deregulation of interest rates to accomplish their goal. If any other measures had been taken or were contemplated to reduce the relative importance of foreign-denominated domestic financial assets, he would appreciate hearing about them.

Mr. Erb stated that he was in general agreement with the staff appraisal and could support the proposed decision. The fiscal and external objectives of the program had not been attained in 1982, partly because of exogenous events and partly because of policy shortcomings. It was to be hoped that, during the second year of the program, the authorities would work diligently to meet the objectives through full implementation of agreed policies. He found it troubling that much of the larger than targeted fiscal deficit had been financed through short-term foreign borrowing, which had not been covered by a performance criterion during 1982; more progress on the fiscal front could perhaps have been made through timely adjustment of certain controlled prices.

That needed adjustments had been ignored or postponed under the extended arrangement was disturbing, Mr. Erb continued. When a country undertook an extended arrangement, it was expected that the authorities would commit themselves fully to both stabilization and the pursuit of structural change. Given the limited action taken by the Peruvian authorities during the first year of the arrangement, he wondered whether a one-year stand-by arrangement might not have been more appropriate. Generally speaking, there appeared to be tendency for many governments engaged in multiyear arrangements to delay certain actions until later years, and the case of Peru--where minimal structural adjustment had taken place thus far--underscored his skepticism about the extent to which structural adjustment was pursued under such arrangements.

Regarding policies to be pursued in the second year of the arrangement, Mr. Erb noted that progress in resolving Peru's balance of payments problems would be closely tied to a containment of the fiscal deficit, and broad-based fiscal measures would be needed. No doubt, it would be difficult to hold down investment spending, given the recent flood damage. On public sector pricing, he urged the authorities to eliminate the remaining price controls on rice and to continue to implement flexible pricing policies on petroleum products. He also hoped that the free trading in wheat would proceed smoothly.

A major problem faced by the authorities was the dollarization of the economy, which underlined the importance of maintaining competitive rates on sol deposits so that drawdowns in dollar deposits were reflected in a buildup in sol deposits rather than in a decline in international reserves, Mr. Erb remarked. He was encouraged by indications in the supplement to EBS/83/85 that the rate on sol deposits had been increased in May and that the exchange rate had been managed flexibly in order to maintain competitiveness. He hoped that the authorities would continue to adjust the rate as needed, in a timely manner. It was obvious that Peru faced a difficult period ahead because of uncertainties about external financing and the problems related to the flood damage; in the circumstances, there was little room for policy slippage.

Finally, with respect to the staff references to official debt relief--pages 4 and 14 of EBS/83/85, Supplement 1--Mr. Erb considered that the Fund should make it clear in its documents that it was making assumptions about official debt relief rather than a judgment about the appropriate level of such relief; if the assumed level of debt relief was not forthcoming, it would be necessary to find other sources of financing or make changes in domestic economic policies. The same caveat should also apply to other important variables on which assumptions had been made in structuring Fund programs.

Mr. Taylor observed that adverse weather conditions earlier in the year had dealt a serious blow to the Peruvian economy, as evidenced by the large fall in output during the first quarter of 1983. The staff maintained that the problems could be overcome and that the original program targets could still be largely achieved, provided that public sector investment was cut back and that agreement could be reached with Paris Club creditors on a further debt relief exercise; however, no significant modification to the program was proposed.

He commended the authorities' resolve to stick to the adjustment program, despite the recent setback, but he wondered whether their goal was feasible in the drastically changed circumstances, Mr. Taylor continued. In the December 1 review of the extended arrangement, in conjunction with the Article IV consultation (EBM/82/155, 12/1/82), several Executive Directors had expressed doubt that Peru would be able to meet either the fiscal targets or the balance of payments targets for 1982, and they had noted that the program had appeared to be running out of steam even at that early stage. Those doubts had been borne out by the latest staff paper, which showed that the current account had in fact been slipping off track by some $300 million in 1982 and that the public sector deficit in 1982 had turned out to be more than double the originally programmed level. Given the natural disasters that had occurred since that time, it was only reasonable to ask whether the program had any chance of attaining its objectives; yet the staff was proposing relatively few readjustments of the sort that would represent a distinct sharpening of the adjustment path. He recognized, of course, that a number of cutbacks and other economies were implicit in the latest staff paper. Nonetheless, it was difficult to be confident that Peru was on the right track toward a reasonably sustained external position by the end of the program.

In 1982, the fiscal deficit had been targeted to fall from its 1981 level of 8.6 percent of GDP to 4.2 percent, Mr. Taylor remarked; in fact, the deficit had grown to 8.8 percent of GDP. For 1983, the staff was again proposing to cut the fiscal deficit in half, to about 4 percent of GDP, despite the assumption in April of a medium-term reconstruction plan for the northern region--which would add expenditure equivalent to approximately 0.7 percent of GDP in 1983--and a projected decline in central government revenues of another 0.8 percent of GDP. The target of a reduction in the deficit thus seemed overly ambitious, particularly as little or no allowance had been made for the likelihood that reduced industrial and agricultural production would affect tax receipts and that revenues from other domestic sources would also show some decline. He would appreciate hearing any assessment the staff might have made of the impact of a reduced level of economic activity on tax receipts, beyond the indication that tax revenue in the first quarter had fallen by one third in real terms by comparison with the previous year. In passing, he presumed there was little hope of recouping that loss later in 1983.

