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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 82/154

10:00 a.m., December 1, 1982

J. de Larosière, Chairman

Executive Directors	Alternate Executive Directors
	A. B. Diao, Temporary
J. Anson	C. Taylor
J. de Groote	
	A. Le Lorier
A. Donoso	
R. D. Erb	C. Dallara
	S. R. Abiad, Temporary
	I. R. Panday, Temporary
	T. Yamashita
R. K. Joyce	
	C. Robalino
	H. Arias, Temporary
G. Laske	G. Grosche
G. Lovato	
R. N. Malhotra	A. S. Jayawardena
	J. E. Suraisry
J. J. Polak	T. de Vries
A. R. G. Prowse	
G. Salehkhou	O. Kabbaj
F. Sangare	E. I. M. Mtei
M. A. Senior	
J. Sigurdsson	
	Wang E.

L. Van Houtven, Secretary
J. C. Corr, Assistant

Also Present

African Department: J. B. Zulu, Director; E. A. Calamitsis, F. d'A. Collings, M. E. Edo, J. E. Greene, J. W. Kratz, H. Lorie, E. C. Meldau-Womack, R. L. Sharer. Central Banking Department: L. M. Koenig, Deputy Director. Exchange and Trade Relations Department: W. A. Beveridge, Deputy Director; S. Kanesa-Thasan, Deputy Director; M. Guitian, P. Neuhaus, F. L. Osunsade. External Relations Department: A. F. Mohammed, Director; A. M. Abushadi, H. P. Puentes. Fiscal Affairs Department: A. Tazi. IMF Institute: G. Oliveros; M. S. Camara, M. T. Diallo, F. Ly, Participants. Legal Department: G. P. Nicoletopoulos, Director; W. E. Holder, A. O. Liuksila. Research Department: N. M. Kaibni, G. Khatchadourian. Treasurer's Department: W. O. Habermeier, Counsellor and Treasurer; D. Williams, Deputy Treasurer; Q. Md. Hafiz, A. M. Al-Samarrie, T. M. Tran. Western Hemisphere Department: C. E. Sansón, Deputy Director; J. O. Bonvicini, L. A. Kenward, F. Rubli-Kaiser. Personal Assistant to the Managing Director: N. Carter. Advisors to Executive Directors: E. A. Ajayi, J. R. N. Almeida, S. E. Conrado, S. El-Khouri, L. Ionescu, H.-S. Lee, P. D. Péroz. Assistants to Executive Directors: H. Alaoui-Abdallaoui, M. Camara, T. A. Connors, R. J. J. Costa, G. Ercel, C. Flamant, I. Fridriksson, G. Gomel, M. Hull, M. J. Kooymans, P. Leeahtam, W. Moerke, J. A. K. Munthali, V. K. S. Nair, Y. Okubo, G. W. K. Pickering, C. A. Salinas, J. Schuijer, D. I. S. Shaw, H. Suzuki, P. Verly, J. C. Williams

1. EXECUTIVE DIRECTORS

The Chairman welcomed Mr. Ram Malhotra, Executive Director, and Mr. Cesar Robalino and Mr. Wang Enshao, Alternate Executive Directors, to the Board. He bade farewell to Mr. Vijit Supinit and Mr. Qianding Tai, Alternate Executive Directors.

2. REPORT BY MANAGING DIRECTOR

The Managing Director reported that during his recent visit to Europe he had met in the United Kingdom with Sir Kenneth Couzens, Second Permanent Secretary in H.M. Treasury, with whom he had discussed all the main topics under active review by the Board. He had also made a wide-ranging review of those matters with the Governor of the Bank of England, Mr. Gordon Richardson, and with the Chancellor of the Exchequer, Sir Geoffrey Howe; he had had a long and interesting conversation with Prime Minister Thatcher on world affairs and on international monetary and economic matters in particular, including the implications of multilateral surveillance.

In his address to Ministers at the GATT meeting in Geneva on November 24, 1982, the Managing Director added, he had made a straightforward plea in favor of free trade, as shown by the text of his remarks, already circulated.

In France, the Managing Director noted, he had talked to both the Governor of the Bank of France, Mr. Renaud de la Genière, and the Director of the Treasury, Mr. Camdessus, with whom he had also discussed matters with which he was concerned as Chairman of the Paris Club. On November 26, he had spoken at the colloquium held at the Ecole supérieure des sciences économiques et commerciales (ESSEC) at Cergy-Pontoise; a revised text of his remarks on the international monetary system and developing countries would be circulated.

3. GUINEA - STAND-BY ARRANGEMENT, AND EXCHANGE SYSTEM

Executive Directors considered a request by Guinea for a one-year stand-by arrangement equivalent to SDR 25 million or 55.56 per cent of quota (EBS/82/207, 11/10/82; and Cor. 1, 11/29/82).

Mr. Sangare made the following statement:

> On behalf of my Guinean authorities, I commend the staff for its comprehensive paper on Guinea's request for a stand-by arrangement with the Fund.
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> The problems confronting the economy of Guinea were analyzed in detail in my statement of August 27, 1981 on the occasion of the Board's discussion of the 1981 Article IV consultation with

Guinea. These problems which still plague the economy although in varying degrees, include lower than expected rate of growth, rising inflation, widening public sector deficits financed largely by the domestic banking system, serious balance of payments problems with the attendant dwindling of gross official reserves to a precariously low level, barely enough to cover imports for two weeks, and the emergence of external payments arrears. The persistence of the problems is attributable partly to factors clearly beyond the control of the authorities. Among these are repeated droughts the effects of which are often compounded by extensive floods, the continuing recession in the industrial countries, which weakened external demand for Guinea's major export commodities, deterioration in the terms of trade, and rising international interest rates. Other factors include shortages of imported goods, the rapid expansion of domestic liquidity and structural rigidities in the economy.

The authorities recognized these problems, and they have adopted an economic and financial stabilization program for 1982/83. The program aims at, among other things, arresting the deterioration in domestic and external imbalances, reducing the rate of inflation to about 15 per cent, and promoting growth-oriented structural changes. The authorities hope that the 1982/83 program will be followed by another one under the extended Fund facility.

In order to achieve these objectives, the authorities intend to build on the progress already made. Directors will recall that, in 1979, the authorities reauthorized private trading and gave domestic producers the option of selling their output either to official procurement centers at regulated prices or in the free market. Also in 1980, the Investment Code was revised, and last June an investment forum was organized in New York aimed at encouraging private investment. Meanwhile, steps are being taken in collaboration with the IBRD and UNDP to strengthen the planning system. Furthermore, a separate ministry has recently been established to facilitate the development of private small-scale and medium-scale enterprises. A number of agreements have also been concluded with foreign official and corporate institutions with the objective of helping to develop the country's mineral resources.

Measures have been taken to streamline the management structure of public enterprises and make them economically viable. In October 1981, the five holding companies controlling these enterprises were abolished, and each enterprise assumed operational autonomy. The authorities have announced that only financially viable public enterprises would continue to operate. In this regard, over 100 loss-making enterprises have either been sold to the private sector or dissolved by the end of August 1982. The incidence of administered prices had been drastically reduced, reflecting the growth of a market-oriented economy rooted in the

Government's liberalization policy. Regulated producer prices are now limited to some major export commodities in respect of which Guinea has a contractual obligation to make deliveries to foreign buyers. However, following discussions with Fund staff, producer prices of such commodities were increased by 10-67 per cent in February 1982 to stimulate production. Furthermore, a study covering all agricultural producer prices is currently under way with the assistance of the World Bank. The authorities expect that encouragement of the private sector will enhance the operational efficiency of the public enterprises.

In the budgetary area, the objective is to reduce the public sector deficit to 3.5 per cent of GDP by the end of the program period. To this end, the Government has adopted measures to reduce spending and boost revenue. Total central government expenditure in 1982 is being reduced by GS 1.5 billion to GS 16 billion. To achieve this, increases in wages and salaries will not be permitted during the program period, and obligatory retirement of government employees at the required age will be enforced. The policy of automatic recruitment of graduates to the public sector has been abandoned. Capital expenditure under the Five-Year Development Plan (1981-85) has been scaled down. Projects that receive no external financing are being suspended while the counterpart local currency expenditures are frozen. Although the OAU project is being implemented, only $6.6 million of the estimated cost of $112 million is being financed by Guinea. In mid-1982, the authorities decided to stop subsidies to state enterprises which had accounted for a sizable proportion of the public sector deficit. On the revenue side, measures already taken include the introduction of new taxes, including a regional development tax and new tax rates on upper income brackets.

In the monetary sector, growth in total domestic liquidity will be limited to 15 per cent during the program period, and the rate of expansion in domestic credit will be reduced from 19.9 per cent in 1981/82 to 8.3 per cent in 1982/83. The authorities believe that these are consistent with the overall growth, price, and balance of payments objectives of the program. To ensure appropriate use of bank credit, the Government intends to put emphasis on credit policy and to pursue an active interest rate policy. Meanwhile, interest rates were adjusted in September 1981, when deposit rates were raised from 2.5 per cent to 4-7 per cent and lending rates went up from 4-7.5 per cent to 10-14 per cent. The rates are being kept under close surveillance with a view to making changes if necessary. A new credit policy has been instituted that makes it possible for the banks to extend credit to the private sector while requiring the banks not to increase their aggregate credit accommodation to state enterprises. The authorities intend to use Fund technical assistance to strengthen monetary management following the use of similar assistance on the collection and organization of monetary data.

On the external front, the aim is to reduce the current account deficit--excluding transactions on OAU projects not financed by Guinea--from 4.8 per cent of GDP in 1981 to 4 per cent in 1983. The authorities also intend to take steps to prevent a further deterioration in the external reserve position of the banking system and to reduce external payments arrears. They are exercising restraint in contracting new nonconcessional loans so as to promote an improvement in the debt profile. Hitherto, they have engaged in bilateral negotiations with external creditors, which have resulted in some debt consolidation. Nevertheless, they are now considering a multilateral approach to the problem. In this connection, they are making efforts to improve the collection and presentation of external debt data. The authorities have also put into effect a new procedure under which the Central Bank, while receiving payments into a frozen account from all domestic debtors, will pay arrears to foreign creditors as foreign exchange becomes available on a time-precedence basis. One should also note that the Guinean authorities are committed to the objective of making the syli convertible in the long term. Meanwhile, they consider the existence of a parallel exchange market to be temporary, and they have signified their intention to complete a review of exchange rate policy with the staff before the end of 1982 with a view to agreeing on modifications, if necessary, to the policy during the mid-term review.

