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Minutes of Executive Board Meeting 81/129

10:00 a.m., October 7, 1981

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

Executive Directors

R. D. Erb
M. Finaish

J. C. Iarezza

A. Kafka
B. Kharmawan

G. Laske

A. R. G. Prowse
J. Sigurdsson

Alternate Executive Directors

O. Kabbaj
C. Taylor
S. E. Conrado, Temporary
O. Üçer, Temporary

T. Alhaimus
A. Nagashima

M. Casey

V. Supinit
F. Sangare

C. P. Caranicas
A. Le Lorier
A. Alfidja
D. L. Kannangara
S. F. El-Khoury, Temporary
T. de Vries
B. Legarda
L. Vidvei
Tai Q.

J. W. Lang Jr., Acting Secretary
K. S. Friedman, Assistant

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Also Present

African Department: D. E. Syvrud. Asian Department: P. Chabrier,
T. J. Rommel, G. Szapary. Exchange and Trade Relations Department:
D. K. Palmer, Deputy Director. Legal Department: J. K. Oh. Personal
Assistant to the Managing Director: N. Carter. Advisors to Executive
Directors: S. R. Abiad, C. J. Batliwalla, A. B. Diao, J. U. Holst,
K. V. Jännäri, G. Jauregui, P. D. Peroz, F. A. Tourreilles, Wang E.,
F. Yeo, T. Y. Assistants to Executive Directors: H. Alaoui Abdallaoui,
L. Barbone, M. J. Callaghan, J. L. Feito, A. Halevi, J. M. Jones,
J. E. Leimone, J. S. Mair, V. K. S. Nair, J. R. Novaes de Almeida,
J. Schuijjer, H. Suzuki, J. F. Williams.

1. REPORT BY MANAGING DIRECTOR

The Managing Director said that he had recently been host, with Mr. Clausen, at a two-day Tidewater seminar involving persons with professional and intellectual interests in development matters. The seminar had been organized, as was the custom, by Mr. John Lewis, the President of the Development Assistance Committee (DAC) of the Organization for Economic Cooperation and Development. The participants had included heads of international organizations and officials from developed and developing countries.

The seminar had been divided into three sessions, the Chairman explained. The first, which he had introduced, had dealt with adjustment problems in developing countries. He had talked about the balance of payments problems facing developing countries and possible adjustment policies and measures that developing countries could adopt. The second session had been introduced by Mr. Clausen and had dealt with possible ways of stimulating capital inflows in general, and foreign investment in particular, in order to stimulate production in developing countries. Some of the discussion topics had been cofinancing, multilateral investment schemes, and the catalytic role of the World Bank. The discussion on those matters had been one of the most interesting that he had heard, in part because officials from the OPEC countries had given their views, and he hoped to have the opportunity to give Executive Directors further information on the thrust of the debate. The final session, which had been introduced by the Chairman of the DAC, had dealt with the likely evolution of official development assistance in coming years.

The Executive Directors took note of the report by the Managing Director.

2. LAO PEOPLE'S DEMOCRATIC REPUBLIC - 1981 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1981 Article IV consultation with the Lao People's Democratic Republic together with a proposed decision concluding the 1981 Article XIV consultation (SM/81/185, 9/11/81). They also had before them a report on recent economic developments in the Lao People's Democratic Republic (SM/81/187, 9/22/81).

Mr. Kharmawan made the following statement:

The Lao People's Democratic Republic entered into a stand-by agreement with the Fund in support of an economic program covering a 12-month period ended May 1981 in an amount equivalent to SDR 14 million. According to the staff report for the 1981 Article IV consultation (SM/81/185) and a survey of recent economic developments (SM/81/187), the program agreed with the Lao authorities has on the whole been satisfactorily implemented. All the performance

criteria were fulfilled and important price adjustment measures, particularly the procurement price of such a basic commodity as rice, have been implemented.