On the expenditure side, a number of slippages had occurred in 1982, in part because of the failure of public enterprises to implement many of the programmed price increases, Mr. Taylor commented. In December 1982, the authorities had assured the Executive Board that rice and wheat subsidies would be eliminated before the end of the year. The wheat subsidy had been eliminated during April, but the subsidy on rice remained; and, even with the programmed 7 percent increase in the price of rice, it would be some time before the rice subsidy was eliminated, particularly since inflation was likely to exceed 70 per cent throughout the year. Also difficult would be the commitment of the authorities to keep total investment spending by the nonfinancial public sector to a figure somewhat below 7 percent of GDP.

He shared Mr. Caranicas's views on the problem of inflation, which had not been addressed as firmly as it should have been, Mr. Taylor said. Despite the authorities' efforts in the policy during 1982, real wages throughout the economy had apparently continued to rise, and private consumption had declined hardly at all. The high rate of inflation was likely to require a faster depreciation of the sol; while there was some risk that such an approach, if taken too far, could create a vicious circle of depreciation, it was clear that a larger depreciation than targeted might be necessary. In any event, exchange rate policy would need to be pursued flexibly if Peru's competitive position was to be maintained.

He was troubled by some of the figures in the balance of payments projections, Mr. Taylor continued. For example, the staff had appropriately revised estimates in EBS/83/85, Supplement 1 to suggest that exports would fall in 1983. But the staff also suggested that imports in 1983 would fall by about 25 percent in nominal terms, which he presumed was equal to about 30 percent in real terms. The staff had indicated that the reduction in imports would come about through the authorities' decision to implement additional fiscal and monetary measures on the assumption that demand restraint would further limit imports. However, he wondered whether it was realistic to forecast a reduction of such a magnitude in imports when, at the same time, GDP was to be reduced by only 4 percent. He would be interested in hearing from the staff or Mr. Donoso about the sorts of measures the authorities were contemplating to achieve their import objectives. Further tariff increases would be regrettable under an extended arrangement and would moreover have to be extremely large to produce the programmed reductions in imports.

It was unusual to expect structural components in any extended Fund facility program, Mr. Taylor commented, and he was surprised to see so few signs in the staff papers that the much needed structural adjustment in the Peruvian economy was being effected. He accepted that the focus at the moment was on repairing the damage caused by the recent natural disasters; however, he hoped that the authorities would not lose sight of the structural aims of the three-year program, particularly in the area of revenue. He would also have welcomed a somewhat greater involvement by the World Bank in the development side of the program.

In sum, Mr. Taylor explained, it was only with considerable misgiving that he could support the proposed decision. The program for 1983 would, in his view, require much tighter demand management policies, wage restraint, and flexibility on interest rates and the exchange rate if the objectives of the program were to be achieved. The staff was apparently staking a great deal on administrative cuts in expenditure and imports, which, on the basis of evidence so far, would be difficult to achieve. Hence, it would be essential for the staff to monitor progress under the program carefully in the coming months and to design corrective measures if it became clear that the program was moving off track.

Mr. Jaafar said that, like others, he was disappointed in the performance of the Peruvian economy in 1982. The current account deficit had been 8.3 percent of GDP, against a program target of 6 percent; the overall fiscal deficit had been 8.8 percent of GDP, against the program target of 4.2 percent; domestic savings as a percentage of GDP had also been weaker than targeted. In the circumstances, the revised program targets for 1983 seemed overambitious, particularly in view of the recent adverse weather conditions and the weakness in prices for Peru's main export commodities.

He had noted from recent newspaper reports that the inflation rate in Peru was currently running at 75 percent and that some sources were expecting it to reach 100 percent for 1983, Mr. Jaafar continued. In light of those reports, he would appreciate staff elaboration on the prospects for achieving the program target of a 55 percent rate of inflation in 1983. He was also concerned about the low level of national savings, which must be increased if the development effort was to be sustained without excessive reliance on foreign capital. In that regard, he welcomed the authorities' intention to reduce foreign market borrowing and to increase reliance on resources from multilateral agencies and other official sources in order to improve the country's debt structure over the medium term.

Mr. Grosche said that he regretted that EBS/83/85, Supplement 1 had been circulated to Executive Directors only two days before the discussion. He would not have minded so much if the supplementary paper had indicated little change with respect to the outlook for the country's economy, but that was not in fact the case. Only because of Peru's difficult situation was he willing to discuss the second year of the extended arrangement and grant his support for the proposed decision.

Peru had, surprisingly, met all performance criteria for 1982, although, as had been mentioned on other occasions, the meeting of performance criteria was not necessarily an indication that the economy was doing well, Mr. Grosche continued. In the December 1982 discussion of the Peruvian economy, a number of Directors had remarked that the three-year program seemed to be running out of steam; the latest estimates for 1982 suggested that the "steam engine" had in fact come to a halt and that the situation was currently similar to the one that had existed in 1981 before the extended arrangement had been agreed. Peru's current account deficit had been as high as in 1981, relative to GDP; none of the subaccounts had improved. The overall public sector deficit had deteriorated, despite the assumption that it would be cut in half during the year, and only a marginal rate of growth of real GDP had been registered in 1982, despite a target rate of 4 percent. In addition, both inflation and external indebtedness had increased substantially beyond target.