The authorities believe, and the staff agrees, that the measures being taken are adequate to achieve the program's objectives. In the circumstances, I recommend to Directors the adoption of the proposed decision on page 27 of EBS/82/207.

Some additional comments on the public sector, a critical aspect of the Guinean economy, were warranted, Mr. Sangare said. The imbalances in the Guinean economy seemed to stem from the further deterioration of the public sector finances, primarily because of the burden that the public sector enterprises placed on the banking system. However, that deterioration could not be completely explained by the growing mismanagement of the state enterprises. The parastatals had not been created simply to fill the vacuum left at the time of independence in the late 1950s. In view of the total absence of private entrepreneurs and private savings, the Guinean Government had been practically obliged to undertake an investment program to develop the economy, in order to make the independent country viable. Moreover, in a number of cases, the performance of state enterprises had been satisfactory when they had been able to operate in normal circumstances, meaning when they had enough foreign exchange to finance the imports upon which they depended.

In addition to the difficulties faced by the state enterprises, Mr. Sangare commented, the main reason for the deterioration in the public sector finances lay in the lack of proper incentives for the rural sector, mainly the small-scale individual farmers, and in the excessively concentrated focus on the mechanization of agriculture during the second half of the 1970s. Incentives for farmers included sufficient supplies of imports and consumer goods, and inputs such as fertilizers. In view of the chronic shortages of such goods, the small-scale farmers had become discouraged although producer prices had been higher in nominal terms at the official exchange rate in Guinea than in several neighboring countries. Production had declined and had eventually fallen to subsistence level, encouraging smuggling. In order to reverse the trend, the authorities had begun to concentrate, perhaps too strongly, on the mechanization of agriculture in the late 1970s, and they had encouraged farmers to organize themselves into cooperatives that would grant credit facilities to finance the required equipment imports. Unfortunately, as a result of persistent shortages of inputs such as fuel and spare parts, compounded by inadequate training of the users of the new tractors, and by a succession of natural disasters such as droughts and floods, the outcome had been no improvement. In fact, the country had become more indebted than before, since most of the equipment had been imported with commercial loans.

In the circumstances, Mr. Sangare continued, foreign exchange available to the state enterprises had become increasingly scarce. Because they had had to function below their capacity, the parastatals had begun to run losses and to rely more and more on bank credit, with unavoidable consequences for the government budget. Against that background, the Guinean authorities had tried to reform the country's economic management. As he had indicated, and as the staff report mentioned, a number of measures had already been taken. In addition, during the previous Article IV consultation, his authorities had informed the staff of their intention to implement, with the financial assistance of the Fund, a medium-term adjustment program better suited to the deep-rooted and structural nature of the imbalances. His authorities strongly believed in the need to pursue such an effort following the current stand-by program.

Mr. Diao stated that Guinea was one of the countries in Africa most endowed with natural resources. The exploitation of those resources had been limited to date, and, since independence in 1958, the Guinean economy had performed well below its potential. As his chair had pointed out when the Board had discussed the 1981 Article IV consultation with Guinea, the poor performance of the Guinean economy had to be seen in a historical perspective; it was to a large extent attributable to factors beyond the control of the Guinean authorities. The disruption of traditional trade links following independence had led to a situation not conducive to dynamic and efficient economic activity. The situation had been aggravated in recent years by severe prolonged droughts, unusual flooding, and adverse developments in the international economy, such as declining terms of trade, a prolonged recession in industrial countries with the attendant weakening of import demand for Guinean goods, and rising interest rates in world capital markets. As his chair had stated in 1981, such adverse factors, along with the bottlenecks traditionally characteristic of developing countries, namely, lack of managerial know how and shortage of skilled manpower, had seriously hindered development in Guinea during the past 20 years.

Since 1979, the Guinean authorities had come to realize that swift corrective action was needed to stimulate the national economy, and to stabilize the internal and external financial imbalances, which were growing at an unsustainable rate, Mr. Diao continued. Efforts had therefore been initiated in 1979 to open up the economy, to encourage the private sector to play a much greater role, and to attract foreign investment. The efforts had been well described in Mr. Sangare's statement and in the staff report. The Guinean authorities were determined to follow the new policies for domestic and external economic management, and they needed more international financial cooperation to assist them in their endeavor. In that context, they had come to the Fund to seek financial support for carrying out the stabilization program for 1982/83.

The 1982/83 program was well designed, Mr. Diao considered. It aimed at stabilizing the internal and external financial positions through strong fiscal and monetary policy measures. Fiscal action would consist essentially of greater efforts to raise revenues and of tighter control over government expenditures, especially wages and salaries and OAU-related outlays. Public enterprises were to be streamlined to make them more efficient and self-supporting. On the monetary side, a restrictive policy stance would be adopted to keep credit expansion in check. The steps taken by the authorities regarding exchange arrangements constituted a clear indication of their determination to address their economic and financial difficulties, and they were to be encouraged. In sum, the Guinean authorities had put forward a sound program that deserved Fund support.

Miss Le Lorier welcomed the stand-by arrangement, the first between Guinea and the Fund, particularly because it appeared to be an indication of a fundamental revision in Guinea's economic policy. However, it might take some time for the new policy to bear fruit. Guinea was especially well endowed in natural resources. Compared to Sahelian countries, the scope for agricultural development was considerable, and, with regard to mineral resources, the country had often been described as a "geological phenomenon" due to its numerous rich deposits of bauxite, iron ore, diamonds, gold, uranium, cobalt, chromium, lead, zinc, and ilmenite.

Against that rather favorable background, the general economic performance had been substantially below potential, Miss Le Lorier noted. Agricultural products accounted for less than 3 per cent of exports, and the country was dependent on imports of food. Among mineral resources, only bauxite and its derivative, alumina, were being produced in substantial quantities and they represented more than 90 per cent of export earnings. The growth of real GDP over the previous five years had been below the population growth rate, and internal and external imbalances had become unsustainable, with external payments arrears amounting to SDR 140 million at the end of 1981. The adverse situation appeared to be largely the result of inappropriate economic policies and of overwhelming state control.

Nevertheless, the number of measures that the Guinean authorities had already introduced prior to the present program seemed to testify that they realized that they had been going in the wrong direction, Miss Le Lorier continued. Since mid-1979, direct public sector involvement in economic activity had been significantly reduced: private trading had been reauthorized, over 100 public enterprises had been closed or sold, and, the Board was told, producer prices for agricultural products were at present determined mainly by market forces. On the fiscal side, automatic recruitment of new graduates to public service had been ended. Externally, the parallel foreign exchange market had benefited from the tolerance of the authorities, and a dual rate structure had developed, leading to a large depreciation of the Guinean syli.

The measures that would have to be implemented under the present program represented a reinforcement of policies already undertaken, Miss Le Lorier observed, and they were certainly headed in the right direction. She noted particularly that the Government intended to continue in 1983 to abstain from general increases in wages and salaries, which had not been raised since July 1980. According to the figures in Table 3 of EBS/82/207, real wages in the public service would have declined by 57 per cent in the five-year period ending in 1983. If they had really done so, they would well exemplify the firmness of the Guinean authorities and their strong commitment to the program, but she wondered whether there might be difficulties that could lead to many "special" increases. Could the staff comment on that question? She noted that capital expenditures for the conference of the Organization of African Unity would amount to $112.3 million. While Guinea had always played a major role in the OAU, and while she understood that the project was being financed on concessional terms, the fact remained that such expenditures were mostly unproductive and had entailed a reduction in other more productive capital programs; she therefore regretted that it had not been possible to economize on that program.

The targeted reduction by SDR 20 million in external arrears appeared realistic, Miss Le Lorier said. The Guinean authorities had followed a bilateral approach to the problem of debt renegotiation, but Mr. Sangare had informed Directors that they were now considering a multilateral approach. That was most appropriate, as a multilateral approach was generally more favorable to debtor countries and was more likely to avoid discriminatory treatment.

The policy changes, Miss Le Lorier remarked, could lead Directors to wonder whether the trend toward increased liberalization of the economy might not create new and unexpected problems. For example, the staff looked forward to the development of the parallel foreign exchange market; however, an increasing volume of transactions on that market would mean unavoidable increases in unofficial exports and imports to and from neighboring countries belonging to a currency union. That development could lead, in turn, to such an expansion of the parallel economy that government revenues, based mainly on the official sector, would be adversely affected. In other words, the "second window" for foreign exchange could become completely out of control. Had the staff considered a solution along the lines that the Board had recently discussed for Uganda?

The supply side of the program did not appear to be very strong, Miss Le Lorier suggested. In fact, strengthening the free market might not be enough to revitalize the productive sector. Freely determined prices would provide sufficient incentives for primary producers only if the profit margins of the private trading sector did not eat up the greater part of the increases. Moreover, as was well known, to bring about an increase in agricultural production required not only an appropriate level of producer prices and an efficient marketing organization, but also proper inputs for the producers, extensive extension services, and the like. Similarly, rehabilitation of the public enterprise sector, which was still sizable, would require sustained efforts over an extended period. More comments by the staff on such issues, important in the medium term, would have been helpful.

Mr. Prowse said that his authorities supported the stand-by proposal and that they would welcome information on the possible drawing under the compensatory financing facility, particularly on the reasons why it had not been brought to the Board at the same time as the stand-by request. The program was solid and was, appropriately, built on the policy package already under way. While he did not share Miss Le Lorier's concerns about supply-side incentives, he believed that there was scope for more action on the monetary side. As his chair had indicated in 1981, interest rates needed to be increased, and he invited the staff to comment on that issue. The program for the reduction of external arrears appeared relatively moderate. He assumed that it was the best that the staff and the authorities believed could be managed, but the staff might comment on the prospects for a greater reduction in the context of a further stand-by arrangement with Guinea.

