

~~Mr. Guetta~~
~~Mr. Taplin~~
~~Mr. Rosenblatt~~
~~Mr. Blin~~
~~Mr. Ainselle~~
~~Mr. Ley~~
~~Mr. Blackwell~~
~~Mr. Chatham~~

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 82/158

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

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

Executive Directors

Alternate Executive Directors

B. de Maulde

M. K. Diallo, Temporary
 M. Hull, Temporary
 L. E. J. Coene, Temporary
 A. Le Lorier
 J. Delgadillo, Temporary
 C. Dallara
 M. A. Janjua, Temporary
 Jaafar A.

T. Hirao
 R. K. Joyce

C. Robalino
 G. Grosche
 G. Gomel, Temporary
 A. S. Jayawardena
 S. El-Khoury, Temporary
 J. Schuijjer, Temporary
 H.-S. Lee, Temporary
 O. Kabbaj
 J. M. Jones, Temporary
 J. L. Feito
 L. Vidvei
 Wang E.

G. Laske

G. Salehkhoul

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

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Also Present

Asian Department: H. Neiss, Deputy Director; W. G. L. Evers, F. Palanza, T. J. Rommel, K. Saito. Exchange and Trade Relations Department: W. A. Beveridge, Deputy Director; D. K. Palmer, Deputy Director; M. Allen, R. Pownall. Legal Department: J. V. Surr. Personal Assistant to the Managing Director: N. Carter. Advisors to Executive Directors: J. R. N. Almeida, P. Kohnert, I. R. Panday, P. D. Pérez. Assistants to Executive Directors: H. Arias, L. Barbone, M. Camara, G. Ercel, P. Leeahtam, W. Moerke, V. K. S. Nair, J. G. Pedersen, G. W. K. Pickering, J. Reddy, D. I. S. Shaw, H. Suzuki, P. S. Tjokronegoro, J. C. Williams, Zhang X.

1. MEXICO AND ARGENTINA - REPORT BY MANAGING DIRECTOR

Executive Directors heard a report by the Chairman on negotiations between Mexico and Argentina and commercial banks.

The Chairman announced that conclusions had been reached in the negotiations, in which the Fund had taken part, between the authorities of Mexico and of Argentina and the respective advisory groups of international bankers. The responses of the individual banks involved in both sets of negotiations were awaited.

He had requested the advisory group for Mexico to inform him of the responses of the banks by December 15, 1982, the Chairman continued, in order to have the information in hand before the meeting of the Board to discuss Mexico's request for Fund support on December 23, 1982. He would remain in daily contact with the advisory group.

The new commitments by the banks called for in the agreement with Mexico were substantial, the Chairman observed, amounting to \$5 billion new net exposure in 1983 to be shared among the banks concerned in proportion to the exposure of each bank in the total stock of outstanding credits to Mexico. The agreements encompassed a restructuring of the stock of short-term, medium-term, and long-term debt of Mexico covering 1983 and 1984, and they would spread the maturities due over those two years over a period of eight years, with four years of grace. The agreement also contained an understanding that the banks that had deposits with those Mexican agencies operating in the interbank market would maintain their deposits at their present levels. The agreement thus provided solutions to some of the problems that had gone unresolved in previous debt renegotiations, namely, how to ensure that the new commitment made by the banks in terms of credits of more than one year would not be undermined by withdrawals of short-term deposits or short-term credits. It had therefore been important at the technical level to include the short-term financial credits in the restructuring operation and to address separately the problem of maintaining the level of the deposits with the interbank market agencies. The agreement thus contained a number of new technical features, and it represented an innovation in consultation between the Fund and the banks. The latter had been extremely cooperative in the course of the negotiations.

The Fund had not intervened in discussion of the financial terms of the new arrangements, the Managing Director noted, other than to offer the general advice that he had given on November 16 and 17, 1982 that the conditions should be as realistic and moderate as possible. By common consent, the terms had been resolved by the Mexican and Argentine authorities and the banks. The Fund had worked closely with the delegations of the two countries on issues such as the amounts of new money and the terms of the reschedulings, as well as on the question of how best to coordinate the overall effort, including such questions as the relationship between the banks' commitments and the drawings on the Fund. A number of legal aspects had also been dealt with. He had sent telexes to the appropriate Central Banks and Ministries of Finance describing the terms of the agreements.