It would be unfair if the somber prospects for 1983 led Directors to ignore the various policy measures implemented by the authorities in the course of 1982, Mr. Grosche considered. For example, water and electricity charges had been increased along with the price of gasoline, and the subsidy on wheat had been eliminated; at the same time, interest rates had been raised substantially, and exchange rate policy had been conducted with greater flexibility. Nonetheless, there had been little or no progress toward the objectives of the extended Fund facility program approved by the Executive Board in June 1982. In particular, there were no signs of improved resource allocation through a redressing of the public sector deficit. Moreover, on the external side, it could not be said that the objective of opening up the economy had been achieved; indeed, the Government's action in raising the level of protection by imposing a 10 percent across-the-board import tax had done more to close the economy than to open it. The authorities had cited budget reasons for the imposition of the import tax, noting the traditionally weak performance in the collection of domestic taxes. As he understood it, however, another reason had been the strong resistance of domestic industry to a further liberalization of the economy. In that connection, he wondered whether the 7 percent depreciation of the sol in real terms against the currencies of Peru's trading partners had established a realistic level for the exchange rate or whether the increase in protection was a substitute for a further depreciation.

While imports were expected to fall substantially in 1983, exports were projected to decline even more, although lower interest rates and debt service payments would lead to an improvement in the current account deficit, Mr. Grosche observed. The staff had attempted to attribute the stronger than expected decline in imports to a lower than expected level of economic activity and to "the authorities' determination to implement additional fiscal and monetary measures to maintain the program on track." He commended the authorities for their commitment but would appreciate hearing further comment from Mr. Donoso or the staff about the nature of the additional measures contemplated. For example, were the authorities considering even higher import taxes as a way of achieving the 1983 targets? It would also be helpful to know whether the 1983 projections made provision for emergency imports in the aftermath of the natural disasters.

Another area of concern in the program was the public budget, which was supposed to have been one of the keys to adjustment, Mr. Grosche commented. Tight fiscal policy supported by improved control of current expenditure, including military outlays, had been intended; however, current expenditure had overshot the program target by a large margin in 1982, and public sector savings had fallen short of expectations. That outcome appeared particularly striking when he compared the program targets for 1982 not only with the latest estimate in the supplementary paper but also with the previous estimate in the main paper issued only three weeks previously. In April, a lower level of government expenditure in terms of GDP had been expected, but the latest estimates suggested that performance with respect to expenditure would be even worse than the poor performance in 1981. Unfortunately, the supplementary paper did not provide any details about why such large corrections in the 1982 figures had been necessary. Apparently, there had been poor control over expenditure by a number of public entities; hence, he was pleased to note from page 17 of EBS/83/85 that monthly spending authorizations for each ministry and major public entity had been established and that the overdraft facility of the Central Bank had been curtailed. He hoped that the monitoring system for expenditures would be effective in 1983, particularly given the projected scaling down of current expenditure and investment. In addition, measures to strengthen the internal revenue service should be implemented in order to raise further revenues from domestic sources. With the projection for a public savings ratio of only 2.8 percent of GDP, the public sector would contribute only modestly to national savings.

In light of the adjustment necessary in Peru's economy, he found it unfortunate that wage developments were not reflecting the continued marked deterioration in the terms of trade, Mr. Grosche said. The Central Government had apparently tried its best to set an example through a 15 percent reduction in wages in real terms during 1982 for its own employees, but wage developments in the private sector and in public enterprises had reportedly outpaced inflation. He welcomed the intention of the authorities to modify the mechanism of wage determination in state enterprises, but it was not clear how they could legally put pressure on the unionized sector in order to eliminate the link between wage increases and inflation. With inflation rates likely to reach 100 percent, the efforts of the Government would be all the more difficult. If wage developments in public enterprises could not be brought under control, he wondered how the deficits of the public enterprises would be financed, particularly given the reduced overdraft facility with the Central Bank. He would appreciate staff comment on that matter.

In conclusion, Mr. Grosche remarked, it was clear that the Peruvian authorities faced a difficult road ahead. While he appreciated the reaffirmation by the authorities of their commitment to the program for 1983, he wondered, in light of the latest information about the 1982 results, whether that commitment was sufficient. The staff had taken some action by including short-term external borrowing by the public sector as a performance criterion for 1983 in order to close a loophole in public financing; however, additional measures would no doubt be necessary to deal with the current unfavorable situation and to move the Peruvian economy back onto a solid path.

Mr. Péroz considered that the staff papers and Mr. Donoso's statement provided a comprehensive account of the cost to both the Peruvian economy and the adjustment process of the natural disasters that had affected the country in recent months. Even assuming that part of the 10 percent fall in GDP registered in the previous quarter could be recouped during the remainder of the year, the overall decline in GDP could still be as great as 4 percent, implying a shortfall of almost 5 percent from previous estimates. In the circumstances, it was remarkable that all quantitative performance criteria had been observed, and the authorities should be commended for that achievement as well as for the speed with which they had taken corrective action in public finances and monetary and credit policy to meet the changed circumstances. Still, it was unclear to what extent the objectives of the program for 1983 could be considered within reach.

