NOT FOR PUBLIC USE

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 82/3

3:00 p.m., January 8, 1982

J. de Larosière, Chairman

Executive Directors	Alternate Executive Directors
M. Abdollahi	O. Kabbaj
	C. Taylor
A. Buira	M. A. Senior
	O. Uçer, Temporary
	A. Le Lorier
R. D. Erb	J. E. Leimone, Temporary
	H. Suzuki, Temporary
J. C. Iarezza	
R. K. Joyce	M. Casey
	D. I. S. Shaw, Temporary
A. Kafka	J. R. Gabriel-Peña
B. Kharmawan	V. Supinit
S. Kiingi	F. Sangare
	G. Winkelmann
	C. P. Caranicas
S. Nana-Sinkam	
M. Narasimham	V. K. S. Nair, Temporary
	S. El-Khouri
	T. de Vries
	B. Legarda
J. Sigurdsson	
Zhang Z.	

J. W. Lang, Jr., Acting Secretary
R. S. Franklin, Assistant

Also Present

African Department: J. B. Zulu, Director; O. B. Makalou, Deputy Director; E. A. Calamitsis, F. d'A. Collings, S. E. Cronquist, R. E. Daumont, C. N. Egwim, C. Enweze, J. M. Jimenez, B. Karlstroem, J. W. Kratz, M. Sidibe, J. D. Simpson, R. T. Stillson, D. E. Syvrud. Asian Department: T. T. Gibson, T. J. Rommel, J. Schulz. Exchange and Trade Relations Department: W A. Beveridge, Deputy Director; H. W. Gerhard, M. Guitian. External Relations Department: G. P. Newman. Legal Department: W. E. Holder, J. V. Surr. Research Department: N. M. Kaibni, P. Radhakrishnan, P. C. Ugolini. Treasurer's Department: A. M. Al-Samarrie, K. Boese, A. G. Chandavarkar, D. Gupta. Western Hemisphere Department: E. W. Robichek, Director; S. T. Beza, Deputy Director; M. E. Bonangelino, M. Caiola, L. A. Cardemil, R. A. Elson, A. Gomez-Oliver, P. Molajoni, S. Umana, E. V. Zayas. Personal Assistant to the Managing Director: N. Carter. Advisors to Executive Directors: E. A. Ajayi, S. E. Conrado, A. B. Diao, K. V. Jännäri, S.-W. Kwon. Assistants to Executive Directors: H. Alaoui-Abdallaoui, L. Barbone, L. E. J. Coene, R. J. J. Costa, M. K. Diallo, F. Guena, Jiang H., J. M. Jones, P. Kohnert, J. A. K. Munthali, J. R. Novaes de Almeida, J. G. Pedersen, C. N. Pinfield, J. Reddy, J. Schuijer, J. F. Williams, A. Yasseri.

1. KENYA - STAND-BY ARRANGEMENT, AND EXCHANGE SYSTEM

The Executive Directors continued from the previous meeting (EBM/82/2, 1/8/82) their consideration of a request by Kenya for a stand-by arrangement equivalent to SDR 151.5 million (EBS/81/241, 12/10/81; Cor. 1, 12/17/81; Cor. 2, 1/6/82; and Sup. 1, 1/7/82), together with a proposed decision extending Executive Board approval of exchange restrictions in Kenya (EBS/81/242, 12/10/81; and Cor. 1, 12/22/81).

The staff representative from the African Department, continuing his replies to questions that had been raised at EBM/82/2, observed that the program contained both conventional fiscal and monetary measures designed to alleviate short-term problems and measures that were more structural in nature, such as the exchange rate change and the shift in import policy. While it was correct to refer to the program as a short-term stabilization program--as some Directors had done--the medium-term aspects of the program should not be forgotten. Indeed, changes in the exchange rate and in the import regime were entirely in line with what the Kenyan authorities had been discussing within the framework of their latest development plan. Many of the measures advocated for some time in the context of Kenya's medium-term economic strategy had now been implemented.

The Kenyan authorities had raised with the staff the possibility of a further, perhaps longer, arrangement with the Fund once the proposed stand-by arrangement was concluded, the staff representative continued. In his view, there was likely to be a balance of payments need for a further arrangement, and the close working relationship the staff had developed with the authorities had led to discussions of matters that could easily be incorporated into another program later on. It was too early to tell, however, what sort of arrangement would be most helpful; much would depend on the performance under the stand-by arrangement.

In response to questions on the World Bank's involvement in Kenya, the staff representative noted that the Bank had already provided a structural adjustment loan of $55 million and was currently negotiating a second loan of about $130 million. In order not to prejudge the situation with respect to that negotiation, the staff had not gone into great detail on the Bank's assessment of the Kenyan situation. However, the two institutions were keeping one another well informed on developments.

It might be useful to provide some general background information on Kenya's import policy, which had been discussed extensively, the staff representative said. Over the years, Kenya had developed a complex and somewhat arbitrary import system, based originally on the protection of domestic industry. The system had been reasonably successful through the mid-1970s but had thereafter become so complex that it had been difficult to analyze and to administer. The authorities themselves were aware of the problem and had begun to make appropriate changes. Experts had been hired to review the system and organize import items in different schedules and with different degrees of protection. While that technical work had taken longer than expected, new import schedules had finally been issued, together with directives from the Central Bank regarding foreign exchange allocations. The new system had been operating for only one or two months, and it was therefore difficult to say how well it was working; that was one reason why reviews of import policy were being proposed.

In discussing the new policy with the staff, the authorities had found it difficult to be precise about setting a time path for the various measures, the staff representative mentioned. Specifically, they had had trouble quantifying import allocations for those import items still regulated through licenses and setting a time frame--whether on a quarterly basis or otherwise--for increasing them. The only way found to deal with the matter was for the staff to accept the general policy intentions of the authorities to move 20 per cent of the tariff items from the restricted to the nonrestricted schedule within the current fiscal year.

A question had been raised by Mr. Erb about how the shift in the value of imports from restricted to nonrestricted schedules would work, the staff representative recalled. If the shift was formulated in terms of tariff items, there was of course the possibility that the authorities might shift items that had little or no significance. At present, it was difficult to say which items the authorities would shift, which was yet another reason for holding a review of import policy before August 1, 1982.

In the balance of payments forecast, the level of imports in 1982 was projected to be quite low, the staff representative noted. It was particularly difficult to forecast imports while import policy was being liberalized; however, some elements were clear. First, it could be said with certainty that government imports--especially of food and defense equipment--would be lower in 1982 than in 1981. Second, the authorities were predicting no increase in the volume of imports of petroleum products, reflecting a high level of stocks that could be drawn down. Third, the so-called "free" imports under Schedule 1 currently carried higher tariff duties than in the past, which would be a deterrent to the importation of such items, and the devaluation itself would make imports more expensive and should thus have an effect on demand. Finally, general economic activity in Kenya was sluggish at the moment, and the demand for imports was already relatively low. It was for those reasons that the staff felt that the seemingly low import figure for 1982 was justified.