Executive Directors took note of the Chairman's remarks.

2. LAO PEOPLE'S DEMOCRATIC REPUBLIC - 1982 ARTICLE IV CONSULTATION

Executive Directors considered a staff report for the 1982 Article IV consultation with the Lao People's Democratic Republic (SM/82/214, 11/12/82). They also had before them a report on recent economic developments in the Lao People's Democratic Republic (SM/82/218, 11/18/82).

Mr. Jaafar made the following statement, on behalf of Mr. Habib:

In 1980, the Lao authorities adopted a Five-Year Development Plan for 1981-85. Development of the agricultural and forestry sector, and improvements in the economic infrastructure, form the major objectives of the Plan. Production of foodgrains is expected to be raised to a level that will make the country self-sufficient. The infrastructure for internal and external transportation will be improved to promote both external trade and internal distribution of consumer goods and agricultural and industrial inputs. One of the major constraints to an effective and quick implementation of the Plan is the shortage of skilled and managerial manpower. These shortages are being remedied through various training programs, but it appears that manpower problems will continue for some time. In the meantime, Lao will have to rely heavily on foreign technical assistance in implementing its Development Plan. In 1981, the total value of foreign technical assistance was \$28 million.

In recent years, the country has made considerable economic progress in spite of the adverse international economic environment and the temporary closure of access to the port of Bangkok, which has been the main route for Lao imports and exports. In 1979 and 1980, the real GDP growth of 10 per cent was very impressive. In 1981, the growth rate declined to 5 per cent and is expected to decline further in 1982 owing to a drought. Considerable progress has been achieved in foodgrain production, which increased by 50 per cent between 1978 and 1981. This progress has led to the elimination of foodgrain imports. Root crop production has also shown impressive growth of 17 per cent in 1980 and 21 per cent in 1981. These improvements are the result of land reclamation, and of the supply-oriented policies implemented by the Government. The major elements of the supply policies include the relaxation of controls on production and marketing, elimination of restrictions on internal trade, increased procurement prices for the farmers, and the improved availability of consumer goods and of agricultural and industrial inputs.

Price performance continues to be worrisome. The cost of living in Vientiane increased by 3 per cent in 1979, 100 per cent in 1980, and 55 per cent in 1981; it is expected to rise again by 100 per cent in 1982. Numerous internal as well as

external factors have been responsible for the acceleration in the inflation rate. Disruptions in internal transportation, the closure of the Thai border, hoarding, the depreciation of the kip in the parallel market from K 15 per U.S. dollar in 1979 to K 105 per U.S. dollar in 1982, the elimination of subsidies on a large number of consumer goods, and the increases in procurement prices of agricultural commodities have been the major factors behind the high rate of inflation. To the extent that inflation was caused by exchange rate depreciation, by increases in procurement prices, and by the reduction in subsidies on consumer goods, a better balance may result between the demand and the supply of goods. It is hoped that as these price incentives gradually work their way to higher production levels, the rate of inflation will decline and exports will rise to strengthen the balance of payments position.

The budgetary performance has shown a remarkable improvement. As a result of the government program of price rationalization, the state enterprises have been able to increase their transfers to government. A substantial increase in revenues has also been generated from tariff increases on electricity sold to Thailand. Tax revenues have increased substantially because of improvements in tax collection procedures and a higher level of economic activity. At the same time, the Lao authorities have made a bold effort to restrain expenditure by reducing the number of civil servants by 20 per cent in 1981 and by imposing limits on pay increases for civil servants. As a result of these measures, the operating budget, which showed a deficit in 1980, is expected to yield a surplus in 1982. In addition, the authorities have exercised extreme caution in their capital expenditure program by confining themselves to projects that are within their technical competence and for which financing is available. The entire budget deficit is being financed with foreign aid. The monetary policy has been one of restraint, and total liquidity growth fell from 164 per cent in 1980 to only 4 per cent in 1981.