One major area of uncertainty on the domestic side concerned the link between wages and inflation, which had hampered the anti-inflationary drive of the authorities and put the overall objectives of the program at risk, Mr. Péroz continued. It was evident that "wage increases throughout the economy outpaced domestic inflation in 1982"; more worrying, however, was the contrast between wages paid by the Central Government and those paid in the unionized private sector. It was appropriate that government wages should be held in check as an example to others and as a benefit to the budget; however, if wages in other sectors of the economy failed to follow suit, the need for some catching up would be unavoidable over time, a development that might already have begun with the implementation of the policy of special wage increases designed to prevent the loss of particularly skilled civil servants to the better paying nongovernment sectors.

While the fiscal policy objectives seemed to be in line with the program, the experience with the fiscal deficit in 1982 suggested that the target for the overall deficit in 1983--about 4 percent of GDP--was certainly ambitious, Mr. Péroz said. Close monitoring would be essential, particularly since the balance between revenue and expenditure could easily be affected by the assumed weakening of the performance of the tax system and by the performance of current and capital expenditures, which had been severely squeezed. If the assumptions about either revenue or expenditures should prove inaccurate, speedy corrective action would be necessary.

The problem in monetary policy was to maintain consistency between the growth of credit and the growth of money and quasi-money in order to minimize the loss of international reserves, Mr. Péroz observed. At present, the situation was out of balance, with net credit expansion growing at a faster rate than earlier expected. Another concern was the extent to which the present share of dollar-denominated deposits in money and quasi-money could be held down or reduced. Interest rates should play an active role in that regard, and the recent decision to raise maximum levels of interest rates payable on local currency deposits seemed to be a step in the right direction.

On the external side, the case for a steady improvement in the current account could not be overemphasized in Peru, Mr. Péroz considered. In that respect, the projection for an improvement in the current account in 1983 was welcome, as was the contribution that any debt rescheduling by the Paris Club would make to the current and capital accounts. However, the extent of that contribution should be regarded as tentative at present, particularly in view of the assumption of a 100 percent refinancing of the payments due for the period under consideration. With regard to the trade balance, it was noteworthy that the surplus to be achieved in 1983 would come about through a more rapid decline in imports than in exports; such a combination of declines was hardly an optimal one and pointed to the need for maintaining adequate domestic management policies and an appropriate degree of external competitiveness.

Finally, he would be interested in hearing more about the contribution that the World Bank would be making to the implementation of supply-side policy, Mr. Péroz concluded, particularly in view of the physical disruptions that had arisen following recent natural disasters in Peru. The answer to the question whether the World Bank program would be implemented as originally conceived might have some bearing on the scope of the structural process that was associated with the Fund program.

Mr. Senior stated that, like others, he was in broad agreement with the staff appraisal and could support the proposed decision. The financial program for 1982 had been based on controlling domestic demand and achieving realistic levels for the exchange rate, interest rates, and other controlled prices in order gradually to improve economic efficiency and lay the foundation for growth and employment in the years to come. For the first year of the extended arrangement, Peru had been in compliance with all quantitative performance criteria of the program and with all understandings related to its exchange and trade system. However, exogenous factors together with some slippages in the implementation of certain policy measures had adversely affected progress in attaining the program's objectives.

As indicated by the staff, lower than expected international prices for Peru's main exports, weak world demand, and a tightening of the conditions in the world's capital markets had contributed to the low growth rate of GDP of only 1 percent in 1982, while inflation had continued at more than 70 percent, Mr. Senior noted. In the fiscal area, slippages in the control of spending by some public agencies and in the implementation of pricing policies had made it difficult for the authorities to meet the planned target for the overall deficit of the nonfinancial public sector. By contrast, in the external sector, the balance of payments had shifted from a deficit of $500 million in 1981 to a surplus of $100 million in 1982, while the current account deficit had been reduced from 8 percent to 7 percent of GDP over the same period.

The program for 1983 contemplated a continuation of the adjustment effort along the lines of the medium-term plan of the extended arrangement, Mr. Senior observed. Tightened demand policies, moderate wage policies, and continued flexibility of interest rates and external trade management were the main elements by which a further reduction in the current account deficit and the overall balance of payments deficit was expected to be achieved; several of the measures outlined in the program had already been implemented. The authorities should be commended for their commitment to pursuing a flexible exchange rate policy by continuing to depreciate the sol in line with domestic inflation. Moreover, in the external debt area, they had apparently established a new mechanism by which short-term foreign borrowing by the public sector could be effectively controlled and monitored.

As mentioned by others, Peru's adjustment efforts in 1983 would have to be carried out in an unfavorable environment, Mr. Senior remarked. The persistence of weak world demand for Peru's exports, protectionist tendencies elsewhere, and the reduced availability of foreign financing would surely limit the achievement of the program's objectives and result in a lower than expected GDP growth rate for the second consecutive year. In effect, the substantial damage caused by the heavy rainfall had already reduced GDP growth in the first quarter of 1983; the information provided in the supplement to EBS/83/85 indicated that GDP would decline by 4 percent throughout the year, in marked contrast to the originally projected decline of only 0.5 percent. The same unforeseen developments had also affected agricultural supplies and contributed to higher than expected inflation, currently estimated to remain at the same level--70 percent--as in 1982. In the circumstances, the Peruvian authorities should be commended for their firm determination to implement the policy measures contemplated in the program. During the first three months of the year, public spending had been cut, trade policy had been tightened, interest rates had been raised, the rate of depreciation of the sol had accelerated, and performance criteria for the first quarter of 1983 had all been met.