The performance of the economy in 1980 can be characterized as relatively satisfactory. Growth amounted to 1 per cent in 1978, 6 per cent in 1979, and 10 per cent in 1980. Rice production reached a point of practical self-sufficiency, increasing from 487,000 tons in 1978 to 520,000 tons and 625,000 tons in 1979 and 1980, respectively. The improvement in the real sphere was also reflected in the country's financial performance. Fiscal revenues increased due to price adjustments and improved tax administration, a larger share of budget outlays could go to economic development, and the overall deficit was more than covered by foreign aid. Credit policy was accommodating in the first half of 1980 but was tightened in the second half of the year; on the whole, credit expansion was in line with the standby program limits. Price performance was not as good due to the adjustment of administered prices and the closure of the border with Thailand, which affected the supply and price of imports.

The balance of payments was weaker than anticipated because of higher prices for imports and lagging exports, partly due to the closure of the border but also because export producers did not receive the necessary incentives. The balance of payments gap was only partly offset by net capital inflows resulting in a fall of international reserves, which by the end of 1980 amounted to one month of imports.

While on the whole the picture of the Lao economy in 1980 and until perhaps March 1981 showed encouraging signs of progress, developments in the rest of 1981 worsened substantially.

The staff consider that two external factors--increased political tensions in the Indochina peninsula and a sharp reduction in foreign assistance--were underlying causes of the deterioration. A renewed closure of the Lao/Thai border ensued in March 1981, and it was later reopened at only one exit point. But, according to the staff, there were also internal factors contributing to the deterioration of the economy. Policy adjustments, including those of prices, were not continued, and state enterprises failed to improve their performance in the field of trade and distribution.

GDP is expected to decline by 5 per cent in 1981 despite a 4 per cent increase in the rice crop. As a consequence of financial constraints, transportation problems, and a temporary ban on border trade, supply shortages emerged, affecting output of state enterprises and forestry. Export receipts are estimated to be 8 per cent less than in 1980, due to shipment difficulties and insufficient incentives to producers. The current account

deficit is expected to decline by 19 per cent in comparison with 1980, but there will still be an overall deficit of \$7 million. In any case, an improvement due to a large decrease in imports of raw materials and capital goods cannot be considered as healthy. Net foreign aid in 1981 was originally projected to be \$114.0 million; at present, the estimate is \$73.2 million.

Fiscal and monetary policies have to be further restrained in order to adjust to the circumstances. The restraint in fiscal and monetary policies is, however, at the cost of a reduction in expenditures for investment and maintenance.

It is clear that the situation in the Lao People's Democratic Republic in 1981 is far from satisfactory. The country is caught in the political instability of the region. But it cannot wait until the political climate has improved. Domestic measures are necessary to prevent the country from further deterioration. A number of measures have been discussed during the consultations, such as a larger mobilization of domestic resources by way of economizing on unnecessary public expenditures, better tax enforcement, and a more realistic costing and pricing policies, including a review of subsidies which are burdening the budget.

The authorities are fully aware of the seriousness of the situation and the importance of introducing measures to increase efficiency. It is to be hoped that more assistance could be given to a country that is clearly facing numerous problems. The Lao People's Democratic Republic belongs to the category of poor countries with a per capita income of about \$80 a year. The world should not be oblivious to the plight of the Lao people.

On behalf of my authorities I would like to express deep appreciation to the staff for its balanced analysis of the Lao economy.

Mr. Erb noted that there had been some positive developments in 1980, including a 10 per cent rate of growth in GDP and a substantial increase in rice production. However, there had also been a decline in exports, an increase in the current account deficit, and a sharp drop in the level of reserves; and those trends were thought to have continued into 1981. The authorities had taken positive steps--notably a partial liberalization of domestic and international trade, and some price and exchange rate adjustments--under the 1980-81 financial program in support of the stand-by arrangement, but the measures had fallen far short of what had been needed to improve the balance of payments position. Indeed, the Fund program appeared to have permitted a delay in adjustment and to have helped to finance consumption-led growth. As a result, the economy continued to be vulnerable to adverse external developments.