The balance of payments has remained much weaker than expected, although the current account deficit declined somewhat in 1981. The temporary closure of the Thai border, the decline in foodgrain imports, the increase in the price of electricity sold to Thailand, and the exchange rate depreciation have helped in reducing the deficit. As the country intensifies its development efforts, the current account of the balance of payments is likely to continue to show substantial deficits, which will have to be financed with foreign resources. The availability of soft loans and grant aid on a substantial scale will continue to be the key factor in the future balance of payments outcome and on the ability of the Lao authorities to implement their development program. The authorities have already introduced a series of measures to improve economic growth and balance of payments. These measures, which are adequately described in the staff

papers, have started to bear fruit, although improvements in the external sector have been somewhat less than what was expected. The overall developments in the economy and the conduct of financial policies have been satisfactory, particularly in view of the severe shortages of skilled and managerial manpower and the difficult international environment.

On behalf of my authorities and myself, I wish to express our deep appreciation to the staff for its balanced and thorough report of the Lao economy.

Mr. de Maulde noted that there had been a number of positive developments since the previous Article IV consultation with the Lao People's Democratic Republic. Procurement prices of a number of agricultural and forestry products had either been raised or had been left to be determined by the free market. The official exchange rate had been merged with the preferential exchange rate, and the latter had been adjusted from K 30 to K 35 per U.S. dollar. The changes in procurement prices and in exchange rates had been fully reflected in higher official retail prices. In the fiscal area, tax collection procedures had been improved, expenditure restrained, and the number of civil servants reduced by 20 per cent.

To some extent, the measures were a continuation of the policies initiated in 1980, Mr. de Maulde remarked, but developments in other areas pointed in different directions. On the consumer side, the subsidy on rice for public sector employees had been sharply increased from K 0.8 per kilo in 1981 to K 3.6 per kilo in 1982; it represented a little over 13 per cent of budget revenue. At the same time, salary levels had not been adjusted in line with the cost of living, and, together with the reduction in the number of civil servants, there had therefore been a decline in the share of wages and salaries in current expenditure, from 26 per cent in 1980 to 12 per cent in 1982. He invited the staff or Mr. Jaafar to comment on the scope for achieving a better balance between salaries and price subsidies in the total income of public sector employees.

With regard to producer prices, Mr. de Maulde continued, there had been a substantial increase in the price of paddy, and the authorities were convinced that the adjustment had contributed to the expansion of output. It would be essential that adequate incentives would continue to be provided, as per capita rice availability was expected to decline in 1982; self-sufficiency remained fragile. The official procurement price of timber, an important potential export, remained too low despite a sharp increase in early 1982. It was appropriate that a nationwide timber survey should be completed as soon as possible to determine the permissible rate of timber production, review the adequacy of incentives to timber cutters, and undertake a reorganization of the whole timber sector in order to develop exports, estimated at only \$5.9 million for 1982, down from \$8.5 million in 1979.

In the fiscal area, domestic revenue would exceed current expenditure for the first time in 1982, Mr. de Maulde observed, a major achievement. To some extent, the rise in government receipts appeared to stem from a temporary factor, namely, the reduction in excess inventories of state enterprises. The intention of the authorities to increase the rate used for the valuation of customs duties and to seek improvement in the efficiency of state enterprises deserved the Board's strong support. Similarly, he commended their caution in initiating new investment projects.

The staff had abstained from commenting on monetary policy in its appraisal, Mr. de Maulde remarked, in realistic recognition that, in the present circumstances of the Lao economy, it did not appear that monetary policy could play a major role in the adjustment effort. However, the study initiated by the authorities on the structure and level of interest rates would be pertinent. The most important problem remained the external balance, particularly the continuing structural weakness of the export sector despite commendable attempts to overcome it. Data on exports for the first half of 1982 followed the worrying pattern established in 1981; with the exception of electricity, there had been virtually no merchandise exports to the convertible area. In view of the country's heavy dependence on imports of capital goods and basic commodities, and in view of the country's rapidly increasing debt service burden in convertible currencies, it was important to reverse that trend. In that regard, the evidence in Chart I of SM/82/218 suggested that a further, significant adjustment in the level of the preferential exchange rate might well be needed. Together with other incentives to develop exports, especially timber exports, a more active exchange rate policy would be a key element in strengthening the balance of payments.

Mr. Dallara commented that important progress had been made recently in a number of policy areas, including fiscal policy and agricultural policy, progress that deserved the Board's commendation. Nevertheless, much remained to be done if the Lao economy was to continue to move toward a viable balance of payments position.