Unfortunately, Mr. Senor concluded, the demand restraining measures in the program might have an even more adverse effect on growth without bringing about a marked improvement on the inflation front, and he would appreciate staff comments on that point. As had been seen in other programs, the compatibility of performance criteria and the program's objectives was sometimes made impossible by unforeseen developments. Continuing with the policies originally set forth in the Peruvian program would seem to demand a more stringent adjustment effort and might cast doubt on the feasibility of the program itself. In that regard, the Executive Board should maintain a flexible attitude toward strict compliance with agreed criteria to achieve original objectives; perhaps the Peruvian case should be treated like that of Uruguay, for which some of the performance criteria had been flexibly set on the basis of the actual outcome of other important variables, particularly capital inflows.

Mr. Suraisry stated that he was in general agreement with the staff's analysis and conclusions and could support the proposed decision. Peru's performance in the first year of the extended arrangement had not been encouraging: real GDP had grown at a much lower rate than expected, inflation had increased, and the projected improvement in the current account of the balance of payments had not materialized, despite the fact that the overall balance of payments had registered a surplus rather than a deficit as a result of a sharp increase in capital inflows. The performance criteria specified in the program for 1983 had been met, although mainly because of a higher than expected availability of external financing; domestic savings had remained weak.

The program for 1983 aimed at a substantial strengthening of the financial position and was in line with the medium-term adjustment framework envisaged under the extended arrangement, Mr. Suraisry continued. In that regard, the ratio of the public sector deficit to GDP was projected to fall to about half its 1982 level. However, to achieve that target and others, the authorities would need to adhere strictly to all the provisions of the program. Finally, there some scope for improving the timeliness of balance of payments reporting in Peru. In the three-week period that separated the issuance of the main paper and its supplement, the balance of payments figures for 1982--and even those for 1981--had been revised significantly. Such uncertainty not only made the interpretation of the reasons for past balance of payments developments quite difficult; it also complicated the task of financial programming.

Mr. Polak, supporting the proposed decision, said that he shared many of the concerns expressed by his colleagues about the poor performance of the Peruvian economy in 1982 and the prospects for 1983. As noted in other cases, the meeting of performance criteria did not necessarily mean that the overall objectives of a program would be achieved; nor did it mean that the economy was performing well. It appeared that the slippages in 1982, particularly in the fiscal area, had been well within the authorities' control: public enterprises had improperly set prices, the authorities had failed to wind down the subsidization of wheat and rice, and there had been insufficient restraint in military spending. The authorities had since taken steps to control public spending, raise prices, and further reduce subsidies, but an even greater effort might be needed. The control of expenditures in particular would be crucial in 1983, especially since some additional spending would be necessary in response to the recent natural disasters. In that regard, he had read with interest that, despite the deteriorated economic outlook, the authorities intended to stick to their original targets for 1983, and he commended them for their determination. At the same time, however, he agreed with Mr. Taylor that determination alone might not be enough and that it could prove difficult if not impossible to meet the original program objectives. In the circumstances, the implementation of the program would need to be monitored closely and corrective action taken as warranted.

A number of areas in the program demanded particular attention, Mr. Polak considered. Except in the central government sector, wage increases in excess of inflation had been granted in 1982. The present system of wage determination in state enterprises allowed for adjustment based on past inflation and, until recently at least, had helped to sustain inflation and might have led to undue increases in private sector wages. Another matter that concerned him was the 10 percent duty imposed on all imports to raise revenue and help the balance of payments. It might have been better if more appropriate instruments of taxation had been implemented for fiscal purposes; and the balance of payments purposes could have been served better through the exchange rate mechanism. The import duty also made it difficult to judge the appropriate level of the exchange rate, which in real terms seemed to have been stabilized during the past year, but, with wage increases exceeding price increases, Peru's competitiveness in terms of unit labor costs might have been eroded. He wondered in the circumstances whether the correction of the exchange rate based purely on inflation differentials had been sufficient. Of course, the necessary depreciation of the sol had also encouraged the dollarization of the economy until that problem had been met by an adequate adjustment of the interest rate mechanism.

Pricing policies of the state enterprises--which had had an adverse impact through April--had only recently been corrected, Mr. Polak noted. He welcomed the fact that the heavy subsidization of wheat had been eliminated, but he remained concerned about the price of rice, which was being increased on a monthly basis but apparently by no more than the current rate of inflation. Even less adequate was the monthly rate of adjustment--5 percent--on electricity tariffs. Given the unfortunate rise in inflation, the question of pricing policies should be reconsidered with a view to rapidly eliminating the budgetary costs of subsidies and cutting down on the misallocation of resources resulting from them.

Mr. Pickering observed that the weak performance of the Peruvian economy under the current extended arrangement had resulted from a number of adverse external developments in the past year as well as a lack of sufficient perseverance by the authorities in undertaking necessary adjustments. He could join others in commending the authorities for the supportive measures introduced in 1982, including price adjustments, interest rate adjustments, and exchange rate flexibility; at the same time, he shared some of their concerns about prospects for 1983.