In the area of monetary policy, the staff had observed in the paper that interest rates were positive in real terms, the staff representative remarked. Assuming a 10 per cent rate of inflation--which was the rate at present--all interest rates, including both deposit and lending rates, were positive. Interest rates in the uncontrolled or noncommercial bank market could be provided to Executive Directors separately. Although some of them were published, they did not provide a full picture of effective rates because they did not include certain added fees and charges.

A number of questions had been raised about the effect of higher interest rates on savings and on the pace of disintermediation, the staff representative recalled. He had no doubt that higher interest rates would have an effect on savings and on the allocation of credit; interest rate levels in the commercial banking system had increased by about 4-5 per cent in the previous 18 months, which represented a sharp break from the past. On the matter of disintermediation, it should be noted that nonbank financial institutions made up 20-25 per cent of the total financial system at present, and that share had been growing rapidly. The Central Bank was worried that further disintermediation would make monetary control more difficult and thus did not wish to see a further rapid shift of financial resources away from the commercial banks. The staff had made the point that one way of stopping disintermediation was to raise interest rates in commercial banks, but it was difficult to tell at present to what extent the higher rates were having such an effect. However, it was certain that increasing interest rates would always have a beneficial effect on savings, irrespective of whether one believed in the nonbank financial intermediaries' increased efficiency in channeling savings.

With respect to the concern expressed by Mr. El-Khouri about the sharp increase in credit to the Government for the period June-January as compared with that for the period June-June, the staff representative noted that there was a sharp seasonality in the Government's need for bank borrowing, and the seasonal peak was reached around December or January. The situation was really dependent upon the pattern of revenue collections, which were concentrated toward the end of the year. As revenues flowed in, the Government was able to repay some of the short-term financing from the banking system. It should be noted that the ceiling on borrowing by the Central Government referred to borrowing from the banking system plus the use of the counterpart of any Eurocurrency loan drawdown. That definition was the same as the one that had been used for the stand-by arrangement in the previous year.

On Mr. Winkelmann's inquiry about whether government borrowing from banks carried a lower interest rate than borrowing from nonbanks, the staff representative observed that all domestic borrowing by the Government was at the same interest rate; treasury bills were sold at the going rate whether they were sold to banks or nonbanks.

As to whether there were restrictions on investment flows into Kenya, the staff representative remarked that there were no officially announced restrictions, although there might be some discretionary restrictions that had not been published. As he understood it, however, a study was under way that would eventually lead to a White Paper on Kenya's policy toward foreign investment.

Several questions had been raised about the tax system in Kenya, the staff representative recalled, and those could best be answered by reference to Appendix II of the paper on recent economic developments that had been issued in connection with the consultation report in August 1981 (SM/81/177, 8/24/81).

An interesting issue had been raised by Mr. Erb, who had asked how one could avoid sharp fluctuations in the balance of payments and the consequential fluctuations in liquidity in a country like Kenya where heavy reliance was placed on primary products and where prices were quite volatile, the staff representative continued. The matter had been raised with the Kenyan authorities, and the staff was prepared to go into it in further detail. The suggestions by Mr. Erb and others were helpful in that regard.

The effect of the devaluation on the budget had been queried by Mr. Nana-Sinkam, the staff representative from the African Department noted. According to the staff, the 15 per cent devaluation in September had had the effect of raising revenue by about K Sh 900 million (about 1.7 per cent of GDP) and of raising expenditure by around K Sh 300 million. The calculations had been taken into account in the staff's fiscal projections. Finally, in response to a question by Mr. Taylor, there were some limitations on companies with nonresident equity; other companies were treated on a case-by-case basis, although they were treated quite generously.

Mr. El-Khouri said that he recognized the seasonal aspects involved in bank credits to the Government. However, the history of bank credit in Kenya over the past few years showed that the largest expansion of net bank credit to the Government during the six-month period June-December had been about K Sh 1.5 billion, while the proposed ceiling would allow net credit to the Government of K Sh 2.4 billion in seven months. In the circumstances, he failed to see how any adjustment would be taking place.

The staff representative from the African Department observed that the financing of deficits in previous years had been lower because the deficits themselves had been lower. Moreover, given the seasonal pattern in the country and the increase over the year as a whole, the December/January peak was no higher than it had been in the previous year; indeed, it was lower. The focus should be on the targets for the year as a whole, which related to the budget and were therefore more meaningful. Nonetheless, he would review the figures that Mr. El-Khouri had mentioned, and send him a note on the subject.

In response to a further question by Mr. Erb, the staff representative remarked that borrowing from the nonbank financial institutions was not included in the Government's net credit ceiling.

Mr. Narasimham commented, first, that the staff's response to Mr. El-Khouri's question had not clarified the reasons for the large bulge in net credit to the Government in January. A note circulated on the matter would be helpful.

Two of the points he had raised in his earlier intervention had not been answered by the staff, Mr. Narasimham continued. The first concerned development expenditure, which had been lower in real terms than in previous years, while recurrent expenditure had been higher. He had wondered what implications those expenditures had for the adjustment effort and the continuation of the investment program by Kenya. He had also wondered about energy sector policies in Kenya.

The staff representative from the African Department said that he would try to answer the question regarding the January bulge in net bank credit to the Government after reviewing the figures for previous years. As for Mr. Narasimham's question on the investment program, the staff had focused primarily on fiscal policy because the stand-by arrangement was for only one year. The fiscal deficit had been set as the main target, and it had been left to the Kenyan authorities to choose whether to reach that target by cutting current or development expenditure or by raising more revenue; the decision had been to make cuts in the investment program. If a longer-term arrangement were to be negotiated with Kenya after the expiration of the one-year stand-by arrangement, the staff would go into greater detail in reviewing the investment program. It should be noted, in that connection, that the World Bank was covering the investment program fully in the context of the structural adjustment loan currently being negotiated.

On energy policy, the staff representative observed that increases in import prices and production costs for petroleum and petroleum products were being passed through to consumers. There was no subsidy whatsoever; indeed, the authorities had imposed differential taxes on diesel and regular fuel. Moreover, following the most recent devaluation, the authorities had raised domestic prices for petroleum by an average of 19 per cent on the production-weighted averages of different kinds of petroleum products. The result had been a leveling out or decline in their consumption.

Mr. de Vries stated that, in light of the explanations provided by the staff, his confidence in the effectiveness of the import liberalization program had been further reduced. He hoped that when the staff reviewed the program it would be able to provide more concrete information on the way in which the system was working.

The Deputy Director of the Exchange and Trade Relations Department, recalling a number of questions regarding the phasing of proposed amounts, assured Executive Directors that the initial purchase of SDR 60 million--representing 40 per cent of the total--was not intended as a smoothing out operation with respect to the earlier program. Given the extent to which fiscal performance had deviated from targets in the original program, the staff had been looking for ways to minimize the size of the first purchase. However, in the course of the negotiations, the staff had begun to recognize that the proposed program contained considerable prior action and a strong commitment to import liberalization. Moreover it had to be recognized that an initial purchase of 40 per cent of the total amount available was not unusual. There had been several cases in 1980 and 1981 in which the initial purchase had been 40 per cent or more. It had been felt necessary to offer a reasonable inducement to the Kenyan authorities to make their commitment to import liberalization, particularly given that international reserves were equal to less than five weeks of imports and the terms of trade had continued to fall throughout 1981. Moreover, 60 per cent of the total still would not be available until the completion of a substantial review in April; that was fully consistent with practice and policy.