A fundamental point had been raised by Miss Le Lorier, Mr. Prowse commented, namely, whether the authorities had decided what the structure of their economy should be in the medium to long term. That was a basic issue for the authorities to think about. The economy had clearly evolved rapidly since 1978 from one kind of structure to another, more liberal one. For example, there had been a reduction in the amount of public enterprise. But did the authorities have a coherent concept of where the economy would be in five or ten years? What kind of economy did they seek? How far did they wish market mechanisms to determine the allocation of resources? It was unclear from EBS/82/207 whether the authorities held a determined and clear-cut set of objectives in that regard.

Commenting on the OAU Conference, Mr. Prowse remarked that the level of expenditure on that project had at first seemed to be a matter for concern, as the expenditure might not be very productive. On the other hand, the hotels and infrastructure would stimulate tourism, and perhaps some inflow of foreign exchange, and further comments from the staff on that aspect would be welcome. Ultimately, it was a matter for the authorities to determine their own priorities, and, while the staff had no doubt discussed the issue with them, they had accepted the implications of the particular investment. They recognized that there had to be adaptations in the remainder of the program. The Board did not normally attempt to direct in detail the budget programs of members.

The projected terms of trade for Guinea, as indicated in Table 11 of EBS/82/207, suggested a further decline in 1982-83, Mr. Prowse noted. Did that judgment reflect changes in the staff's general thinking about the prospects for primary commodities and commodity trade? In his recollection, it had been expected that there would be an improvement in the terms of trade in 1983 for certain commodities and primary products. Perhaps the slower than expected recovery in the industrial economies had led to a reassessment of that expectation.

Mr. Dallara stated that his authorities were in agreement with the staff evaluation of the direction and extent of the recent reorientation of Guinea's economic policy. They agreed, furthermore, that Guinea's economic problems were mainly structural, requiring a sustained application of the new economic policies initiated since 1981. While much remained to be done, the program was a commendable step in the right direction. The liberalization of productive activity and trading, changes in pricing policy, and rationalization of the public enterprise sector all represented important steps toward laying the basis for rekindling economic growth. In light of those and other measures outlined in the program and touched upon already by other Directors, he supported the proposed stand-by arrangement.

A key recent economic development in Guinea had been the emergence of what the staff had called an "unofficial private market," Mr. Dallara continued. It had become an important growth-oriented sector of the national economy in recent years. Activity in the unofficial market went largely unrecorded, with the result that available economic data provided an inadequate and possibly misleading basis for the formulation of economic policy and for the evaluation of recent economic performance. The basic problem that had to be addressed was how to bring the official and unofficial markets together, a point already made by Miss Le Lorier. He invited the staff to comment on what steps would be appropriate in the current circumstances to strengthen development of the private market without creating undue problems for overall economic management, and on what would be required in order to reflect more fully activity in that sector in the national accounts of Guinea. Any rough estimates that the staff could provide of the level of activity in that sector would be appreciated, in particular with regard to exports.

Commenting on the adjustment program for 1982-83, Mr. Dallara remarked that the principal policy elements appeared broadly appropriate to the task of reinforcing the policies and objectives recently put into place. In particular, he welcomed the continued emphasis on rationalization of the public enterprises. He commended the decisions, first, to discontinue transfers from the Central Government for the purpose of covering operating losses and, second, not to permit the banks to increase aggregate credit to those enterprises. Both were appropriate steps, and he hoped that they would have a beneficial medium-term effect.

With regard to pricing policies, Mr. Dallara observed, the authorities were to be commended for pursuing economic liberalization to the point where, in the majority of cases, prevailing prices for Guinean consumers and producers reflected the free interplay of market forces, but he agreed with the concerns expressed by Miss Le Lorier regarding the supply side of the program. He invited the staff to comment further on the adequacy of prevailing prices for producers of export commodities in light of recently announced increases. What was the expected supply response to the price increases described in paragraph 14 of the authorities' letter of intent? Did the staff have further policy recommendations in that area?

The strong resolve on the part of the authorities to bring down the overall public sector deficit was welcome, Mr. Dallara added, although a different balance in expenditure reductions between current and capital expenditures would have been more appropriate. He agreed completely with the staff regarding the uncertainties surrounding the possible financial implications of the plans to host the OAU Conference in 1983; in that regard, he associated himself fully with the comment made by Mr. Prowse. Consequently, he urged the authorities to follow those developments closely and to make adjustments as necessary. With regard to the requested approval of exchange measures, he strongly urged the authorities to move quickly to adopt the mix of policies that would permit elimination of the various restrictions still in place.

Attention to the exchange rate, as Miss Le Lorier had pointed out, would seem to be fundamental to resolving the basic problem of bringing the official and unofficial sectors of activity together, Mr. Dallara considered, and he was disappointed that the program did not include more detailed consideration of exchange rate measures, given the lengthy discussion that had taken place between the staff and the authorities. He recognized that a study was under way and hoped that, upon completion of the study, immediate and prompt action would be taken to address that area. Interest rate policy, adjusted in late 1981, required further attention and further action. He agreed with Mr. Prowse that the arrears problem was urgent, and that the planned reduction in arrears during the program was possibly not sufficient since Guinea was continuing to build up external debt, albeit largely concessional debt. The buildup of debt when arrears were particularly large relative to reserves was a matter of concern.

In general, the program as outlined seemed to be better suited to a first credit tranche program, Mr. Dallara considered. While the amounts contained in the program were not particularly large by any standard, he questioned, in light of the policies that had been put into place, the appropriateness of providing resources in the third credit tranche in a program that embodied the kind of conditionality more consistent with first credit tranche programs. A substantial volume of resources would not become available until the mid-term review was completed, and he acknowledged that that was a factor to be taken into account in viewing the program and the appropriateness of the policies currently in place.

The lack of a medium-term analysis and of a medium-term framework was a matter of concern, Mr. Dallara added. Miss Le Lorier had commented accurately on the nature of the problem. More generally, his authorities had often reiterated their interest in seeing programs placed in a medium-term context when they were presented to the Board. His authorities believed that the present case was a particularly worrisome example of the glaring lack of such a framework. He encouraged the Guinean authorities to persevere in their efforts to reorient economic policy, efforts that, if successful, would result in improved efficiency in production and trade, and in a marked reduction in both external and internal imbalances. He hoped that a more comprehensive analysis of the medium-term prospects for the economy could be completed.

Mr. Salehkhou noted that negotiations with Guinea for the use of Fund resources had taken exceptionally long; the length of the negotiations was particularly striking given the serious economic difficulties confronting the economy and the modest amount ultimately requested. Indeed, after the completion of the 1981 Article IV consultation with Guinea, it had been expected that the use of Fund resources and technical assistance could help the country overcome its structural rigidities and short-term imbalances stemming from years of economic mismanagement and from the adverse impact of various exogenous factors such as bad weather, sharp increases in the prices of petroleum and external capital, a weakening of export demand, and a continuing deterioration in the terms of trade. The availability of Fund resources had also been expected to encourage the Guinean authorities to persevere in carrying out their new policies and in adopting more market-oriented mechanisms.

He had also been surprised to note the small volume of Fund resources that it had been agreed to make available to Guinea, and the stiff conditions for their use, Mr. Salehkhou remarked. The country would be able to draw slightly more than 50 per cent of its very small quota, while members with much larger quotas had been able to draw the maximum available even though they had often approached the Fund previously. He drew attention to the way drawings under the requested stand-by were to be phased out, and to the review clause calling for understandings on exchange rate policy before the end of February 1983, a clause that seemed to be neither in proportion to the amount of the stand-by, nor really necessary after the courageous and far-reaching action already taken by the authorities in accepting a substantial de facto devaluation of the syli through official tolerance of the parallel market.

Commenting on the adjustment program, Mr. Salehkhou added that, in light of the performance of the Guinean economy in the past two years, and of the measures and policies already implemented, the targets seemed to be reasonable. They ought to pave the way for a deeper adjustment and for increased liberalization of the economy.

He particularly welcomed the elements of the program related to fiscal policy, Mr. Salehkhou continued, elements aimed at reducing the overall public sector deficit to the equivalent of 2 per cent of GDP and at streamlining direct public sector involvement in economic activity. The wide range of measures aimed at fiscal adjustment showed how seriously the authorities took the program and how greatly they were committed to the reorientation initiated in the past two years. The measures included significant cuts in expenditure in absolute terms, the suspension of capital expenditure projects with no immediate prospect of external financing, and the ending of financial transfers to public enterprises to cover their operational losses. They also included a decisive move by the authorities aimed at liquidating loss-making public enterprises and at enhancing the public sector's operational autonomy.

In the discussion of the report of the 1981 Article IV consultation with Guinea, Mr. Salehkhou noted, a number of Executive Directors had expressed reservations with regard to the 1983 OAU Conference to be hosted by Guinea, and to the impact on the fiscal and current account deficits of the cost of preparations for the Conference. In that regard, he welcomed the inclusion by the staff of Table 6 in EBS/82/207 showing the different elements of the OAU project and their financing. The table showed that the bulk of the overall cost, 94 per cent, was to be financed through concessional loans and grants, and that the impact on the central government budget would be delayed at least until 1985. Further elements of the program related to credit policy, external borrowing, pricing policy, and exchange arrangements were also consistent with the general objectives of the stand-by, and they should help to achieve the main targets of the program, i.e., the decline in domestic inflation and domestic liquidity growth, and the reduction of external payments arrears. He invited the staff to comment on the question of the amount of the stand-by arrangement, the phasing out of the drawings, and the performance criterion related to exchange rate policy.

Mr. Abiad stated that he fully supported Guinea's request for a stand-by arrangement and endorsed the proposed decision. He agreed with the thrust of the staff appraisal. In EBS/82/207, the staff made it clear that the Guinean economy had been suffering in recent years from sluggish growth, high rates of inflation, and considerable pressures on the balance of payments and foreign exchange reserves that had led to a rapid deterioration in domestic and external finances. According to the staff, the disappointing performance of the economy in recent years had in part been due to policy shortcomings associated with existing institutional arrangements, as well as to a number of adverse exogenous factors, including bad weather, rising costs of external capital, and the prolonged recession in export markets.