With regard to fiscal policy, Mr. Pickering agreed with the staff on the importance of reducing the public sector deficit to 4.1 percent of GDP from the 8.8 percent registered in 1982; careful monitoring of the deficit would be required, given the slippages that had occurred in 1982. The recent elimination of the wheat subsidy was a positive development, but the scheduled monthly price increases for other items subject to control might prove insufficient, given that the monthly inflation rate had averaged more than 8 percent since the beginning of 1983. In the previous year, the inability of many state enterprises to recover their costs through appropriate price increases had been a major factor in the overshooting of the programmed deficit of the nonfinancial public sector. In that regard, because the overshooting of the deficit had eventually led to a heavy reliance by the public sector on foreign financing, he was happy to note that short-term foreign borrowing was to be included in the limit on nonfinancial public sector borrowing, even though the ability of the public sector to borrow abroad was in any event quite limited at present.

It was important to encourage domestic savings in Peru, particularly sol-denominated savings, Mr. Pickering continued. In part, such encouragement would require that savers gain more confidence in the domestic financial system. Given that the stability of financial institutions in Peru had become suspect and economic activity was likely to be weak, a close monitoring of the situation by the Central Reserve Bank would be required.

In the December review of Peru's extended arrangement, his chair had expressed concern that the staff papers had not adequately focused on the clear threat of the continued high levels of inflation, Mr. Pickering recalled. At present, it appeared that the inflation rate in 1983 would be greater than 70 percent and that the average of the past two years, together with the inflation rate in the first quarter of 1983, exceeded 100 percent on an annualized basis. In that regard, he remained troubled by the vagueness of the authorities' intentions in wage policy, particularly in view of the real wage increases granted in 1982.

Like others, he was worried about the introduction of the 10 percent across-the-board import duty in Peru, Mr. Pickering said. That policy measure was a continuation of the authorities' apparent reluctance or inability to undertake a restructuring of trade policy, which, as Mr. Grosche had noted, had been an important cornerstone of the original program.

Recalling the suggestion by several of his colleagues that Peru had met all performance criteria under the program, Mr. Pickering noted that Table 3 of the supplementary paper showed that Peru had in fact failed to meet some performance criteria in December 1982 and February 1983, a failure indicative of some slippage in program implementation. The breaching of the December 1982 performance criterion on the contracting of foreign debt had not been particularly serious since the authorities had chosen, for whatever reason, not to make their SDR 40 million drawing in February; nonetheless, the ceiling had been breached, and he wondered whether there was some need for improvement in debt reporting procedures.

In sum, Mr. Pickering said, he was in broad agreement with the thrust of the policies set for the second year of the extended arrangement, which were designed to restore some of the important features of the original program. Despite the unfavorable developments referred to in the supplement to EBS/83/85, he endorsed the decision of the staff to continue with the original performance criteria, which had appropriately become more binding because of the deterioration in inflation and the exchange rate. While he would have preferred greater evidence by the Peruvian authorities of their commitment to the spirit of the original program in recent months, he could accept the assumption that the current situation would improve if the authorities were to implement the policy measures described in the main paper. Finally, like Mr. Taylor and Mr. Grosche, he was concerned about the relatively short period of time that had elapsed between the release of the supplementary paper and the current discussion.

Mr. Malhotra, supporting the proposed decision, observed that the Peruvian authorities had faced a difficult situation in 1982 that was likely to deteriorate further in 1983. Several policy initiatives had been undertaken by the authorities in the previous year. They had also adopted a more flexible approach to interest rates and exchange rates. However, inflation was running at a rapid pace, and the fight against inflation should be a priority for the authorities in the coming months. Regarding the trade-off between devaluing at a rapid rate and controlling inflation, he believed like Mr. Caranicas that a greater weight should be attached to the anti-inflationary fight. In that light, it was of the utmost importance that progress should be made in public finance. Given the recent natural disasters in Peru and their implications for government expenditure, it was important to make improvements in pricing policy.

The supplementary paper suggested that prospects for 1983 had worsened considerably, with output likely to contract by as much as 4 percent, but that the objectives of the program would remain unaltered, Mr. Malhotra continued. In commenting on that matter, Mr. Taylor and Mr. Senior had queried whether the objectives originally envisaged for 1983 were still attainable. In his own view, it was inadvisable to persist in adhering to objectives when the economic conditions under which they had been set had changed significantly. In particular, when a country experienced a major setback because of natural disasters, it was important for the staff to examine whether some changes in the original objectives were necessary and, if so, whether the performance criteria should be adjusted to make the achievement of the revised objectives feasible.

The authorities had taken bold steps to moderate and control wages of public servants, Mr. Malhotra noted; unfortunately, wages elsewhere in the economy had not been restricted. It was conventional wisdom in the Fund to recommend to the authorities of member countries that they leave the setting of wages to individual firms, whether in the private or in the public sector. The assumption was that such an approach would result in a desirable level of wage settlements. However, the Peruvian case and many others that had come before the Board belied that assumption, and it was perhaps time to reconsider the role that the state might need to play in setting wages, even in market economies. His own view was that when an economy faced difficulties with inflation and the balance of payments, the state had to continue to play an important role in guiding the level of wage settlements in both the public and the private sector; it was not sufficient to take action only with respect to government employees whose salaries were drawn from the budget. A solution to the problem might lie in developing guidelines and exerting a degree of persuasion to ensure that wage increases throughout the economy were reasonably consistent with economic developments.