Another question on the phasing was related to the postponement of the purchase of some SDR 31.5 million until November 1982, the Deputy Director recalled. Mr. de Vries had noted that November 1982 would already be in a new fiscal year and that a new program might be in place by that time. However, the staff had deliberately wanted to move a certain proportion of the available money until late in the program year. The authorities had committed themselves to further reducing the size of the overall budget deficit in relation to GDP in the new fiscal year beginning July 1, 1982, and it was hoped that the SDR 31.5 million purchase in November might act as an inducement for the authorities to give effect to that intention.

A number of Directors had raised the issue of the two proposed review clauses, the Deputy Director continued. Two of the more important ingredients of the program--the cutbacks in government expenditure and the commitment to a liberalized import system--would be difficult to implement on a day-by-day basis. Those actions were certainly far more difficult to implement than changes in tax or price policy or in the exchange system and their effects could not easily be estimated over a given period of time. Both the authorities and the staff had felt that the proposed reviews were appropriate as a way of providing a formal basis for checking progress in those two areas. The April review was particularly important, given the shortcomings in fiscal policy in the previous fiscal year.

One Executive Director had wondered about the feasibility of a "band" approach of the sort that had been used in other cases, the Deputy Director of the Exchange and Trade Relations Department recalled. Indeed, the band approach had been employed for Kenya in the previous program. While such an approach might be useful in certain circumstances--because it triggered consultations or serious discussions when the lower limit of the band was exceeded--it had not represented an adequate safeguard in the case of Kenya in 1980/81. The monitoring process and the two reviews would take the place of the band approach for the Kenyan program.

The staff representative from the Treasurer's Department, responding to Mr. Erb's question about the nature of the commitment of borrowed resources under the proposed arrangement, observed that, under the existing arrangement with the Fund--which would be canceled upon adoption of the proposed arrangement--Kenya had an amount of about SDR 134 million unused under the supplementary financing facility. Kenya had previously used about SDR 49 million in the credit tranches so that, based on 100 per cent of quota, there had been room for financing through ordinary resources just over SDR 54.5 million. The remainder would come from the supplementary financing facility resources that would be released from the amount unused under the existing arrangement; that would be in accordance with the decision on enlarged access.

The Deputy Director of the Exchange and Trade Relations Department said that the staff had felt that the use of enlarged access resources was warranted in the Kenyan case because the program contained substantial prior action and Kenya's payments imbalances were large in relation to its quota.

Mr. Kharmawan wondered, first, why a performance criterion was being proposed with respect to import liberalization. Second, he had the feeling that the introduction of two reviews for a one year stand-by arrangement was excessive and seemed to suggest that the staff had no confidence in the intentions of the authorities. If that was the case, perhaps the staff should have negotiated a different program with more preconditions. His main concern, however, was that the requirement of two reviews might be interpreted as a change in the Fund's policy on conditionality.

The Deputy Director of the Exchange and Trade Relations Department replied that the need had been felt for a performance criterion related to import liberalization in order to ensure continued progress in an area to which the authorities attached much importance. In an earlier intervention, Mr. Kharmawan had wondered why the staff was not proposing the use of a balance of payments test instead. The staff had felt that observing a balance of payments test might perversely lead to the intensification of restrictions, and its use had therefore not been considered in cases like that of Kenya where import restrictions and exchange controls existed on an important scale. The Kenyan authorities themselves had felt that the performance clause relating to import liberalization was justified in order to give a quantified benchmark of the progress of the liberalization. While the measurement of the degree of liberalization used in the clause might not be comprehensive, a more detailed set of performance criteria might impinge on the country's sovereignty. There was certainly no intention to change Fund policy with respect to conditionality. However, in cases where certain policies needed to be implemented on a day-by-day basis, it was not possible to have prior actions that were meaningful; and that was the case with respect to expenditure policy and import liberalization. The staff and the Kenyan authorities saw the two reviews as a formal opportunity to check on progress in the two areas he had mentioned.

Mr. El-Khouri stated that, while he would not wish to be interpreted as being opposed to front-loading--either in the Kenyan case or in any other--he had raised a question on the matter earlier because the staff had made no attempt to justify the front-loading in the paper. He appreciated the explanations that had later been given by the staff but hoped that any future papers proposing front-loading would at least address the issue.

The Chairman considered the Kenyan case to be of particular importance and interest because it was one in which a two-year stand-by arrangement had been negotiated and had failed. A multiyear arrangement that, during the first year, had failed in some of its major features should not be eligible for revival. One of the most notable slippages in the program had occurred on the budgetary side, with a fiscal deficit that had gotten out of hand. The projected overall fiscal deficit of 6 per cent of GDP had turned out to be about 10.6 per cent of GDP. In the circumstances, it would not have been appropriate to ask the Board to ignore such a slippage and to continue with the second year of the program.

Given the decision to go with a new one-year stand-by operation, it might then be asked why a purchase equivalent to 150 per cent of quota was being proposed, the Chairman said. The amount was justified for a number of reasons. First, the balance of payments adjustment had not been completely distorted; indeed, the current account deficit--at 13 per cent of GDP in 1980, 10 per cent of GDP in 1981, and a projected 8 per cent of GDP in 1982--was moving in the right direction. Even if the projected deficit for 1982 was not sustainable, Kenya should be able to move toward a sound adjustment and reach a sustainable deficit by 1983.

Second, management and staff considered the program to be strong and it was one to which the authorities were committed, the Chairman continued. The authorities had taken an impressive number of prior actions, and a 150 per cent of quota program would not have been proposed if those actions had not taken place. In the recent Executive Board discussion on the review of experience under stand-by arrangements, it had been made clear that prior conditions would be necessary in cases in which the past record had been poor. It had also been noted that prior conditions were not always sufficient to ensure the implementation of future measures. Having those ideas in mind, and recognizing the large number of structural adjustment measures in the existing program, the staff and the Kenyan authorities had looked for ways to set up a new program under which the implementation of measures could better be monitored. The authorities had requested Fund assistance in monitoring progress on a monthly basis and in finding a mechanism by which they would be able to know how the Executive Board was reacting to that progress. In the event, it had been proposed to review the program more frequently than would have been done under other circumstances and to provide an expert from the Fund to aid in the monthly monitoring. Because those proposals gave greater assurance that the program would be implemented properly, management and staff had felt more confident in approaching the Executive Board with a proposal for a purchase equivalent to 150 per cent of quota.

On the matter of front-loading, the proposal had not been made simply for the sake of giving Kenya the same benefit it would have received if the existing program had been revived, the Chairman stated. Rather, the financial needs of the country had been closely reviewed, and it had been felt that some front-loading was probably necessary to encourage the Kenyan authorities to commit themselves to strong trade liberalization measures.

The Kenyan case was a complex one, to which an enormous amount of time had been devoted by both staff and management, the Chairman remarked. The economy was vulnerable, and success would not be easy to achieve. It was felt that the program, if implemented, would be helpful to the economy. However, even if the reviews showed that the country was moving toward a sustainable balance of payments situation under the program, Kenya would probably still need further help after 1983.