Since mid-1979, Mr. Abiad continued, the authorities had begun to introduce wide-ranging policy measures aimed at arresting the deterioration of the domestic and external imbalances, stimulating production, reducing excessive inflationary pressures, and strengthening the financial position of the Government and public sector enterprises. Those measures seemed to have laid the ground for a broad-based fundamental policy reform, of which the adjustment program in support of the requested stand-by arrangement was an important part. In that context, like Mr. Salehkhou, he noted the staff's references to "the extended period of the discussions" that had preceded agreement on the arrangement. It would be useful if the staff could comment further on the factors that had militated against an earlier agreement. In any event, the structurally oriented program under consideration seemed to be a strong one, involving courageous and far-reaching corrective actions on both the demand and supply sides, as well as changes in the institutional framework.

On the demand side, Mr. Abiad noted, the program envisaged a package of fiscal measures intended to strengthen budgetary discipline and to reduce the overall public sector budget deficit. They included reduction in current budgetary expenditures, streamlining spending on less pressing capital projects, expansion of the Government's revenue base, and further rationalization of the operations of public sector enterprises. The measures were to be supported by a tight monetary policy geared toward moderating demand pressures, promoting savings, and restoring a measure of financial stability. To that end, the authorities intended to limit the growth of total domestic liquidity and to observe ceilings on total domestic bank credit and on net domestic bank credit to the Central Government. Together with other measures, they were expected to contribute to a considerable reduction in the rate of inflation by the end of the program period.

On the supply side, Mr. Abiad continued, the authorities had expressed their intention to strengthen during the program period the measures already taken. The measures were aimed at promoting real economic growth by encouraging productive investments, providing appropriate incentives to the agricultural sector, reducing cost-price distortions, and improving the operational efficiency of public sector enterprises.

One of the objectives of the program in the external sector, Mr. Abiad observed, was to prevent net international reserves from declining below their end-June level. Another important and welcome objective related to the authorities' intention to reduce external payments arrears by at least SDR 20 million during the program period. In that connection, he agreed with the staff that the achievement of that objective would greatly enhance international confidence in the Guinean economy and in its potential. He noted the references in EBS/82/207 to the procedure established by the authorities regarding the reduction of arrears under which settlement with foreign creditors would be made on the basis of time precedence. He invited the staff to elaborate further on the practical functioning of that method.

In sum, the program reflected the authorities' commitment to adjustment, Mr. Abiad said, and their determination to tackle effectively the country's economic problems that were, in the staff's words, "of a structural nature." The staff had also stated that the arrangement would "support an important reorientation of Guinea's economic policy." Given the scope of the task involved, and in view of the remarks made on the subject by previous speakers, he invited the staff to comment on the adequacy of resources to be provided by the Fund under the proposed arrangement and on the prospects for subsequent arrangements.

Mr. Sigurdsson stated that the Fund ought to support the important reorientation of Guinea's economic policy that the authorities had undertaken, of which the proposed program constituted a part. Like most other developing countries, Guinea was fighting an uphill battle in the face of the protracted recession in the international economy and deteriorating terms of trade. The forecast of continued decline in Guinea's terms of trade in 1983 raised the question whether there had been a change in the Fund's appraisal of the world economic outlook for 1983 in general and of the terms of trade outlook in particular.

The adverse developments in the external environment, coupled with shortcomings in domestic policy and structural weaknesses in the economy, had led to serious imbalances and to a disappointing economic performance, Mr. Sigurdsson continued. The basic policy reforms that the Guinean authorities had embarked upon, including liberalization of economic activity and efforts to strengthen the country's finances, were headed in the right direction. He joined Mr. Prowse in asking the staff about the prospects for the development of exports and about the case for a purchase under the compensatory financing facility by Guinea. The staff might have been right in considering that hosting the OAU Annual Conference could turn out to be a mixed blessing. It was essential to maintain firmness in public sector finances; he hoped that the OAU project would not prove to be too burdensome. He supported Mr. Prowse's comment that it was a question of national priorities.

As the staff had pointed out, Mr. Sigurdsson remarked, the present arrangement implied a de facto acceptance of a change in the exchange rate of the currency. The official SDR peg of the Guinean syli had, at a time of a rapidly strengthening U.S. dollar, resulted in a dramatic appreciation vis-à-vis the CFA franc as well as a substantial appreciation in nominal trade-weighted terms. In the rapidly developing parallel market, the syli was valued at an 80 per cent discount compared to the official rate. There could be little doubt that the official rate was sharply out of line. The intention to undertake a further review of the exchange rate policy was therefore welcome. He urged the authorities to adopt a flexible attitude in that regard. It was essential for their investment effort to maintain a realistic official exchange rate, and it was through such a policy that foreign exchange transactions could best be attracted to official channels and the markets unified and monitored. He noted that similar comments had been expressed by Miss Le Lorier and Mr. Prowse. A realistic official exchange rate was the cornerstone of a well-functioning price system.

The initiatives taken relating to producer prices and to the operations of public enterprises were welcome, Mr. Sigurdsson added, and he hoped that the authorities would continue to demonstrate their commitment to making structural improvements and promoting a more efficient economy. The staff comment that Guinea's economic problems were structural deserved emphasis. The solution required sustained application of the new economic policies that had been initiated at the beginning of the 1980s. Such a sustained policy effort was required from Guinea if the growth potential inherent in the rich resource endowments was to be brought to fruition for the benefit of the Guinean people. Mr. Sangare's statement that the authorities were making efforts to improve their collection and presentation of foreign debt data and to strengthen their foreign debt management procedures in general was encouraging. It was an area in which technical assistance from the Fund would be helpful and appropriate.

Mr. Suraisry commented that two principal problems lay behind the deterioration in almost all economic activities in Guinea. First, like other countries, Guinea had been affected by the unpleasant developments in the international economy that had begun a few years earlier. Such developments had adversely affected Guinea's exports of bauxite and alumina, the main sources of foreign exchange earnings. The effects on the viability of the balance of payments were obvious. Second, a problem arose from the way in which the economy was managed. Giving a small role, if any, to the private sector, and the creation and protection of unsuccessful public enterprises, had weakened the entrepreneur's fundamental role in the development process and its contribution to the evolution of social and economic institutions. Such institutions were critically important to the achievement of a viable and mature economy. In addition, incentives had been weakened, opportunity costs had become high, and economic resources had been highly misallocated.

Fiscal policy had been expansionary, Mr. Suraisry noted, and its effects had probably been intensified by the decline in the share of capital expenditure in public expenditures. Monetary policy had also been expansionary, and its impact had been magnified by the way in which domestic credit had been allocated. The outcome was a high rate of inflation, large budget deficits, a critical level of liquid foreign assets, a large external public debt, and declines in the growth of the economy's productive sectors. The private sector should be allowed to evolve further. However, the cost could involve splitting the economy into two sectors: an official but stagnant sector, and an unofficial but growing one. Restoration of a unified economy was important and ought to be achieved as soon as possible. Unfortunately, it would not be easy, involving issues such as liberalization and rationalization, as well as the performance of the economy in general and its response to adjustment. It was a long-term process, and the economy might remain disunified for a lengthy period. If that happened, institutions and procedures might adapt themselves to the situation, a development that could hamper the reunification process, weaken the development effort, and above all make adjustment too difficult to achieve. He invited the staff to comment on that question.

The problem of the Guinean economy was structural and should be tackled accordingly, Mr. Suraisry suggested. Like Miss Le Lorier and others, he believed it was long term and required long-term solutions. He joined Mr. Prowse and Mr. Sigurdsson in asking why a request for a compensatory financing drawing had not been included in the program and what the prospect was for such a request. The Guinean authorities were aware of the problems to be faced and had adopted a stabilization program for 1982-83 that recognized and dealt with the problems. They therefore deserved the Board's support.

Mr. de Groote remarked that the proposed decision on a stand-by arrangement was an important event on the African scene. The request by the Guinean authorities for a stand-by arrangement of SDR 25 million showed that Guinea was engaged in an ambitious liberalization and that its openness toward Western countries and toward other African states was increasing. The decision to sponsor the forthcoming summit of the Organization of African Unity in Conakry in mid-1983 was a good example of the new openness to the world and would doubtless enhance Guinea's international image. The resulting financial burden and the increase in the public sector deficit, which would materialize only in 1985, had to be seen in that perspective.

Against that background, the conclusion of the stand-by arrangement was particularly timely, Mr. de Groote continued. Ideally, the implementation of the agreement submitted for the Board's approval should lead to a longer-term arrangement once all the necessary structural policies were in place. The World Bank was considering a formal request for technical assistance that might eventually lead to a structural adjustment loan, and it was satisfactory that Guinea was ready to cooperate with the World Bank. If a structural loan was agreed to, however, it was of overriding importance that there should be effective coordination with the Fund. He had recently expressed his concern that in certain cases the World Bank did not seem to require the fulfillment of the monetary and budgetary conditions essential to the successful achievement of the macroeconomic objectives of structural assistance loans. It should be recognized once and for all that a country embarking on a program to tackle macroeconomic structural elements could be successful only if its monetary and budgetary policies were sound. Whether the World Bank granted credit under the legal form of a structural adjustment loan or a program loan had no effect on the substance of the matter.

The willingness of the Guinean authorities to stimulate small and medium-sized private enterprises was particularly welcome, Mr. de Groote considered, as was their intention to reduce domestic and external imbalances, and to try first to limit and then to reduce external payments arrears. Such policies represented the beginning of a comprehensive program, the various elements of which were aimed in the right direction. It was a moment of fundamental transition for the Guinean economy, and great uncertainties surrounded the impact of some of the procedures that the Fund was asking the Guinean authorities to adopt. In the circumstances, the program offered the maximum chances of success in the present stage of transition and adjustment, given appropriate world conditions.

He had been particularly struck by the staff description of the exchange rate system, Mr. de Groote stated. It was apparently impossible for the staff to calculate an effective rate for the syli. As a temporary measure, the authorities had resorted to a dual exchange rate system, under which transactions on the official market were to be strictly limited to the foreign exchange earned in that market, with all other transactions being channeled through the unofficial market, and with the latter expected gradually to absorb the official market. The authorities had therefore imposed ceilings on transactions in the official market. If he understood the situation correctly, such ceilings would be lowered further in order to reduce the number of transactions passing through the official market. He hoped that his interpretation was correct because such ceilings should be regarded as the means for a transition to a more effective exchange market; in themselves, the ceilings had little meaning. They could hardly be regarded as an appropriate policy tool in view of the need to restructure the economy. He particularly welcomed the fact that a separate performance clause required the Guinean authorities to complete a detailed review of the question in cooperation with the Fund staff before the end of 1982, and to reach an understanding on exchange rate policy by the end of February 1983.