The staff representative from the Western Hemisphere Department recalled that the most pressing question raised by Directors concerned the feasibility of the adjustment effort proposed for 1983. Given developments in the real sector of the economy, the program was in fact tighter than originally designed. Revenues had declined from initial projections because of the drop in activity, and additional expenditures would be needed to deal with the natural disasters; both those elements required further adjustment. The staff had in fact described cuts in underlying expenditures during the course of the year, and those cuts were still planned. In that regard, the limit on the deficit of the nonfinancial public sector through March had been met, which gave evidence that the spending cuts were on track. On the revenue side, performance had been weak in 1982, and few improvements were expected for 1983. However, the Fiscal Affairs Department had been providing the authorities with assistance in sales and income taxation, and staff members from that department would be visiting Peru often during the year to ensure that the schemes that they had designed were put into effect.

The program was also tighter on the monetary side, the staff representative continued. The ceilings in nominal terms remained the same, which, by implication, suggested that in real terms the monetary program was tighter than in the past. In assessing the feasibility of the monetary program, the staff again found it necessary to look at what had been accomplished so far, and it was clear that the authorities had performed according to their intentions.

Some Directors had asked whether the program should not have been redesigned entirely, given the changes in the underlying assumptions, the staff representative recalled. Having thought about the matter, the staff had come to the conclusion that the level of available real resources left little scope for any greater adjustment than that originally planned. International reserves were already at a minimum, and the authorities had made efforts to find additional resources to meet the shortfalls in projected exports and the capital account; in fact, all avenues--including bank financing, Paris Club renegotiations with bilateral creditors, and financing from the multilateral institutions--

had been explored, and it was doubtful that resources would be available from any other source. In passing, he noted that an effort was being made to speed up the disbursements of the structural adjustment loan from the World Bank. In sum, any effort to redesign the program would have come to naught because of the resource constraint.

With respect to the dollarization of the Peruvian economy, the staff representative remarked that the authorities were attempting to slow the growth of dollar deposits by increasing interest rates on sol deposits. They had created a new certificate of deposit in soles designed to compete with the foreign currency savings instrument. The authorities recognized that flexibility would be necessary and that interest rates would probably have to be increased further, although they had already been increased by more than 20 percentage points over the past three months.

Regarding the suggestion by several Directors that greater emphasis should have been placed on lowering inflation, the staff representative agreed that, over the medium term, inflation would have to be reduced. However, the authorities were also faced with the problem of protecting the balance of payments; the level of reserves was at a minimum, and exports would have to be encouraged. Maintaining a flexible exchange rate policy was therefore of utmost importance, although it did not help in lowering inflation. The same approach was necessary with respect to adjustments of controlled prices, although inflation was unlikely to be reduced until all the corrective adjustments had been made.

It was the view of the Peruvian authorities that wages in the private sector should be determined by collective bargaining, and there had been some effort at tripartite coordination between the Government, employers, and employees, the staff representative continued. Unfortunately, that effort had not progressed very far.

Some Directors had suggested that the level of imports in Peru projected for 1983 was quite low, the staff representative recalled. Imports for the first three months of 1983 were consistent with projections for the year as a whole. Moreover, there had been a shift in the spending pattern of the public sector, so that a large number of highly capital-intensive investment projects had been slowed, delayed, or stopped in order to make room for the reconstruction effort, which was expected to have a smaller direct import component. On a related question, an increase in the emergency imports of certain food items had been included in the import projections.

With regard to the possibility of introducing flexible targets in the program, the staff representative from the Western Hemisphere Department noted that such an approach had in fact been used in the Peruvian program in 1978. It could not be used again, however, because reserves had fallen too low. With flexible targets, if the needed capital inflows did not occur, Peru could lose more reserves and still remain within the program. At the present time that was not advisable, as the level of reserves was already at a minimum.

The staff representative from the Exchange and Trade Relations Department, commenting further on the suggestion by Mr. Caranicas and others that the staff had emphasized the protection of the balance of payments rather than the fight against inflation, observed that there was really no trade-off between balance of payments targets and inflation targets. If there was any trade-off at all, it was in the degree of tightness of the domestic policy program, so that what Directors were really questioning was whether the program was sufficiently tight. Directors had observed that some of the balance of payments results had been due to the flexibility of the exchange rate, which had insulated the balance of payments from the adverse effects of inflation, and for that reason, some Directors had expressed concern about the tightness of the program in 1982. That matter had in addition been linked, indirectly at least, to the relationship that existed between performance criteria and objectives. It seemed, ex post, that the performance criteria had been met for most of the year, mainly because there had been short-term borrowing that had not been included in the ceilings and also because longer-term borrowing had been higher than expected and thus, at the end of the year, the limit had been exceeded. In simpler terms, expenditure in the economy had grown more than intended, and that was really the reason why the targets of the program had not been attained.

An intriguing point had been made by Mr. Erb, who had wondered whether disappointing performance under a three-year arrangement should not lead to consideration of a move to one-year stand-by arrangements, the staff representative commented. It would be unwise for the Fund to give the impression that the quality of the adjustment effort supported by the Fund under a one-year arrangement was in any way less than the quality of the effort expected in the first year of a three-year arrangement. If an argument was to be made in favor of a shift, it should be based on the structural nature of the imbalance rather than the quality of the adjustment effort.