A less sympathetic approach might have been taken under which the authorities might have been told that, because of the significant divergence from targets under the existing program, only a small holding operation would be proposed, the Chairman commented. However, management and staff had felt that the framework for adjustment was in place and that the appropriate way to tackle the Kenyan situation was through a one year stand-by arrangement under which purchases could be made up to 150 per cent of quota. Still, it had been felt that some precautions were necessary, and that was the reason for the two proposed reviews. It was certainly not the intention to create any precedent by such a proposal or to change the guidelines on conditionality. The authorities themselves had agreed with that feature of the program, recognizing that the reviews would help them through the difficult adjustment process.

Mr. Kiingi stated that he wished to allay the fears of those Directors who had expressed some doubts about whether certain aspects of the program were too harsh on Kenya. He had no reason to believe that the authorities were not in full agreement with the program, which included both the reviews and the proposal for front-loading.

Most of the questions raised by his colleagues had been ably answered by the staff, Mr. Kiingi continued, and he would limit his comments to highlighting certain areas. He was in agreement with staff responses to questions on the adequacy of the depreciation, the restrictions on dividends, and the removal of the export compensation scheme. Expenditure control techniques were improving and, while it was difficult to tell whether expenditure control was adequate at present, it was clear from the paper and from his discussions with the authorities that efforts were being made to ensure tighter control over expenditure.

A number of Directors had expressed the hope that momentum in the Kenyan economy would be maintained, Mr. Kiingi recalled. He could assure Executive Directors that the authorities had every intention of maintaining momentum; that intention was reflected in their willingness to hold reviews at frequent intervals.

It had apparently been assumed that the development effort would or could be improved simply by increasing revenue, Mr. Kiingi noted. However, it was important to look at a country's ability to raise revenue in conjunction with the uses to which that revenue could best be put. Considering both aspects, one could not automatically assume that Kenya could easily tax its people more heavily and thereby increase development.

The problem of declining capital inflows was an important one, Mr. Kiingi considered, and was related to the question of whether policies should change in response to fluctuations in exports. During colonial days countries like Kenya, Uganda, and others had had reserves that had been created when prices of exports had increased and producer prices had remained stable. Those reserves had been invested in every conceivable Commonwealth country and state. Later it had been felt that the resources should be used internally, and expenditures had been incurred. The social and political pressure to continue with those expenditures, even when money was not available, made it unlikely that the policy would change in response to export fluctuations. His authorities would of course be grateful for any fresh advice on how to deal with the problem.

The latest available information showed the inflation rate at only 10 per cent, but he could accept the statement that the rate was "relatively high" as a way of encouraging the country to stay on the right track, Mr. Kiingi remarked. Taking account of the size of the economy, per capita income, the rate of population increase, the internal mobilization of capital, and a number of other factors, it could be said that the rate of inflation was relatively high but nonetheless manageable.

He agreed in principle with those of his colleagues who felt that more should be spent on development in countries like Kenya, Mr. Kiingi said. However, the authorities may have felt that less emphasis should be placed on development during a period when so much adjustment was required. In the circumstances of the Kenyan economy, higher development expenditure might even be a distorting factor; besides, the resources were not available.

He strongly supported the new interest rate policy and the higher rates accepted by the authorities, Mr. Kiingi continued. Kenya was part of the international trading and monetary system, and the reward for investment saving in Kenya should be no different from that in other countries.

A question had been raised about the adequacy of the income tax structure in Kenya, Mr. Kiingi recalled. As set up, the structure was one of the best in the region, although whether it was contributing as much to national revenue and development as it should was difficult to say. Sometimes the cost of collecting taxes was as high as the taxes themselves. His authorities would be happy to hear any specific suggestions on how to improve the tax structure if it was felt that such improvement was called for.

In general, people seemed to be sympathetic toward and understanding of the difficulties experienced by countries like Kenya, Mr. Kiingi commented. However, it was clear that the problems could not be explained away and that, in the final analysis, the countries themselves would have to find solutions. Kenya had already begun to take steps toward solving its problems. It was in that context that his authorities accepted the review clauses and other elements of the new program as part of the effort to get the economy back on track. They did not feel that the regular and continuous relationship with the Fund implied in the reviews represented an infringement upon their sovereignty.

The staff representative from the African Department, referring to an earlier question by Mr. Erb about the decline in capital inflows in 1981, noted that Table 6 of the staff paper showed a decline in total capital inflows from SDR 526 million in 1980 to a projected SDR 326 million in 1981. Two main reasons could be given to explain the decline. First, there had been a reduction in the transfer of public capital into Kenya, which represented only a delay in the disbursement of some large amounts of balance of payments assistance from bilateral donors; however, those would be coming in January or February. The decline in private long-term investment in Kenya had been much smaller, at about SDR 138 million. The projected figure for 1982 for public investment included the assumption of another structural adjustment loan from the World Bank, which was one reason why the 1982 figure was higher than that for 1981. Also, some of the decline might have been due to the overvalued exchange rate, which did not attract much foreign investment.

The Chairman, in concluding the discussion, recalled that three well-founded requests of a presentational nature had been made of the staff. First, some Directors had suggested that, where exchange rate matters were important, the staff should attempt to show the evolution of the real exchange rate over time on a trade-weighted basis because that evolution would give greater perspective to any discussion of the exchange rate. Second, a number of Directors would have preferred to see projections for external debt extended further into the future. Finally, at least one Director had suggested that, when phasing of purchases diverged from the usual pattern, a clear explanation should be given in the staff paper of the proposed phasing. All those suggestions would be taken into account in future papers.

Mr. Legarda considered that, if an effort was going to be made to compute real effective exchange rates, the computation should perhaps be done by direct measurements rather than through the use of purchasing power parity, which might raise questions on comparability, the relevance of the time period, and so on, that were difficult to answer.

The Chairman agreed with Mr. Legarda that such issues were not easy to resolve. Efforts should be directed to using unit labor costs, the GDP deflator, and the cost of living index in the attempt to compute real effective exchange rates.

The Executive Board then took the following decisions:

a. Stand-By Arrangement

1. The Government of Kenya has requested a stand-by arrangement for the period from January 8, 1982 to January 7, 1983 for an amount equivalent to SDR 151.5 million.

2. The Fund approves the stand-by arrangement set forth in EBS/81/241 and waives the limitation in Article V, Section 3(b)(iii).

3. The Fund notes that in accordance with the request of the Government of Kenya, the stand-by arrangement approved by the Fund for Kenya on October 15, 1980 (EBS/80/215, Supplement 1) is canceled as of January 7, 1982.

Decision No. 7035-(82/3), adopted
January 8, 1982

b. Exchange System

Kenya continues to retain restrictions on payments and transfers for current international transactions and multiple currency practices subject to approval by the Fund under Article VIII, Sections 2 and 3 as described in EBS/81/242. In view of the program of the requested new stand-by arrangement for Kenya (EBS/81/241), and of the circumstances of Kenya, the Fund extends approval from January 1, 1982, for their retention until December 31, 1982, or the completion of the 1982 Article IV consultation with Kenya, whichever is earlier.