The correction of the present imbalances on the external side, especially the stimulation of exports, was essential to the success of the program, Mr. de Groote observed. In that regard, it would be interesting to know how the profitability of the mining sector had been affected in recent years by the appreciation of the syli vis-à-vis the CFA franc. The Guinean mining sector had to have an exceptionally high level of profit per ton to compensate for the large financial costs arising from the behavior of the exchange rate. It would also be interesting to know the intentions of the Guinean authorities with regard to agriculture, a sector that, as Mr. Sangare had mentioned, had been subjected to excessive mechanization. It was important for the Guinean authorities to take fully into account the conclusions of the World Bank on that issue.

The remarks by Mr. Dallara on the need to base the Board's decision on a medium-term view of the evolution of the Guinean economy were particularly interesting, Mr. de Groote continued. He had himself expressed similar concerns several times with regard to other cases. However, it had to be stressed that it might be difficult at the present juncture to obtain realistic projections for the medium-term outlook for the Guinean economy. It was essential, therefore, to have complete certainty regarding the policy intentions of the Guinean authorities themselves, intentions that should lead to improved results in the coming months, and that should help the Fund to formulate better quantitative projections in due course. Miss Le Lorier had correctly observed that the basic problem was to know whether the Guinean authorities had firmly opted for an overall change in their economic policies, or whether they wished to retain important sectors of the economy under a nonmarket system, thereby courting the inherent dangers of incoherence and misallocation of resources. He hoped that world conditions would enable the Guinean authorities to achieve the courageous goals that they had set for themselves in the stand-by program, and that the Board would soon be in a position to envisage a longer-term involvement of the Fund in one of Africa's leading countries.

Mr. Malhotra stated that he supported the proposed decision and that he had been impressed by the series of actions already taken by the Guinean authorities. He hoped that those far-reaching measures would continue to be viewed in the context of the difficult situation, both domestic and exogenous, confronting the Guinean economy. The Fund had shown considerable understanding and had adopted a helpful attitude in dealing with the request of the Guinean authorities; it should continue to show that understanding because of the inherent nature of the change taking place. It was important to note that the external trade situation confronting Guinea was likely to continue to be difficult in 1983 and perhaps beyond, depending on developments in the international demand for Guinea's goods.

A number of Directors had commented on the OAU project, Mr. Malhotra noted. The staff had indicated that the financing of the project was on concessional terms, and that its impact on the budget was not likely to be felt before 1985. It was a decision for the Government to take, reflecting its own priorities. It was a question of the exercise of sovereign authority.

It would take time to resolve the structural difficulties faced by the Government of Guinea, Mr. Malhotra observed. It was quite possible that, in order to be successful, the stand-by arrangement would have to be developed further into a long-term program. If the Fund and Guinea should enter into that kind of relationship, he hoped that the whole program would be pursued on both sides in a spirit of understanding, in view of the major changes being effected at home and of the difficulties abroad.

Mr. Grosche said that he supported the proposed decision. The program appeared to be appropriate, particularly in light of the relatively low amount, about 55 per cent of Guinea's quota. He associated himself with most of the remarks made by Mr. Prowse, Miss Le Lorier, Mr. Dallara, and others.

Mr. Prowse commented that the relationship between World Bank structural adjustment loans and Fund programs was an important issue, affecting some of the countries in his constituency, and it was important to establish clearly policy in that area. In the view of his authorities, when programs from each institution were concurrently in application or negotiation, it made sense that they should be complementary and coordinated, as appropriate. However, it would be inappropriate to formalize such coordination. Perhaps more important, there should not be any presumption that a structural adjustment loan should be conditional on a concurrent stand-by or extended financing facility program from the Fund. The circumstances of the particular member should be the determining factor in the view of some of his authorities.

The Chairman said that he understood the view expressed by Mr. Prowse, although it was not necessarily one shared by all Executive Directors. It could more appropriately be discussed on another occasion.

A staff representative from the Exchange and Trade Relations Department, leader of the mission, noted that Miss Le Lorier had asked about the near-term prospects for wages. The staff had taken the view that it was not an opportune time to increase wages, in light of the expenditure growth of the preceding few years and of the budget situation in the current year, including the program of expenditure for the OAU project. The authorities had reluctantly agreed. As the parallel market expanded, the proportion of wage expenditures on parallel-market goods and services, whose prices were rising rapidly, was increasing. He expected that the authorities would hold out against increases in wages, at least for the program period, as indicated in their letter of intent. There was a possibility that the question of wage policy would arise in the context of the exchange rate review, since any exchange rate action would have an important bearing on real wages.

Commenting on the sources of supply for the parallel foreign exchange market, the staff representative explained that the primary supply source was the smuggling of exports, especially coffee. Because of the differential in prices between official prices in Guinea and prevailing prices in neighboring countries, agricultural exports through official channels had virtually disappeared. In addition, the authorities had informed the staff that there had been a decline in the supply of foreign exchange from the diplomatic community through official channels, with the implication that that had been an important source of supply to the parallel market. There was also a growing activity in the mining of diamonds, and it was proposed to establish an arrangement whereby, in return for sales of diamonds by private marketers through the official channel, diamond producers would be allowed to retain 60 per cent of their sales in foreign exchange. That was another important source of the supply of foreign exchange to the parallel market.

The question of the relationship between the parallel market and the official market for foreign exchange had been raised, the staff representative continued. As the authorities had stated in their letter of intent, they viewed the parallel foreign exchange market as a transitional phenomenon, and their longer-term objective was to have a unified official market. Until quite recently, the parallel market had not been officially recognized, so that there had been a substantial element of risk built into the exchange rate prevailing in that market. To that extent, it had not represented a market equilibrium rate. As the parallel market had become increasingly tolerated, the risk element had declined, so that the rate became closer to a free-market equilibrium rate, although still subject to fluctuations. The authorities intended that, given successful demand management policies and the expected supply response to the depreciation in the parallel market, it would be possible to stabilize or even to bring down the level of the rate in the parallel market and to adjust the official market, so that there would eventually be a convergence of the two rates.

The rehabilitation of public enterprises was a complex issue, the staff representative commented, because the authorities were introducing their rationalization measures after some 20 years of a variety of unsuccessful policies. Each enterprise was expected to observe a basic criterion of financial viability, and, if it failed to do so during the review that the authorities intended to undertake every few months, it would be closed down and its assets sold to the private sector. While the staff welcomed the new policy, it agreed with the comments made by several Directors that the authorities needed to define more broadly and more clearly their long-term goals with respect to the role of the public enterprises in economic development. The authorities had stated their intention to have the World Bank staff undertake a detailed study of that question.

Several Directors had referred to the expected request by Guinea for a drawing under the compensatory financing facility, the staff representative remarked, particularly to the reason why the request had not yet been put before the Board. The request had been forwarded by the Guinean authorities subsequent to the final negotiation on the stand-by arrangement in July, and the staff had discussed with them the data that the Guinean representatives had presented in Toronto. A number of technical problems concerning the data had had to be resolved, and it had not been possible to do so in time for the present Board meeting. It had been agreed that the exchange rate review mission that was to go to Guinea in the near future would look into the question more thoroughly and would establish agreement with the authorities on data that would serve as the basis of the request.

The question of what further increases in interest rates might be necessary in light of Guinea's inflation experience had been raised, the staff representative continued. The staff had discussed the issue in great detail with the authorities, who had felt that the many shortcomings of the banking infrastructure presented a more important obstacle to the mobilization of the resources that financial factors did. The staff had studied the question and, having found merit in the authorities' argument, it had therefore supported their request for technical assistance in banking. As Directors were aware, the request had been granted, and, beginning in January 1983, Guinea would be benefiting from the services of a Fund-sponsored resident expert in some of the basic practical aspects of banking. Another factor in the staff's thinking had been the existence of forced savings, resulting in physical holdings of cash rather than deposits at banks. Part of the explanation was the strict controls on foreign trade when inflation was very high, and part was a problem of confidence that would take time to resolve. It was expected that when the fundamental obstacle of the inadequacies in the banking infrastructure had been removed, it would then be a suitable occasion to re-examine the adequacy of interest rates.

With regard to the prospects for more substantial reductions in external payments arrears, the staff representative added, the position of the authorities during the negotiations had been that SDR 20 million was the maximum reduction that they could undertake in the present circumstances, was given that net reserves were substantially negative and that gross reserves were negligible. However, as stated in the letter of intent, if the expected improvement in the overall situation took place, it would be possible to consider a more substantial reduction in the course of Guinea's relationship with the Fund. The present program was viewed by the authorities as the beginning of a process of making the necessary adjustments in the economy.

The staff shared the concern expressed regarding recurrent expenditures relating to the OAU project, the staff representative remarked. The staff had tried to ensure that the authorities took adequate account of the fact that there might be recurrent expenditures brought about by the project, even after the OAU Conference had taken place. The authorities had assured the staff that they were aware of the possibility and that they would do their utmost to minimize such recurrent expenditures. The authorities also intended that expenditure from their own resources would be kept to a minimum and that foreign assistance would be mobilized, as much as possible on a concessional basis.

The decline in the terms of trade projected in EBS/82/207, the staff representative observed, was based on data furnished by experts in Guinean mining companies with whom the authorities worked in partnership in the mining of bauxite and alumina. The data allowed for increases in export prices in 1983 of about 5-7 per cent; however, the projected increase in import prices was slightly higher, resulting in a deterioration in the terms of trade.

The development of the private market was a crucial element in the program, the staff representative noted. It was important to know the size of the market and to develop a strategy for integrating it with the rural economy. The technical question of estimating the size of the private market had been extremely difficult to answer because of the problem of finding reliable data on which projections could be based. The staff had refrained from making projections based on inadequate data and had therefore concentrated on trying to assess the extent of the authorities' commitment to the private sector. The staff had concluded that there were indications that the commitment was fundamental in the medium to long term. The only areas in which it had been possible to be precise about the medium-term to long-term commitments were the balance of payments and external borrowing, hence the requirements in the program that the decline in foreign assets be arrested for the time being, and that external borrowing be limited to relatively small amounts. As for other data, the staff had worked closely with World Bank staff, who, in response to a request from the Guinean authorities, were attempting to restructure the 1981-85 Development Plan so as to make it more internally consistent and to integrate it with the Fund's financial program. Until that work was further advanced, it was difficult to make meaningful medium-term projections in the context of a financial program.