The difficulties facing the domestic economy and the balance of payments could be traced to a number of the Government's policies, Mr. Erb considered. There were widespread inefficiencies in the domestic allocation of resources, and the government sector continued to subsidize domestic consumption at the expense of new productive investment. The staff and Mr. Kharmawan had clearly spelled out the kinds of measures that would have to be undertaken to bring about balance of payments adjustment and to provide a solid foundation for domestic economic growth.

Mr. Prowse said that, while he agreed with the staff analysis and supported the proposed decision, he harbored some doubt whether the staff's recommendations could in fact be implemented by the authorities. The policies that they had adopted in 1980 were courageous and comprehensive, but there had apparently been a lack of follow-through and flexibility in 1981. The provision of basic consumer items to public employees at subsidized prices and the apparently mediocre management and performance of the state economic enterprises were matters that the authorities clearly could deal with themselves, the former more easily than the latter. He wondered whether its bilateral trade agreements did not limit Laos in its efforts to improve the balance of payments position.

The staff representative from the Asian Department commented that it was certainly true that the negotiation of bilateral trade arrangements on an annual basis limited the country's ability to bring about an improvement in external trade. In addition to constraining the choice of imports, the trade agreements contained special pricing arrangements that made it uncertain whether the Lao People's Democratic Republic would benefit from any increase in world market prices in coming years. The staff had made known its reservations about the bilateral trade arrangements during the discussion with the Lao authorities. As for the state economic enterprises, the authorities had clearly made substantial adjustments in prices in 1980, and additional adjustments were planned. The main weaknesses of state enterprises included poor management, inadequate capacity to implement policies, and a lack of sufficient control over outlays. The enterprises would greatly benefit from more technical assistance.

Mr. Kharmawan remarked that the shortcomings that had been described by the staff and Executive Directors had been clearly recognized by the authorities themselves. They understood the need to adopt certain domestic measures in order to make the necessary adjustments in the economy. However, Executive Directors should bear in mind that, as the staff had stressed, the economic situation in the country was complicated by two external factors: namely, the political tensions in the region, and the sharp reduction in foreign assistance. The latter had obviously had a serious adverse effect on the balance of payments position, and countries that were in a position to do so should provide further financial assistance; after all, the Lao People's Democratic Republic was a poor country, with a per capita income of only \$80 a year. He hoped that donor countries recognized the country's plight and understood that the Lao effort to make the needed adjustments in the economy would be particularly difficult without an adequate inflow of financial assistance.

The Chairman made the following summing up:

There was broad support by Executive Directors for the thrust of the views expressed in the staff appraisal for the 1981 Article IV consultation with the Lao People's Democratic Republic.

It was noted that the policy changes introduced in early 1980--such as the greater scope given to private activities, the adoption of more realistic official pricing and exchange rate policies, and improved budget discipline--had resulted in some progress in several areas in 1980. However, in recent months exogenous factors, shortcomings in economic policies, and a lack of follow-through in policies in 1981 had resulted in a less favorable economic performance, as evidenced by renewed inflationary and balance of payments pressures, and the re-emergence of large price distortions.

Given the magnitude of the external current account deficit, which has reached an unsustainable level, the expected increase in foreign debt servicing, and the existing structural problems, Executive Directors and management stressed the need for resolute and comprehensive policy actions in several areas in order to achieve a lasting improvement in economic performance and to maintain the current account deficit of the balance of payments at a sustainable level.

The Executive Directors stressed the need for a large and sustained effort to mobilize more domestic resources, largely through an improvement in the financial position of the public sector. This would reduce inflationary pressures and finance the development effort at a time when foreign aid is falling and its prospects are uncertain. The Executive Directors noted the intention of the authorities to introduce a substantive reform of official costs and prices in early 1982, thus reducing subsidies, and they pointed to the role interest rate policy can play in mobilizing domestic private saving and in allocating scarce financial resources more efficiently.