Decision No. 7036-(82/3), adopted
January 8, 1982

2. HONDURAS - PURCHASE TRANSACTION - COMPENSATORY FINANCING FACILITY

The Executive Directors considered a request by Honduras for a purchase equivalent to SDR 23.3 million under the compensatory financing facility (EBS/81/249, 12/23/81; and Sup. 1, 1/7/82).

The staff representative from the Western Hemisphere Department made the following statement:

Some recent developments have had a bearing on Honduras' performance under the extended Fund facility program approved by the Fund in June 1981. Data available to the staff indicate that, as of December 18, 1981, the program ceilings on both the net domestic assets of the Central Bank and the banking system's net credit to the public sector continued to be exceeded. In an effort to reduce these departures under the program, the authorities have recently approved a tax package in the context of the 1982 budget exercise. The sales tax rate has been raised from 3 per cent to 5 per cent; and income tax surcharges of 10 per cent and 15 per cent--depending upon the level of income--have been introduced. Certain income tax exemptions have been eliminated, and the standard deduction under the income tax has been changed to a uniform tax credit. These measures are estimated to yield an incremental L 70 million in 1982, or the equivalent of 1 per cent of the projected GDP.

In early December 1981, a Fund staff member took up an assignment as Fund Resident Representative in Tegucigalpa and it is expected that an expert from the Fund's Fiscal Panel will be assigned to Honduras in mid-February 1982 to assist the authorities in improving tax administration.

Mr. Leimone remarked that he could support Honduras' request for a purchase under the compensatory financing facility. Honduras had a clear balance of payments need, and the export shortfall upon which the request was based had resulted from a shortfall in world prices for coffee--the country's major export product--and from certain other factors that were largely beyond the control of the authorities. However, since the amount of the request equaled the shortfall amount, he would appreciate some further explanation of the assumptions underlying the shortfall calculation, particularly with respect to projections for coffee prices in the postshortfall years. The U.S. Department of Agriculture had indicated that world coffee supplies during 1981/82 were expected to be about 50 per cent higher than world consumption, and a similar picture had been painted for 1982/83. In the circumstances, it would be helpful to know on what basis the staff was suggesting a 25 per cent increase in coffee unit values in the second postshortfall year. He noted that coffee prices in the futures markets for the latter part of 1982 and for early 1983 were down from current spot quotations.

He also wondered about the extent to which the shortfall in lumber exports could be considered beyond the control of the authorities, Mr. Leimone continued, especially since part of the shortfall was attributable to conservation policies that had been implemented by the authorities. Some elaboration on those policies would be helpful, together with estimates of how much they had constrained lumber production. He would also be interested in hearing whether the increase in domestic consumption of lumber that had been associated with a sharp rise in housing construction reflected the influence of government policies.

He welcomed the opening statement by the staff announcing the new measures that the authorities intended to take to get the economy back on track, Mr. Leimone remarked. However, because Honduras had not been in compliance, since August, with targets under the extended Fund facility program, he would have preferred a more detailed explanation in the staff paper of the reasons for the deviation and some more specific indication of the ways in which Honduras had been cooperating with the Fund. The intention of the authorities to take new measures gave some assurance that Honduras would continue to cooperate with the Fund in seeking to resolve its balance of payments difficulties, but the severity of the deterioration in the balance of payments during the previous two years, together with the problems that had been experienced in observing targets under the current three-year arrangement, demonstrated the need for a stronger commitment to balance of payments adjustment.

Mr. Iarezza stated that he too could support Honduras' request for a purchase under the compensatory financing facility. The sharp deterioration in the value of coffee exports--due to the drop in coffee prices during 1982 and the imposition of quotas since October 1980 by the International Coffee Council--together with the adverse weather conditions that had affected the banana crop were the main factors behind the severe shortfall in the exports of Honduras for the year ended June 1981. The shortfall was clearly attributable to circumstances beyond the control of the authorities and was expected to be temporary in nature; the request for a purchase under the compensatory financing facility was thus justified.

He welcomed the intention of the authorities to implement internal policy adjustments--such as restraints on public expenditure and improvements in tax administration--and the measures announced by the staff in its opening statement, Mr. Iarezza continued. While those measures should prevent any further aggravation of the current balance of payments situation, he agreed with the staff that developments in the balance of payments should be closely monitored to ensure the effectiveness of the proposed compensatory financing facility purchase. The program for the first year of the extended arrangement with Honduras had been approved by the Executive Board in June 1981, and, while the program ceilings as of the end of 1981 had been exceeded under that program, his authorities believed that the implementation of the policies most recently mentioned by the staff should help to bring performance back within the ceilings.

Mr. Gabriel-Peña stated that he could support the request by Honduras for a purchase under the compensatory financing facility because all the requirements had been met. Despite the difficult political environment in Central America, Honduras had fulfilled the performance criteria under the extended arrangement through late August, although there had been some slippages since that time. He would be interested in knowing whether the departures from performance criteria could be explained by fiscal developments.

Mr. Legarda considered the request by Honduras to be straightforward. The shortfall in export earnings was clearly attributable to circumstances beyond the control of the authorities, and the staff forecast of future price movements suggested that the shortfall would be temporary; in the circumstances, he could support the proposed decision.

The fall in coffee prices had been mentioned by some speakers as justification for acceding to the request by Honduras, while others had raised the question of the restriction by international agreement of Honduras' main export crop, Mr. Legarda recalled. Both points were relevant. In general, one could not look upon the request in a vacuum; recently, for example, certain social and regional forces had been taken into account in the case of a neighboring country. As far as Honduras was concerned, the current effort toward social normalization should be welcomed, and it was to be hoped that a purchase under the compensatory financing facility would assist the authorities in their effort.

He welcomed the intention of the Honduran Government to cooperate with the Fund, Mr. Legarda remarked. There was no formal requirement of cooperation tied to the particular request because there were no outstanding compensatory financing facility purchases and the amount requested was within the first 50 per cent of quota. However, any further efforts on the part of the authorities to improve the balance of payments situation in Honduras would be helpful.

Finally, Mr. Legarda noted that beef prices were expected to rise by 15 per cent in SDR terms for the year June 1981 to June 1982. On the other hand, beef prices in dollar terms had apparently been flat for the first half of 1981/82, and he wondered how much of the projected 15 per cent increase was simply a reflection of changes in the U.S. dollar/SDR conversion rate.

Mr. Nair stated that he could support the request by Honduras for a purchase under the compensatory financing facility because all the requirements for a drawing under the facility had been satisfied. Honduras certainly had a balance of payments need, with foreign exchange reserves equivalent at present to less than two weeks' imports. Moreover, the shortfall in export earnings was mainly attributable to factors beyond the control of the authorities. Earnings from coffee had declined because of international factors, including a fall in world prices for coffee; and the banana crop--the other major export item to show a decline--had suffered from adverse weather conditions.