Mr. Donoso observed that some of his colleagues had expressed doubt about the ability of the authorities to achieve the objectives of the program during 1983 in view of the difficulties that had occurred in the previous year. As he saw it, there were two main differences between the two years. First, in 1982, there had been weaknesses in the control over public sector expenditure; second, some unforeseen developments in the performance of the economy had occurred during the year. For example, the expectation had been for a 4 percent increase in GDP; in the event, only a 0.7 percent increase had been registered. In a sense, many of the problems in attaining the program objectives in 1982 had been related to the difficulties experienced by the authorities in adjusting to unforeseen developments in performance. For 1983, the institutional arrangements to control public expenditure had been strengthened, and a performance criterion to control external borrowing--particularly short-term borrowing--had been established. Moreover, Peruvians were fully aware that the economic situation required a strong adjustment, so that the commitment to needed measures was strong, particularly given the clear picture that had been painted about the availability of resources. In spite of the difficulties experienced in the first quarter of the year, all performance criteria for March had been met, and the authorities had taken measures to increase interest rates and tighten monetary policy as needed. For all those reasons, he expected good progress toward the program objectives for 1983.

Regarding questions on the measures under consideration to keep imports to their programmed level, Mr. Donoso noted that the tools to constrain imports were already in place. If the projections relating to exports and capital inflows were realized and international reserves could not be reduced below the level contemplated in the program, then the targeted level of imports would have to be attained. There was no need for specific additional measures to control them because monetary policy and the objectives for net domestic assets would guide aggregate demand in the country. The target for net domestic assets was a strict one. The program for 1983 had been devised in February with the assumption that inflation would be no more than 55 percent and GDP would rise by 0.5 percent. Since that time, it had become clear that GDP would fall and that inflation would be much higher than projected; yet the net domestic assets limits had not been changed.

Mr. Erb, responding to a remark by the staff representative from the Exchange and Trade Relations Department, said that his intention in suggesting a move to a one-year stand-by arrangement had been to guard against possible relaxation by a government during the first year of an extended arrangement. The tendency of most governments operating in a medium-term context was to put off until later some of the actions that should be taken much sooner.

On another matter, Mr. Erb noted the statement on page 21 of the paper that "growth of nontraditional exports is expected to be boosted by some recovery in industrial countries and by the strengthening of Peru's competitiveness but could be hindered by protectionist tendencies abroad." It might be helpful in future reviews if a staff member from the GATT could somehow be involved in the Fund mission in order to identify precisely where protectionist measures elsewhere might be creating specific problems for the relevant government.

The Executive Board then adopted the following decision:

1. Peru has consulted with the Fund in accordance with paragraph 4 of the letter of April 2, 1982 attached to the extended arrangement for Peru (EBS/82/77, 5/4/82) in order to reach understandings with the Fund regarding the policies and measures that Peru will pursue during the period from March 1, 1983 to February 29, 1984.

2. The letter dated May 13, 1983 from the President of the Central Bank and the Minister of Economy, Finance, and Commerce, together with the attached memorandum on economic policy of the Government of Peru for the second year of the

extended arrangement, shall be attached to the extended arrangement for Peru (EBS/82/77, 5/4/82), and the letter dated April 2, 1982, together with the attached memorandum of the economic policy of the Government of Peru shall be read as supplemented and modified by the letter dated May 13, 1983, together with the attached memorandum on economic policy.

3. Accordingly, Peru will not make purchases under this extended arrangement until February 29, 1984:

a. During any period in which:

(i) The data at the end of the preceding period indicate that the limit on net indebtedness of the nonfinancial public sector referred to in paragraph 7 of the memorandum annexed to the attached letter has not been observed, or

(ii) The data at the end of the preceding period indicate that the target for the net international reserve position of the Central Reserve Bank and the Banco de la Nación of Peru referred to in paragraph 10 of the memorandum annexed to the attached letter has not been observed, or

(iii) The limit on the net domestic assets of the Central Reserve Bank and the Banco de la Nación of Peru referred to in paragraph 8 of the memorandum annexed to the attached letter is not observed, or

(iv) The limit on the contracting of new public external debt referred to in paragraph 12 of the memorandum annexed to the attached letter is not observed; or

b. After September 30, 1983, if the review contemplated in paragraph 5 of the attached letter has not been completed.

4. Purchases under this arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 140 million until May 20, 1983; SDR 202.5 million until August 20, 1983; the equivalent of SDR 265 million until November 20, 1983; and the equivalent of SDR 327.5 million until February 20, 1984.

Decision No. 7404-(83/74), adopted
May 20, 1983

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/83/73 (5/20/83) and EBM/83/74 (5/20/83).

2. ZAMBIA - PURCHASE TRANSACTION - COMPENSATORY FINANCING FACILITY

1. The Fund has received a request by the Government of Zambia for a purchase equivalent to SDR 97.2 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 Zambia and approves the purchase in accordance with the request.

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

Decision No. 7405-(83/74), adopted
May 20, 1983

APPROVED: October 12, 1983

LEO VAN HOUTVEN
Secretary