The question of supply responses to recent price increases had been raised by Mr. Dallara, the staff representative continued. The increases put into effect in February 1982 had been based on a World Bank study, and it had been intended that they should be sufficient not only to cover costs but also to leave an adequate profit margin. Since then, however, the parallel market had expanded significantly, and the higher prices in that market for a number of commodities had made it more profitable for producers to sell there, despite the increase in official prices. To that extent, the staff could conclude that the supply response had been substantial; however, it was difficult to determine how much of the increase in supply reflected a diversion of what had previously been sold outside Guinea and how much reflected new output.

The staff had looked carefully into the question of the profitability of the mining sector, particularly in view of the position of the syli versus other currencies, the staff representative from the Exchange and Trade Relations Department commented. One consideration had been that Guinea was an efficient producer of minerals, richly endowed, and profitability had been increasing in recent years to about $22 per ton. A second consideration had been that the mining companies operated in an enclave, so that their local currency costs were minimal. Their profitability was primarily determined by costs and prices in dollars, and in those terms they had been doing well.

The staff representative from the Exchange and Trade Relations Department noted that one Director had suggested that the program was more in the nature of a first credit tranche program, while others had observed that Fund support should have been larger. The staff was convinced that the program provided for a substantial effort and that therefore, it met the standard of an upper tranche arrangement. For example, the size of the adjustment, as measured by the expected change in the budget deficit, was large. The ratio of the public sector deficit to GDP was expected to decrease from 8 per cent in 1981 to 5 per cent in 1982 and to 2 per cent in 1983. A similar effort was expected on the balance of payments. Furthermore, in terms of the specification of the measures called for under the program, the program clearly met the standard of a substantial effort. The measures covered a wide spectrum, ranging from the usual measures related to the fiscal area, to public enterprises, the exchange rate, and other areas.

Ideally, a greater degree of specification might have been sought in some areas, the staff representative continued, particularly with regard to public enterprises and the exchange rate. While the program provided that budgetary support to public enterprises would end and that bank credit to public enterprises would stay at the present level, it did not specify the individual steps that would be taken in respect of each major public enterprise in order to achieve that objective. Similarly, with regard to exchange rate policy, the Government would limit transactions at the official rate so that there would be no net loss on transactions through the official market, leaving all other transactions to be cleared by the parallel market. It could be argued that that was not an adequate level of specification in such an important area of the program. On the whole, the staff had concluded that while the program itself represented a fundamental reorientation of economic policies, certain questions remained unanswered, at least to the extent that might have been desired. Therefore, the staff had recommended an upper tranche arrangement, but had believed that it would be appropriate to hold the level of Fund support to slightly above the second credit tranche level. Since Guinea's problems were clearly structural, an ideal program would have been medium term. However, many uncertainties existed, including the question of expenditures on the OAU project. The balance of factors had led the staff to provide that a mid-year review would be conducted fairly early in the program and, additionally, that purchases under the program prior to the mid-year review would be held to slightly above the first credit tranche.

Miss Le Lorier acknowledged that it was inappropriate to build precise, quantified scenarios in cases in which the data were subject to question or in which sensitivity to external developments made the exercise impracticable. She suggested that, when projections proved as difficult as in Guinea's case, an attempt should be made to delineate areas of policy that appeared crucial to long-term growth and to define, at least tentatively, a sequence of adjustment measures. That view did not imply prescribing detailed measures at the microeconomic level vis-à-vis individual public enterprises, but rather, for example, attempting to define what supply constraints, other than the level of producer prices, affected agriculture, and outlining a sequence of steps that could be taken to alleviate them. In other words, it was necessary to distinguish between medium-term prospects and medium-term scenarios.

Mr. Sangare commented that his authorities were most concerned about the problem of external debt and that they had therefore committed themselves to severely limiting the number of new loans. With regard to arrears, the Guinean Government had followed a bilateral approach to date and had been able to obtain some debt relief in that way. However, about 70 per cent of the country's debt was owed to two countries, the Soviet Union and China, which were not members of the Paris Club. Only about 42 per cent of external arrears were owed to members of the Paris Club; the authorities had therefore considered that a multilateral debt rescheduling would have had no significant impact on their situation. However, following discussions with the Fund staff, they had reconsidered their position and were demonstrating greater flexibility.

Commenting on the exchange rate, Mr. Sangare stated that the Guinean authorities had, until recently, been reluctant to accept a devaluation of the syli. However, with the expansion of the private sector and with almost 90 per cent of trade passing through the parallel market, the authorities were more prepared to see the two exchange rates merged. Therefore, they had requested in their letter of intent that a study be undertaken on the appropriateness of an adjustment of the currency. He could assure Directors that the Guinean authorities were prepared to take whatever decisions were necessary to redress the imbalances in the economy.

With regard to the question of the OAU Conference, Mr. Sangare continued, Directors should recall that Guinea had been a founding member of the organization in 1963 but had never previously hosted the OAU summit. The Government had been requested to host the 20th anniversary meeting of the OAU and, as Mr. Malhotra and Mr. de Groote had correctly indicated, that was a priority decision for the country. Indeed, it was a priority for Africa that the OAU should play a role in encouraging cooperation among African countries and between Africa and the rest of the world. While such cooperation might initially be on political issues, it opened the way to economic cooperation, and the hosting of the summit could be taken as an indication of the increased openness of Guinea to the rest of the world. Directors should understand the importance of the commitment to the OAU among African countries.

His Guinean authorities shared the view expressed by Mr. Salehkhou regarding the size of the amount to be provided by the Fund under the program, Mr. Sangare noted. In view of the measures already taken and the significant reorientation of economic policies, they had expected that more resources would have been made available. Nevertheless, they had accepted the proposed amount because they were committed to showing their willingness to undertake the adjustment of their economy. They hoped that the small size of the program would not hinder the continued implementation of the new policies and that, as some Directors had suggested, an extended arrangement involving a substantial amount would follow the present stand-by arrangement.

The Executive Directors turned to the proposed decisions, which they approved.

The decisions were:

Stand-By Arrangement

1. The Government of Guinea has requested a stand-by arrangement for a period of one year beginning December 1, 1982, in an amount equivalent to SDR 25 million.

2. The Fund approves the stand-by arrangement attached to EBS/82/207.

Decision No. 7255-(82/154), adopted
December 1, 1982

Exchange System

Guinea maintains the following measures subject to Fund approval under Article VIII, Sections 2 and 3: (a) multiple currency practice arising from a dual exchange rate structure; (b) maintenance of external payments arrears; and (c) bilateral payments agreements with Fund members. The Fund welcomes the declaration of the Guinean authorities that these restrictions are being maintained essentially on a temporary basis. In the circumstances, the Fund grants approval of the restrictions referred to under (a) and (b) of this paragraph until February 28, 1983, or the completion of the review of the stand-by arrangement, whichever is the earlier; the Fund also welcomes the progress made by Guinea in reducing reliance on bilateral payments arrangements.

Decision No. 7256-(82/154), adopted
December 1, 1982

4. MALAWI - PURCHASE TRANSACTION - BUFFER STOCK FINANCING FACILITY - SPECIAL STOCKS UNDER INTERNATIONAL SUGAR AGREEMENT

Executive Directors considered a request by Malawi for a purchase equivalent to SDR 0.922 million under the buffer stock financing facility (EBS/82/201, 11/4/82).

Mr. Sangare noted that the purchase was the first that Malawi had requested under the buffer stock financing facility to finance sugar stocks. Malawi's balance of payments had weakened in recent years. The overall balance had deteriorated from a surplus equivalent to 0.7 per cent of GDP in 1980 to a deficit of 2.2 per cent in 1981, with no improvement expected in 1982. Total exports were projected to decline by about 11 per cent from the previous year's level, mainly as a result of the decline in sugar exports caused by lower prices. Hence, the improvement in the current account primarily reflected the decline in imports and reduced outflows for services. Meanwhile, gross reserves, which had declined from SDR 61.5 million in 1980 to SDR 48.4 million in 1981, were expected to drop even further in 1982 to SDR 24.7 million, the equivalent of a little more than one month's imports.

The Executive Board had approved a one-year stand-by agreement with Malawi on August 6, 1982, in support of a stabilization program being implemented by the authorities, Mr. Sangare continued. As Directors were aware, the program aimed at stimulating economic growth while bringing the balance of payments position to a sustainable level. The authorities believed that the program would also help to establish the basis for dealing with structural problems in the economy. It was clear, therefore, that Malawi had a balance of payments need and that the authorities had demonstrated their commitment to cooperate closely with the Fund in seeking solutions to the present financial and economic difficulties. The staff had assured the Board that the request satisfied all the requirements of the buffer stock decision, and he therefore urged the Board to approve the proposed decision.

Mr. Grosche said that he supported Malawi's request. It met all the requirements of the relevant Executive Board decisions.

Mr. Diao commented that Malawi had been experiencing serious economic and financial difficulties. The situation had been reviewed by the Executive Board, and a one-year stand-by arrangement had been agreed with the Fund in August in support of the efforts by the authorities to address the country's economic and financial problems and to restore a viable balance of payments position. Malawi was an Annex I member of the International Sugar Agreement and was therefore required to accumulate and hold special stocks amounting to 5,849 tons, for which it was seeking Fund assistance under the buffer stock facility. In view of the balance of payments need facing Malawi and the authorities' determination to take corrective measures and to cooperate closely with the Fund, his authorities lent their full support to the proposed decision.

Mr. Prowse expressed strong support for the decision.

Miss Le Lorier remarked that she also supported the proposed purchase. She noted that Malawi had accumulated its total compulsory contribution well in advance of the deadline of December 1983. She wondered whether the staff could indicate the reasons for that decision and whether there were other countries that had also contributed to the sugar buffer stock well in advance of the deadline.

Mr. Dallara observed that the request by Malawi met all the relevant criteria set forth in the buffer stock financing decision as well as in the decision relating to the financing of special stocks under the Sugar Agreement. He joined other Directors in supporting the request.