Performance under the extended arrangement with Honduras had mainly been in line with program targets, Mr. Nair continued, although there had been some deviation from the targets since August 1981 because of a deterioration in the financial position of the public sector. He wondered whether the slippages had been related to any seasonal factors or whether, as was the case with respect to the request for a purchase under the compensatory financing facility, there were factors that had been beyond the control of the authorities. In general, he was satisfied with the assurances given by the authorities of Honduras that they would cooperate with the Fund to find appropriate solutions for their balance of payments difficulties. And he had been reassured in that respect by the staff's opening statement regarding recent policy commitments by the authorities.

Mr. Nana-Sinkam said that he could give full support to the request by Honduras for a drawing under the compensatory financing facility. If the staff paper had included the kinds of explanations that had been requested by some of his colleagues in the course of the discussion, it would have been clear that the factors leading to the shortfall were completely beyond the control of the authorities; indeed, even the divergence from targets under the extended arrangement could be attributed to those factors. If a country relied mainly on a few export products and suffered a strong shortfall, it was only natural that there would be a great impact on its ability to abide by the performance criteria of any arrangement with the Fund. In future, when a request was received for a purchase under the compensatory financing facility by a country that already had a program with the Fund, it would be useful if the staff could provide a short explanation in the paper of the impact of the shortfall on the ability of the country to meet the targets under the existing program.

On the question of the test of cooperation that had been raised by Mr. Leimone, it was his understanding that the only obligation of the country was to work with the Fund to find solutions to the balance of payments difficulties facing the country, Mr. Nana-Sinkam continued. Honduras had always been in contact with the Fund in an effort to find solutions to its problems, and the authorities had, according to the staff, taken additional measures in order to keep within the targets.

Mr. Shaw stated that, like others, he could support the request by Honduras for a purchase under the compensatory financing facility. He had not understood Mr. Leimone to be questioning Honduras' cooperation with the Fund but only to be asking about the nature of the deterioration in the financial position of the public sector, and about prospects for performance under the extended arrangement coming back on track. He too would appreciate clarification from the staff on that matter.

Mr. Leimone confirmed Mr. Shaw's understanding of his earlier remarks. He had not been raising the issue of the test of cooperation; he had only wished to have a clearer understanding of the status of Honduras under the extended arrangement and some detail on how the authorities had been cooperating with the Fund.

Mr. Winkelmann commented that he could support the request and wished only to ask a question for information. The shortfall in coffee exports, at least in volume terms, appeared to arise in part out of the membership of Honduras in the International Coffee Council. If Honduras had agreed with other members of the Council to reduce the volume of exports, he wondered how it could be said that such a decrease was beyond the control of the member.

The staff representative from the Exchange and Trade Relations Department commented that, as noted by others, the request by Honduras for a purchase under the compensatory financing facility within the first 50 per cent of quota meant only that the country had to cooperate with the Fund in finding appropriate solutions to its balance of payments difficulties. The simple fact that Honduras already had an extended arrangement with the Fund was an indication of its willingness to cooperate, and the departures from targets under that arrangement, while hardly desirable, were not unusual. As noted by the staff representative from the Western Hemisphere Department at the beginning of the discussion, the authorities were undertaking measures to reduce those slippages, so there was little doubt of their willingness to cooperate.

The staff representative from the Western Hemisphere Department observed that the main departure from targets under the extended arrangement with Honduras had been caused by deviations in the fiscal area. In particular, the growth of revenue in the public sector had been slower than anticipated. Expenditure policy had been basically in line with the program, although current outlays had grown somewhat faster than estimated while capital expenditure had turned out to be lower than anticipated. In the circumstances, the only real difficulty was that performance on the revenue side had not measured up to projections. The staff felt that revenue performance reflected a weakening of the tax administration, a matter that had already been discussed with the authorities. In the letter of intent, the authorities had committed themselves to improving the tax administration, although progress had been slow and the public sector had required more financing than had originally been envisaged. In addition, there had been some deviation from targets regarding credit to some of the public sector financial institutions.

Based on the results of a general election in November 1981, a new government would be taking office in Honduras at the end of January 1982, the staff representative observed. The newly elected authorities had shown a willingness to continue in close cooperation with the Fund, and they attributed a great deal of importance to the strengthening of the tax administration as a means of bringing the program back on track. Unfortunately, it was as yet too early to know whether the recently adopted measures would be sufficient to bring Honduras within the ceilings under the existing program; but they were certainly a step in the right direction.

The staff representative from the Research Department, responding to a question by Mr. Legarda, noted that the world price of beef in dollar terms had been stable over the past three years; and, if the export unit values had been expressed in terms of dollars, the projections would imply only a 4 per cent increase over the 1980/81 level. Similar differences, because of the conversion rate between U.S. dollars and SDRs, could also be seen for coffee prices. While projections indicated an 8 per cent increase in those prices in SDR terms, as shown in Table 4 of the staff paper, there was no change in in U.S. dollar terms. Coffee prices on the world market had tended to increase in recent months, partly because of the operations of the International Coffee Council in regard to export quotas, but more fundamentally because the world supply outlook had been changed by prospects for a sharp decline in Brazil's capacity to produce at a normal rate for some time to come.

The price of coffee had declined from its peak of over $3 a pound in mid-1977 to only $1.10 a pound by June 1981, the staff representative continued. Since the frost in Brazil in July 1981, prices had been rising gradually to the current level of $1.42 a pound. The difficulty Brazil was experiencing in its coffee sector would only be fully reflected in the crop that would be harvested beginning in mid-1982; in fact, the crop that would be harvested in the 12 months beginning June 1981 would be the largest ever recorded and would represent a complete recovery from an earlier setback that Brazil had encountered some five-six years previously because of a similar frost. Based on the staff assessment of the extent of the damage in 1981, it was likely that the world supply situation would be affected for at least three or four years.

The specific projection in the staff paper for the coffee price in the first postshortfall year was $1.19 a pound, the staff representative noted. As he had already mentioned, the price had recently risen to $1.42 a pound, so that $1.19 a pound seemed conservative; however, it was not expected that unit values would immediately reflect the improvement in prices because of the lagged effect of price movements on unit values. Hence, no change in prices was projected for the first postshortfall year, but an increase of about 15 per cent was projected in the year beginning June 1982.

One speaker had wondered whether, given the Government's conservation policy, the fall in lumber exports could be considered beyond the control of the member, the staff representative recalled. The question had come up in previous discussions of similar cases, and the view had been expressed that conservation policies were the sort of long-term measures that members found themselves obliged to take to prevent their natural resources from becoming exhausted too quickly. The actual effects of the policy on exports were spread out over a long period of time and were not confined to a specific year. Hence, while it could be argued that the conservation policy might have changed the trend in volume of exports, it could not be said to have caused a deviation from that trend, which was what the staff was concerned about in looking at a shortfall.

A similar question had been raised with respect to the participation of Honduras in an international coffee agreement that committed participants to reduce their volume of exports, the staff representative noted. It was the view of the staff that, if a country or group of countries participated in an international commodity agreement for the purpose of stabilizing export prices of the commodity, the decision to reduce the volume of their exports was designed to stabilize the price of the commodity and was thus for the general good of the participants. One could argue that, to the extent that participation in the agreement might be expected to stabilize the earnings from the commodity over a long period of time, claims under the compensatory financing facility would tend to be reduced.