There continued to be serious problems with regard to domestic resource allocation and mobilization, Mr. Dallara considered, and the external balance, particularly to the convertible area, was under considerable strain. One source of concern was the recent surge in inflation, particularly because of the implications it carried for the underlying developments in the economy. As Mr. Habib had pointed out, the cost of living in the Vientiane area was expected to rise by 100 per cent again in 1982. To some extent, the increase reflected increases in the prices of various goods and services, including rice, coffee, and timber, as well as the depreciation of both the preferential, or official, exchange rate and the parallel exchange rate. If such market-sensitive prices were accorded sufficient scope for influencing the allocation of resources within the Lao economy and were reinforced, as necessary, by further pricing and exchange rate changes, they could result in higher overall production levels in sectors that were experiencing supply deficiencies. Such a development could in turn lead ultimately to a stronger productive base and to more stable prices at a relatively higher level of economic activity and efficiency.

In that regard, Mr. Dallara continued, it was worth recalling the Lao People's Democratic Republic's recent success in attaining virtual self-sufficiency in foodgrains. Appropriate incentives for producers, directly related to government pricing policies, had been the sine qua non for success. It was obvious, however, that significant price distortions remained and that they continued to foster misallocation of resources and to contribute to inflation. He encouraged the authorities to continue to pursue the initiatives that they had already taken in certain areas of pricing policy, with particular attention to tradeables. Such initiatives were clearly related to the need for action on the exchange rate.

The authorities were to be commended for the steady improvement in fiscal performance, Mr. Dallara suggested. He noted in particular that domestic revenue would exceed current expenditure in 1982, and he encouraged the authorities to push ahead in their efforts at restraining expenditure and raising revenue. He agreed fully with the staff's conclusion that the level of prevailing interest rates in the country should reflect the scarcity of capital and competing interest rates abroad. The authorities should be encouraged to review their policies in that area and to move expeditiously to bring interest rates to a more appropriate level.

Commenting on the balance of payments, Mr. Dallara said that the situation was serious. The staff appraisal characterized the balance of payments as "weak," a statement that might be a little optimistic. It was not clear that the balance of payments with the convertible area was sustainable without substantial action on the part of the authorities. Exports to the convertible area had amounted to \$14 million in 1981, and imports not financed by aid had been \$36 million, leaving a trade deficit of \$22 million when the aid-financed exports were excluded, roughly one-and-a-half times the value of exports. The sustainability of the Lao People's Democratic Republic's balance of payments in convertible currencies was critically dependent on the continuation of grants from the convertible area, an amount of \$20 million in 1981. Much of the aid was apparently project related, or commodity related; he invited the staff to comment on the efficacy and appropriateness of that type of aid in the country's current circumstances.

The overall picture of the balance of payments in convertible currencies suggested an urgent need to expand exports to the convertible area, Mr. Dallara continued. In that regard, he fully concurred with the recommendations by the staff regarding the importance of expanding timber exports. There appeared to be significant potential for the export of timber already cut, and, in addition, a substantial margin remained between export prices and prices paid to domestic timber cutters. More appropriate price incentives were clearly required if domestic production was to be increased. More generally, there appeared to be a pressing need for a more active exchange rate policy in order to promote exports and, he hoped, along with changes in other prices, in interest rates, and in other policy areas, to foster a more appropriate allocation of resources.

His authorities were concerned about the recent developments in bilateral payments arrangements, Mr. Dallara stated, and about the related

increase in the relative amount of exports directed to the nonconvertible area. While he would not question that latter development in principle--and there could be good reasons for expanding the trade in that area--the two trends could further diminish the ability of the Lao People's Democratic Republic to meet its international financial obligations to the convertible zone, could limit its ability to achieve its own medium-term growth objectives, and, not incidentally, could call into question the country's future ability to meet its obligations to the Fund.

The staff representative from the Asian Department, responding to Mr. de Maulde's question regarding the balance between salaries and subsidies in the government sector, said that, although subsidies had increased recently as a percentage of GDP, they had not changed during the previous two years. Previously, subsidies had actually declined from 5 per cent of GDP in 1979 to zero per cent in 1980. The recent increase had arisen from the authorities' desire to place more emphasis on wage restraint as a means of limiting public expenditure. The number of civil servants had been reduced by 20 per cent in 1981, and salaries had not kept pace with the increase in the cost of living. Therefore, the authorities had felt that it would not be feasible to reduce the subsidy element for the public sector; thus, the relative importance of subsidies had increased. The staff believed that the subsidy policy would remain flexible and that subsidies would be reduced once the policy of salary restraint had been terminated.