The staff representative from the Research Department said that several countries were facing a difficult situation arising from the export restrictions imposed, as a market stabilization measure, under the terms of the International Sugar Agreement. Unmarketable supplies could be declared special stocks for the purpose of the Agreement, and many countries were taking up that option. By doing so, they forfeited the right to export the supplies until the market price recovered to a sufficient level.

Conditions in the world sugar market had entered a very serious stage, the staff representative added. It was widely recognized that the Agreement had not been able to cope with the pressures of excessive supplies on the market. Prices had reached extremely low levels: at present, they were probably less than half of the cost of production of the most efficient producers of sugar, and there appeared to be no relief in sight. It was likely that the surplus of production would continue for several years, a situation that raised questions for the members of the International Sugar Agreement. One suggestion put forward by some members of the Agreement had been to advance the negotiation of the next agreement so that a successor agreement, with more effective economic provisions, could enter into force by January 1984 instead of January 1985. It was difficult to say what the prospects were for that proposal, but preparatory meetings had been scheduled, with an international conference tentatively planned for May 1983.

Executive Directors turned to the proposed decision, which they approved.

The decision was:

1. The Fund has received a request by the Government of Malawi for a purchase of the equivalent of SDR 0.922 million under the decision on Buffer Stock Financing: The Problem of Stabilization of Prices of Primary Products, Executive Board Decision No. 2772-(69/47), adopted June 25, 1969, as amended by Decision No. 4913-(75/207), adopted December 24, 1975, and the decision on Buffer Stock Financing Facility: 1977 International Sugar Agreement, Executive Board Decision No. 5597-(77/171), adopted December 16, 1977.

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

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

Decision No. 7257-(82/154), adopted
December 1, 1982

5. PERU - 1982 ARTICLE IV CONSULTATION, AND REVIEW OF EXTENDED ARRANGEMENT

Executive Directors considered a staff report for the 1982 Article IV consultation with Peru and a review of the extended arrangement for that country (EBS/82/191, 10/19/82). They also had before them a report on recent economic developments in Peru (SM/82/211, 11/10/82).

Mr. Donoso stated that the staff had correctly asserted in EBS/82/77, (5/4/82), that "the Peruvian authorities have set in motion the structural changes needed to lead to a faster long-term growth of output and employment." One of the main characteristics of the medium-term economic program designed to improve economic efficiency and resource allocation was the opening of the economy to international competition. In order to promote the development of those economic areas in which Peru had a comparative advantage, the authorities were intending to achieve a reduction in the average tariff from the level of 32 per cent existing at the end of 1981 to 25 per cent by the end of 1984, together with a reduction in the degree of tariff dispersion from 17 per cent at the end of 1981 to 8 per cent; a reduction in subsidies to nontraditional exports; and the elimination of the state monopoly on imports of a number of agricultural products. There had been no reversal of trade policies implicit in the measures adopted to raise government revenue, but only a temporary slowing of progress toward the permanent objectives set out in the staff report.

A second feature of the medium-term program, Mr. Donoso continued, was the modification of the legal and administrative structure of the domestic economy in order to stimulate private investments and to improve the functioning of market mechanisms. Important legislative changes in that area included the Agricultural Promotion Law, which was intended to improve the productivity of the agricultural sector and increase the area of land used for agriculture. The law formalized land holdings acquired through the Agrarian Reform Law, improved the creditworthiness of the agricultural sector, authorized the maintenance of support prices for the main agricultural products, and promoted the expansion of technical support services provided by the Government and of investment in rural roads, small-scale irrigation, and marketing facilities. In addition, the Petroleum Law modified the standard model of contracts with foreign investors. The law introduced tax incentives for reinvestment of profits and eliminated the state monopoly in secondary recovery. There was also the Mining Law, permitting foreign private capital to be invested in partnership with the Government and introducing a variety of incentives for investment and reinvestment. The Industrial Law improved the terms of worker participation in profits and ownership, and created better conditions for the participation of the private sector in industry. Finally, the Electricity Law opened up the electricity sector to private investment.

Furthermore, the role and scope of the public sector had been more clearly defined, Mr. Donoso remarked. The Government had entrusted the National Development Corporation with the job of defining the criteria under which enterprises currently under state ownership should remain public, and with deciding which enterprises should be transferred to the private sector. In addition, there had been a reduction in the range of commodities subject to price controls. Only a few of the 130 commodities with prices under control or regulation in mid-1980 were still subject to such control. Improvements had also been made in the functioning of the domestic financial market. A more realistic level and structure of interest rates had been adopted to promote an increase in domestic savings. There had been measures aimed at enhancing competition among financial intermediaries, at reducing the degree of intervention of the monetary authorities in financial intermediation, and at increasing the degree of financial intermediation in the economy.

Another feature of the medium-term program, Mr. Donoso observed, had been the definition of a World Bank-supported public investment program aimed at creating physical infrastructure to foster economic development, expanding productive capacity in crucial sectors, and improving the living conditions of the rural and urban poor. In that regard, considerable efforts were being made to strengthen the public sector's capacity to prepare and operate projects.

The program's development had encountered difficulties in 1981, Mr. Donoso noted, when the Peruvian economy had experienced a deterioration in its financial performance. The rate of inflation had accelerated from 61 per cent in 1980 to 73 per cent in 1981. The balance of payments had registered an overall deficit of $600 million in 1981, after a surplus of $2 billion in 1979-80. An important factor behind the balance of payments development had been the deficit of the nonfinancial public sector, which had reached 8.5 per cent of GDP in 1981, when the country's terms of trade had deteriorated significantly. In response, the Peruvian authorities had implemented a series of measures in late 1981--including accelerating the pace of exchange rate depreciation and raising interest rates--to strengthen the public sector's finances and the balance of payments.

In support of the authorities' medium-term strategy and of their policies to restore balance of payments equilibrium, Mr. Donoso recalled, the Fund had granted Peru an extended arrangement of SDR 650 million in June 1982. The main effort had been focused on reducing domestic demand, with accompanying measures to keep interest rates, the exchange rate, and controlled prices at realistic levels. The overall deficit of the public sector was to be reduced to slightly above 4 per cent of GDP to help to bring the current account deficit down to 6 per cent of GDP and to reduce the loss of net international reserves to $100 million. Peru had been in compliance with the quantitative performance criteria subject to quarterly limits on the first quarterly test date, June 30, 1982. The quantitative performance criteria subject to continuous testing had been steadily observed through August 31, 1982.

However, difficulties had appeared during the third quarter of 1982, Mr. Donoso pointed out, as a result both of the larger than expected deterioration in the terms of trade and of the prospect for a larger overall deficit of the public sector than had been projected. The deterioration in the terms of trade accounted for most of the reduction of $400 million in exports for 1982 relative to the projections made at the time that the program had been designed. The public sector's financial difficulties had arisen from lower than projected tax revenues, from the failure to eliminate price and wheat subsidies in a timely fashion, and from large operational losses of MINEROPERU and CENTROMIN, the two state-owned mining corporations, as a result of low mineral prices. Other factors had been the excess of current expenditures in conjunction with a large investment program in ELECTROPERU, the national electricity company.

Strong measures had been taken to reduce the public sector deficit, Mr. Donoso stated. Drastic cuts in nonwage current spending had been effected, the scheduled October quarterly wage adjustment had been reduced, and investment spending had been restrained. In addition to their impact on public finances, those measures had helped to alleviate the external current account through reducing imports by about $150 million. The fact that such a reduction had been accomplished by measures applied only during the second half of the year indicated the magnitude of the effort being made to attain the overall financial adjustment sought by the authorities. The Peruvian authorities expected that such measures would maintain the overall balance of payments performance for 1982 in line with the original targets.

The staff had pointed out that Peru had not yet been able to benefit fully from the important structural reforms implemented, Mr. Donoso remarked. The main effect of greater exchange rate and interest rate flexibility, as well as of higher efficiency in financial intermediation and trade policy, were yet to be seen. The authorities believed that demand and wage policies already in effect would offset the deterioration of external conditions, and they expected that the pursuit of external equilibrium, together with the implementation of market-oriented structural reforms, would quicken the pace of economic activity in the country.

Mr. Arias commented that the Article IV consultation and review of the extended arrangement with Peru was timely because the authorities had managed to keep the program on track through major adjustment efforts and, therefore, deserved continued Fund support. The principal objectives contained in the extended arrangement approved by the Executive Board on June 7, 1982, included, first, an inflation rate of 60 per cent for 1982; second, a reduction in the overall balance of payments deficit to $100 million; and, third, an overall domestic investment level equivalent to 23 per cent of GDP in 1983. Each of those objectives had largely been met.

Even though the inflation rate in 1982 was marginally greater than targeted, the authorities had made tremendous efforts to contain inflation during the period of adjustment, Mr. Arias considered, at a time when the most fundamental relative prices of the economy were being corrected to reflect true scarcities. Monthly price increases of petroleum derivatives were being speeded up from 7.8 per cent to 12 per cent, electricity tariffs had been increased, basic food subsidies had been eliminated, interest rates had been increased to make them positive in real terms, and there had been frequent depreciations of the Peruvian sol. Wage adjustments had also been taking place and they had obviously contributed to inflationary pressures; nevertheless, the authorities had been courageously resisting wage-push pressures by limiting increases to less than the rate of inflation. He strongly supported the efforts of the authorities to continue to resist those pressures and urged them to break the link to cost-of-living adjustments by giving the National Labor Council a more active role in the negotiation of further wage increases.

In one year, the Peruvian authorities had successfully reduced the overall deficit of the balance of payments, Mr. Arias noted, from $600 million in 1981 to a projected $100 million for 1982. Their timely additional demand management policies would assure compliance with the targeted reduction in the external deficit. The return to the agreed schedule for the elimination of wheat and rice subsidies was particularly important.

The deterioration of international trade and the depressed external prices for minerals had played an important role as a result of the unexpected operational losses of MINEROPERU and CENTROMIN, Mr. Arias remarked. While he appreciated the strong commitment of the authorities to maintain the program on track, he hoped that the decision to implement additional investment cuts in energy and transportation projects would affect only projects, the temporary suspension of which did not widen the resource gap in future through the opportunity cost of foreign exchange not earned or saved in those investments.

Holding the loss of international reserves to $90 million in the first half of 1982 demonstrated that monetary and credit policy had again become consistent following the large increase in 1981 in credit to the nonfinancial sector, Mr. Arias continued. He urged the authorities to maintain the overall growth of bank credit in line with the growth of money and quasi-money, variables that appeared to be responding positively to the realistic interest rates that had been implemented.