Mr. Buira remarked that he had little to add to staff replies on questions that had been raised during the discussion, although he was concerned about the staff's explanation of performance under the extended Fund facility program. According to the staff, the deviation from targets had resulted mainly from problems in the fiscal area; a shortfall in revenues had increased the need for financing beyond what had originally been envisaged. He was not certain that the staff was correct in its view and hoped to prove his point with the help of several tables on the economy of Honduras that he would circulate to his colleagues. 1/ Table 3

1/ The tables circulated to Executive Directors have been reproduced in the Annex.

(see Annex) covering public sector operations in Honduras, showed an estimated public sector deficit in 1981 of L 422 million; the ceiling established under the program was L 420 million, and he doubted that the deviation of less than 1/2 of 1 per cent from the overall deficit could be considered a deterioration in the financial position of the public sector. Indeed, performance in that area had been creditable, particularly given that GNP in Central America was stagnating in real terms and declining in per capita terms. Without going into the composition of tax revenues, it was clear that the authorities in Honduras had reduced expenditure below an already tight program level, and they should therefore be commended for having made a serious and, practically speaking, successful effort to comply with the target.

The real reason why the credit ceilings had been exceeded could be seen clearly from some of the other tables he had distributed, Mr. Buira continued. Annex Table 4 on the balance of payments, for example, showed that an inflow of capital of $305 million had been envisaged under the program for 1981, while the actual inflow was some $100 million less. The credit ceilings had been broken because the decline in capital inflows had required a greater expansion in domestic credit in both the public and private sectors. In the public sector, mention had already been made of the cutback in investment programs, which had been an austerity measure aimed at keeping within the ceiling. However, it had had the effect of reducing the flow of external financing by about $70 million, which was equivalent to about L 140 million. The excess in domestic credit to the public sector was much smaller than the L 140 million; indeed, Annex Table 2 showed it to be about L 33 million. Of course, the ceiling on the domestic assets of the Central Bank had also been exceeded, although that had been the result of greater financing to both the public and the private sectors.

It should be noted that the commercial banks had also suffered from lower capital inflows and had therefore required a substitution of internal for external financing, Mr. Buira remarked. The decline had been due to several factors. First, there had been political uncertainties in the region, and foreign banks had been reluctant to provide credit to Central America in the circumstances. Second, one of the financial institutions in Honduras had become bankrupt, which had raised additional questions about the creditworthiness of the other banks in the country. Moreover, foreign banks wished to press the Government of Honduras to grant them privileged creditor treatment, and they had not been particularly forthcoming with credits to Honduras. Finally, there had been speculation on the exchange rate, which had discouraged some bankers in Honduras from seeking external credit and had encouraged some accelerated payments of external liabilities. In sum, it could not be said that the slippages under the program were simply a fiscal deviation; rather, they were caused by a substitution of internal for external financing that had occurred because capital inflows had been well below expected levels.

The case of Honduras was certainly not the first in which there had been failure to comply with the credit ceilings because of lower than expected capital inflows for reasons largely beyond the control of the authorities, Mr. Buira commented. To the extent that the problem was a general one, members might be faced with a situation in which they would have to undertake substantial additional adjustment simply to comply with the program as initially envisaged; but such further adjustment might be impossible, particularly where income levels were declining. The problem was one that had been raised by other Directors in the past, and he hoped that it could be given full consideration by the Executive Board at an early date.

The staff representative from the Exchange and Trade Relations Department wondered whether Mr. Buira was suggesting that, whenever expectations of capital inflows did not materialize, credit ceilings under the program should be adjusted. Many arguments could of course be used to justify such a suggestion. One might even argue that, to the extent that expected resources did not materialize, the level of adjustment that had originally been assumed in the program was thereby increased in some sense and that, since the lacking resources would not be generated simply by raising the credit ceiling, the shortfall in capital inflows might call for a reconsideration of the optimal pace of policies. However, to compensate for any shortfall in capital inflows by raising credit ceilings was tantamount to trying to establish a certain level of aggregate demand regardless of what resources were available. There was a relationship between the amount of total financial resources--domestic and foreign--in the sense that they were substitutable. However, on occasions where inflows did not materialize, what was needed was more internal savings or some degree of adjustment to the level of spending.

Mr. Buira observed that he had not intended to draw the conclusion that had been attributed to him by the staff representative from the Exchange and Trade Relations Department. He had wished only to suggest that it was incorrect to state that there had been a deterioration in public finances that had resulted in breaking the ceilings; indeed, according to the tables he had produced, public sector finances seemed to be on target. His feeling was that the ceilings had been exceeded because of a shortfall in capital inflows and that, because the problem was hardly unique, the Board should take the time to consider what its policy should be toward countries that found themselves in such circumstances. It was apparent that raising the credit ceilings would not bring additional resources; it was equally apparent that, in the case of Honduras, there had been no attempt to compensate precisely for the shortfall. However, when a great effort had been made to keep within the program targets and when factors beyond the control of the authorities had prevented compliance with the ceilings, those factors should be taken into account before judgment was passed on performance under the program.

The staff representative from the Western Hemisphere Department observed, first, that the numbers in the various tables distributed by Mr. Buira were quite tentative. While he could agree that there had been a decline in use of foreign funds, that lower use had been related strictly to the slower pace of the execution of investment projects.

The most recent information available to the staff for the public sector indicated that there had been a shortfall in revenue collection from what had been anticipated under the program. At the same time, there had been a greater than anticipated growth in current expenditure and a tentatively estimated decline of 20-25 per cent in capital expenditure. The latest estimates on the balance of payments seemed to indicate a decline from projected net inflows for the nonfinancial public sector on the order of 20-25 per cent. In sum, while there had been less foreign financing and a lower amount of capital expenditure, there had also been a shortfall in revenue collections and somewhat higher current expenditure, both of which had added to the greater need for domestic financing.

There was yet another aspect to the problem of capital inflows, the staff representative continued. In some cases there had been delays in the payments that had been expected from the medium-term and long-term foreign loan institutions, such as the Mexico/Venezuela oil facility. In part, those delays had been due to difficulties in the local refineries that had prevented them from using oil from Mexico and Venezuela and had therefore prevented them from drawing all that it had earlier been assumed would be drawn. Finally, the staff also believed that the net inflow of private capital had been somewhat lower than anticipated.

The Chairman remarked that, particularly without firmer figures, it was difficult to enter into a detailed discussion of the Honduran program, although note should be taken of both Mr. Buira's observations on the impact of the problems of external financing and the staff's remarks about some of the features of the fiscal performance. The more general question raised by Mr. Buira about the effects of reduced capital inflows was relevant to the Fund's approach to a number of member countries and should therefore be looked at on another occasion.

The Executive Board then adopted the following decision:

1. The Fund has received a request from the Government of Honduras for a purchase of SDR 23.3 million under the Decision on Compensatory Financing of Export Fluctuations (Executive Board Decision No. 6224-(79/135), adopted August 2, 1979).