The question of the composition of commodity aid had been raised by Mr. Dallara, the staff representative noted. The staff did not have detailed information, but most commodity aid came from the nonconvertible area; it had increased substantially in recent years. Imports from the nonconvertible area were mostly related to projects and to the development effort, being mostly raw materials rather than consumer goods. In the past two years, about \$10 million of petroleum products had been imported from the Soviet Union. It was open to question whether the Lao economy could generate enough resources to service the debt resulting from such imports, even if the terms of trade remained relatively favorable. A similar problem arose with regard to imports from the convertible area. There had not been a rapid enough expansion in exports to the convertible area in order to ensure the Lao People's Democratic Republic's ability to service its future debt obligations. The authorities were very much aware of the issue, and the staff believed that they would take adequate measures to cope with the problem.

With regard to the export of timber, the staff representative from the Asian Department commented, the authorities had recently reversed their earlier policy of restraint and had concluded a number of agreements with Thailand to export timber. The staff expected that timber exports would increase, as would electricity exports in 1984 with the installation of a third generator. The increase would be about 33 per cent, a significant amount in what was already the major export sector.

Mr. Jaafar said that he would communicate Directors' comments to his Lao authorities, who were very much aware of the problems that they had to face on the road to recovery from the war. As the country intensified its development efforts, the availability of soft loans and grant aid on a substantial scale would continue to be the key factor enabling the Lao authorities to implement fully their development programs and objectives. They would welcome the support of the Fund and other bodies for the continued provision of such financial assistance.

The Chairman made the following summing up:

Directors observed that the move toward production-oriented policies in recent years, including the adoption of more flexible pricing and the removal of restrictions on internal trade, had contributed to high rates of growth and impressive progress toward self-sufficiency in food. However, despite the improved supply situation and a slowdown in monetary expansion, domestic prices had continued to rise rapidly and price distortions had continued.

Directors commended the authorities for their pragmatic approach toward the implementation of the Five-Year Plan and for the steady improvement in fiscal performance, but noted that the fiscal position remained weak. The subsidy on official rice distribution had recently increased sharply and nearly half of total budget expenditure remained foreign financed. Additional revenue measures and expenditure restraint were therefore needed. A review of interest rate policy and the upward adjustment of rates were also regarded as important.

Directors observed that debt service payments in convertible currencies were expected to rise rapidly and that, under bilateral arrangements, exports had increasingly been directed toward the nonconvertible area. They stressed that, in view of the already sizable deficit on the current account and the uncertain aid prospects, there was an urgent need to develop exports, in particular those to the convertible area. Together with more remunerative domestic procurement prices, a more active exchange rate policy would be essential for the achievement of that objective.

The need for a continued high level of concessionary aid, in conjunction with the implementation of adjustment measures by the authorities, was also stressed.

Executive Directors then took the following decision:

1. The Fund takes this decision relating to exchange measures of the Lao People's Democratic Republic subject to Article VIII, Sections 2 and 3, and in concluding the 1982

Article XIV consultation with the Lao People's Democratic Republic in the light of the 1982 Article IV consultation with the Lao People's Democratic Republic conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund welcomes the removal of the multiple currency practice arising from the maintenance of the preferential exchange rate as described in SM/82/214, and encourages the Lao People's Democratic Republic to terminate the bilateral payments arrangement with Fund members as soon as possible and to further liberalize its restrictive exchange system.

Decision No. 7265-(82/158), adopted
December 10, 1982

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/82/157 (12/8/82) and EBM/82/158 (12/10/82).

3. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/82/423 (12/7/82), EBAP/82/424 (12/8/82), EBAP/82/426 (12/8/82), EBAP/82/427 (12/8/82), and EBAP/82/428 (12/8/82) is approved.

4. STAFF TRAVEL

Travel by the Managing Director as set forth in EBAP/82/429 (12/8/82) is approved.

APPROVED: May 17, 1983

LEO VAN HOUTVEN
Secretary