Fiscal constraints had prevented an increase in the level of domestic investment higher than the projected 21 per cent of GDP for 1982, Mr. Arias observed. Nevertheless, that increase was already a substantial improvement over the 17 per cent in 1980, and there were growing signs that favorable responses from both the domestic and foreign private sector would play a key role in reaching the 1983 investment target of 23 per cent of GDP. Could the staff or Mr. Donoso provide details on the status of the investment program that had been set up under the aegis of the consultative group of the World Bank?

The Peruvian authorities should be congratulated for the capable management of their external debt, Mr. Arias suggested. Their reliance on concessional debt for development projects, and the legislated control of commercial debt through overall ceilings and through greater supervision by the Banco de la Nación and COFIDE, provided an example that other countries could follow.

Mr. Grosche stated that the Peruvian authorities were to be commended for their firm commitment to a medium-term strategy of structural reform. The short-term measures undertaken within the broader framework had produced some progress in the first half of 1982. The public sector deficit had been reduced to 5.5 per cent of GNP, and the inflation rate had been only 62 per cent at the end of July. At the end of August, Peru had been in compliance with all the quantitative performance criteria of the program and with the understandings related to the exchange and trade system. However, the poor export performance arising from lower international prices and the slippages in implementing budgetary restraint posed serious difficulties in achieving the objectives set out in the program.

The further increase in the external current account deficit in the first half of 1982 had been disappointing, Mr. Grosche considered, especially in view of Peru's high debt service ratio. If the deterioration was not reversed, he questioned the staff expectation that debt service payments through 1986 were likely to remain manageable. Therefore, additional adjustment measures appeared necessary, not only to attain the targeted reduction in the external account deficit, but also to strengthen Peru's international creditworthiness. In that context, he welcomed Peru's intention to pursue cautious debt contracting policies and to give priority to borrowing from bilateral and multilateral development agencies.

In addition, since mid-1980, the authorities had been making steady progress toward improving the procedures governing the contracting and the monitoring of disbursements of external public debt. Those control mechanisms had only recently been complemented by new rules for the contracting by nonfinancial state enterprises of public debt with maturities of less than one year. He hoped that those most recent steps would help to bring about better control of the short-term foreign borrowing by state enterprises, borrowing that had grown rapidly in recent months. Those credits had not been included in the performance criteria, and the need to repay them at short notice could endanger Peru's still fragile international creditworthiness.

The authorities had already decided to ensure that fiscal performance for 1982 remained broadly as envisaged in the original program, Mr. Grosche continued. However, he doubted whether the targeted budget deficit of 5.5 per cent of GNP for all of 1982 could be attained without taking further measures. He invited the staff to comment on that question. The unexpectedly high operating losses of state enterprises, particularly in the mining sector, called for additional efforts. He shared the staff's view that a major tightening in fiscal and monetary policy, together with a quick elimination of subsidies, and restraint on wage policy, would be crucial in bringing about a substantial reduction in inflation during 1983. He welcomed the authorities' intention to abandon the system of granting quarterly wage adjustments to public sector employees and nonunionized private workers, but he believed that the close relationship between price increases and wage increases should be ended in the private sector as a whole.

Monetary policy had played a positive role in bringing about more balanced development, Mr. Grosche suggested. However, the possible higher than expected net domestic credit needs of the nonfinancial public sector might raise the net domestic assets of the monetary authorities above the level envisaged in the program. He therefore supported the staff's recommendation to halt further credit expansion to development banks and to the export and mining sector. The possible imposition of a marginal reserve requirement on deposit liabilities might help to bring about the envisaged result.

Exchange rate policy had supplemented the adjustment process to date only to a limited extent, Mr. Grosche remarked. The accelerated pace of exchange rate depreciation since the middle of 1981 had not been sufficient to re-establish Peru's competitiveness lost in preceding years as a result of the strength of the U.S. dollar. Perhaps the basis for exchange rate policy should be not the U.S. dollar but rather a basket of currencies of Peru's main trading partners.

Mr. Lovato commented that the staff's description of economic developments and policies in Peru had been exhaustive, and the issues involved in the current review did not appear to be at all controversial. He agreed broadly with the emphasis in the staff appraisal on the design, execution, and control of an effective anti-inflation strategy. Disinflation was the most urgent medium-term policy target that the Peruvian authorities had set out to attain. An array of instruments had to be devised and used to accomplish the task, for no single instrument would be capable of accomplishing it alone.

When the Peruvian request for Fund assistance had been discussed by the Board in June, Mr. Lovato recalled, some Directors had suggested that the staff should undertake a special analytical effort to investigate countries with persistently high inflation rates and to recommend on that basis a range of policy options for overcoming the problem of inflation in the context of Fund-supported programs. Extended arrangements obviously gave greater leeway and greater opportunities for experimenting with corrective actions for structural adjustment that could be instrumental in reducing inflation in combination with more conventional demand restraint measures.

The authorities were to be commended for fully observing the two quarterly performance criteria on net international reserves and on net domestic debt of the nonfinancial public sector, Mr. Lovato continued. The two targets under constant review, the net domestic assets of the monetary authorities and the contracting of foreign debt, had been continuously observed by a wide margin. However, external events and slippages on the fiscal front had contributed to undercutting the adjustment program for the second half of 1982. Supplementary measures were therefore needed to ensure that the program would be implemented effectively.

There were a few areas of major uncertainty, Mr. Lovato considered. First, there seemed to be a trade-off between current account adjustment and inflation control as far as exchange rate policy was concerned. While a steadily depreciating currency was helpful in redressing external imbalances, it could adversely affect the country's anti-inflation strategy. Had the staff attempted to quantify the two effects of a continuous depreciation? Would a stronger exchange rate help reduce inflation in the Peruvian economy?

Second, imports had risen at a remarkably high rate in 1981, Mr. Lovato remarked, although they appeared to be stationary in 1982. Was the staff able to estimate, even qualitatively, the impact of the tariff surcharge imposed in early 1982? How price-elastic were Peruvian imports? An argument could be made that the trade liberalization process encouraged by the staff and the authorities, while desirable in principle, was inconsistent, at least to some degree, with the actual scope for import competition in the country.

Third, fiscal policy had been assigned a leading role in the adjustment program, Mr. Lovato noted. Fiscal restraint was to be based upon a combination of higher tax revenue, tighter control of current and capital public expenditures, and the removal of price subsidies from basic necessities. That combination was expected to result in a drastic reduction in the overall deficit of the public sector, from 8.6 per cent of GDP to 4.2 per cent. That targeted reduction had been overambitious. The deficit projected for 1982, at 5.5 per cent of GDP, represented an impressive achievement. However, an anti-inflation strategy could not rely solely on fiscal restraint, but had to be supplemented by incomes policy. He encouraged the authorities to find ways to set negotiated guidelines on prices and wages and to modify the cost of living escalator mechanism for private and public sector wages.

Executive Directors agreed to resume their discussion in the afternoon.

6. REPORT BY STAFF

Executive Directors heard a report by the Treasurer on the recent meeting of G-10 Deputies in Paris.

The Treasurer stated that the G-10 Deputies had had a general exchange of views on pending international monetary issues, in particular on the Eighth General Review of Quotas in the Fund, and on the assessment of existing arrangements, including the General Arrangements to Borrow, to cope with major strains in the international monetary system.

With regard to the Eighth General Review of Quotas, the Treasurer continued, there had been a widespread feeling among the Deputies that it would enhance confidence in the functioning of the international monetary system if the quota review could be completed earlier than had been contemplated in Toronto and that, if possible, the date of the next meeting of the Interim Committee could be advanced. On that point, the general feeling had been that further thought would need to be given in the coming weeks to what work was still required and to how to assure a successful outcome of such an earlier meeting of the Interim Committee before a decision could be taken on the setting of a date.

With regard to the existing financial arrangements to cope with current major strains in the international financial system, the Treasurer observed, it had generally been considered desirable to build on the existing forms of borrowing arrangement in the Fund. In particular, discussion had centered on the General Arrangements to Borrow (GAB) and on how the GAB might be adapted to serve broader purposes. In that connection, consideration had been given to enlarging the size of the GAB and to what arrangements might be introduced to permit the Fund to call on the GAB to finance purchases of non-GAB participants if the liquidity of the Fund and the strains in the international monetary system required such a supplement to the Fund's resources. The Deputies would meet again on December 10 to consider those issues further in detail.

The Chairman said that it was an appropriate time to discuss the question of the chairmanship of the Interim Committee. An informal meeting on that question would be held in his conference room in the afternoon, following the conclusion of the Board's discussion on the Article IV consultation with Peru.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/82/153 (11/24/82) and EBM/82/154 (12/1/82).

7. NEPAL - 1982 ARTICLE IV CONSULTATION - POSTPONEMENT

The Executive Board notes the request contained in EBD/82/252, Supplement 1 (11/24/82). Notwithstanding the period of three months specified in Procedure II of the document entitled "Surveillance over Exchange Rate Policies" attached to Decision No. 5392-(77/63), adopted April 29, 1977, the Executive Board agrees to postpone its consideration of the 1982 Article IV consultation with Nepal until not later than December 13, 1982. (EBD/82/252, Sup. 1, 11/24/82)

Decision No. 7258-(82/154), adopted
November 29, 1982

8. RELATIONS WITH GATT - CONSULTATIONS WITH CONTRACTING PARTIES - FUND GUIDANCE

The Executive Board approves the proposal set forth in EBD/82/258, Supplement 2 (11/23/82).

Decision No. 7259-(82/154), adopted
November 26, 1982

9. APPROVAL OF MINUTES

The minutes of Meetings 82/88 and 82/89 are approved. (EBD/82/287, 11/18/82)

Adopted November 24, 1982

10. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/82/403 (11/24/82), EBAP/82/404 (11/24/82), EBAP/82/406 (11/29/82), EBAP/82/407 (11/29/82), and EBAP/82/412 (11/30/82) is approved.

11. STAFF TRAVEL

Travel by the Deputy Managing Director as set forth in EBAP/82/405 (11/26/82) is approved.

APPROVED: May 11, 1983

LEO VAN HOUTVEN
Secretary