2. The Fund approves the purchase in accordance with the request.

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

Decision No. 7037-(82/3), adopted
January 8, 1982

APPROVED: June 14, 1982

LEO VAN HOUTVEN
Secretary

Table 1. Honduras: Central Bank Operations and Performance Under the Extended Fund Facility Program

(In millions of lempiras)

	1979	1980		1981		
	Dec.	Oct.	Dec.	Oct.	Prel. Nov.24	Proj. Dec.
I. Central Bank Operations						
Net international reserves 1/	359	262	219	49	40	39
Net domestic assets	-59	6	87	241	242	273
Net credit to public sector	271	376	421	518	520	513 2/
Credits	(437)	(517)	(549)	(557)	(551)	
Deposits (-)	(-166)	(-141)	(-128)	(-39)	(-31)	
Net credit to banks	-83	-19	-47	60	86	70
Credits	(168)	(183)	(235)	(225)	(284)	
Deposits (-)	(-251)	(-202)	(-282)	(-165)	(-198)	
Medium- and long-term foreign liabilities	-243	-303	-287	-328	-336	-320
Other	-4	-48	--	-9	-28	10
Currency issue	300	268	307	290	282	312
II. Performance Under EFF Limits						
Ceiling on net domestic assets 3/	-8	-40	-1	165	165	165
Actual	-59	6	87	241	242	273
Margin under ceiling (excess -)	51	-46	-88	-76	-77	-108
Ceiling on net credit to public sector	270	275	310	480	480	480
Actual	271	377	421	518	520	513 2/
Margin under ceiling (excess -)	-1	-102	-111	-38	-40	-33 4/

Sources: Weekly cable; monthly monetary accounts; and Fund staff estimates.

1/ Corresponds to the definition in the extended arrangement (EBS/81/130).
2/ Assumes that proceeds of U.S. AID housing foreign loan of US$25 million are deposited temporarily at the Central Bank.
3/ The definition of this ceiling changes for 1981.
4/ Without deposit of proceeds of above loan, excess is estimated at L 83 million.

Table 2. Honduras: Summary Operations of the Central Bank

(In millions of lempiras)

	1980	1981				1982	
		September		December		March	
	December	Prog.	Actual	Prog.	Proj.	Prog.	Proj.
Net foreign assets 1/	219	160	79	150	39	171	53
Net domestic assets	88	115	193	165	273	150	260
Net credit to public sector	421	460	510	480	513 2/	480	560
Credits	(549)		(568)				
Deposits (-)	(-128)		(-58)				
Net credit to banks	-46	-15	31	13	70		55
Credits	(235)		(231)		(285)		
Deposits	(-281)		(-200)		(-215)		
Medium- and Long-term foreign liabilities	-287	-330	-322	-338	-320		-340
Other		--	-26	10	10		-15
Currency issue	307	275	272	315	312	321	313
Difference with Program (Acutal or Projected less Programmed)							
Net foreign assets			-81		-111		-118
Net domestic assets			78		108		110
Net credit to public sector			50		33 2/		80
Net credit to banks			46		57		
Medium- and long-term foreign liabilities			8		18		
Other			-26		--		
Currency issue			-4		-3		-8

Sources: Weekly cable; and Fund staff estimates.

1/ Corresponds to the definition in the extended arrangement (EBS/81/130).
2/ Assumes that a housing foreign loan of US$25 million will have been negotiated before end of 1981 and the proceeds deposited at Central Bank.

Table 3. Honduras: Public Sector Operations

(In millions of lempiras)

	1979	Revised 1980	1981 Prog.	1981 Est. 1/	1982 Prog.	1982 Prel. Budget 2/
Total revenues	861	997	1,134	993	1,335	
Tax revenues	605	724	824	729	977	
Central Government	(574)	(697)	(792)	(697)	(940)	(776)
Rest of general government	(31)	(27)	(32)	(32)	(37)	
Nontax revenue	177	203	240	208	273	
Central Government	(43)	(43)	(50)	(36)	(55)	(38)
Rest of general government	(134)	(160)	(190)	(172)	(218)	
Operating surplus of public enterprises	73	57	70	56	85	
Capital revenue and transfers	6	13	--	--	--	
Total expenditure and net lending	1,098	1,461	1,554	1,415	1,775	
Current expenditure	603	847	881	921	1,000	
Capital expenditure and net lending	495	614	673	494	775	
Fixed investment	(385)	(498)	(541)	(391)	(625)	
Preinvestment	(57)	(15)	(50)	(5)	)	
Capital transfers	(14)	(32)	(32)	(9)	) (150)	
Net lending	(39)	(69)	(50)	(89)	)	
Current surplus 3/	252	150	253	72	335	
Central Government	106	33	117	-64	167	62
Rest of public sector	146	117	136	136	168	
Rest of general government	(78)	(60)	(...)	(80)	(...)	
Public enterprises	(68)	(57)	(...)	(56)	(...)	
Overall deficit	-237	-464	-420	-422	-440	
Foreign financing	196	283	340	311 4/	400	
Central Government	(126)	(247)	(255)	(270) 4/	(293)	(408)
Rest of public sector	(70)	(36)	(85)	(41)	(107)	
Domestic banking system	44	124	60	82 4/	30	
Central Government	(21)	(100)	(34)	(92) 4/	(20)	(36)
Rest of public sector	(23)	(24)	(26)	(-10)	(10)	
Other	-3	57	20	29	10	

Sources: Central Bank of Honduras; Ministry of Finance; and Fund staff estimates.

1/ Calculated as of December 7, 1981.
2/ Only Central Government has so far prepared a preliminary budget.
3/ Includes current transfers.
4/ Assumes that a housing foreign loan of US$25 million will have been negotiated before end of 1981 and the proceeds deposited at Central Bank.

ANNEX

Table 4. Honduras: Balance of Payments, 1979-82

(In millions of U.S. dollars)

	1979	1980 Prel.	1981 Prog.	1981 Est. 1/	1982 Proj. 1/
Current account	-192.0	-320.6	-345.0	-299.1	-353.9
Trade balance	-75.5	-170.2	-207.0	-144.6	-159.2
Exports, f.o.b.	(756.5)	(849.1)	(880.0)	(817.9)	(884.7)
Imports, c.i.f.	(-832.0)	(-1,019.3)	(-1,087.0)	(-962.5)	(-1,043.9)
Net services and transfers	-116.5	-150.4	-138.0	-154.5	-194.7
Capital account 2/	212.7	246.2	305.0	204.2	293.9
Nonfinancial private sector 2/	57.3	96.0	95.0	46.5	90.1
Nonfinancial public sector	98.0	125.4	170.0	117.3	165.0
Financial intermediaries	57.4	24.8	40.0	40.4	38.8
Allocation of SDRs	4.9	4.9	5.0	4.9	--
Change in net international reserves of the Central Bank (increase -)	-25.6	69.5	35.0	90.0	60.0
Memorandum items:					
Gross international reserves of the Central Bank at year-end	219.3	162.5	145.0	139.0	109.0
Equivalent in months of imports	2.6	2.0	1.7	1.6	1.4

Sources: Statistical Appendix Table 11, EBS/79/328; and Fund staff estimates.

1/ Calculated as of December 8, 1981.
2/ Includes errors and omissions.