The authorities were urged to take strong policy action in the areas mentioned above. These policies should also be supported by steps aimed at increasing the efficiency of state enterprises, and by procedures to monitor their performance. The question was also raised whether the existing bilateral trade arrangements are adversely affecting the balance of payments of the Lao People's Democratic Republic.

The Executive Board then took the following decision:

Decision Concluding 1981 Article XIV Consultation

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 1981 Article XIV consultation with the Lao People's Democratic Republic in the light of the 1981 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 notes that the exchange system of the Lao People's Democratic Republic remains restrictive and involves a multiple currency practice, as described in SM/81/187. The Fund encourages the authorities of the Lao People's Democratic Republic to proceed with the elimination of the multiple currency practice in the context of their intended reform of the pricing system. In the meantime, the Fund approves the multiple currency practice resulting from the application of an exchange premium for certain transactions until September 30, 1982, or the completion of the 1982 Article IV consultation with the Lao People's Democratic Republic, whichever is earlier.

Decision No. 6960-(81/129), adopted
October 7, 1981

3. EXECUTIVE DIRECTOR

The Chairman bade farewell to Mr. Syvrud on completion of his term as Alternate Executive Director.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/81/128 (9/16/81) and EBM/81/129 (10/7/81).

4. GREECE - EXCHANGE SYSTEM

The approval under Decision No. 6616-(80/131) of Greece's exchange restrictions and multiple currency practice, with the changes described in EBD/81/245 (9/23/81), is extended until June 30, 1982, or the completion of the next Article IV consultation with Greece, whichever is earlier.

Decision No. 6961-(81/129), adopted
September 25, 1981

5. SFF SUBSIDY ACCOUNT - BORROWING - LUXEMBOURG

The Fund, acting as Trustee of the Supplementary Financing Facility Subsidy Account established under the Instrument annexed to Executive Board Decision No. 6683-(80/185) G/TR, adopted December 17, 1980, approves the borrowing arrangement with the Grand Duchy of Luxembourg on the terms and conditions set out in the attachment to EBS/81/195 (9/28/81).

Decision No. 6962-(81/129) SBS, adopted
September 30, 1981

6. MADAGASCAR - TECHNICAL ASSISTANCE

In response to a request from the Malagasy authorities for technical assistance, the Executive Board approves the proposal set forth in EBD/81/236 (9/16/81).

Adopted September 21, 1981

7. BHUTAN - MEMBERSHIP - GOVERNORS' VOTE

The Executive Board approves the report of the Secretary (EBD/81/214, Supplement 1, 9/24/81) on the canvass of votes of the Governors on Resolution No. 36-7, with respect to membership for Bhutan, adopted by the Executive Board for submission to the Board of Governors at EBM/81/116 (8/26/81). The Governors' vote on the Resolution is recorded as follows:

Total affirmative votes		603,185
Total negative votes		0
Total votes cast		603,185
Abstentions recorded	0	
Other replies	0	
Total replies		603,185
Votes of members that did not reply		38,719
Total votes of members		641,904

Decision No. 6963-(81/129), adopted
September 24, 1981

8. EXECUTIVE BOARD - WAIVER OF ACCELERATED REPAYMENT OF SALARY
ADVANCE TO PURCHASE A HOME

The Executive Board approves the proposal set forth in EBAP/81/304 (9/22/81).

Adopted September 24, 1981

9. RULES AND REGULATIONS AMENDED SINCE 1980 ANNUAL MEETING

The Executive Board approves the draft Resolution set forth in EBD/81/241, Annex II (9/16/81).

Adopted September 18, 1981

10. SFF SUBSIDY ACCOUNT - SWITZERLAND - TRANSMITTAL OF FUND
DOCUMENTS

The Executive Board approves the request of Switzerland with respect to the release of Executive Board documents relating to proposals for the amendment of the Instrument establishing the Supplementary Financing Facility Subsidy Account or the review of the list of eligible beneficiaries of the Subsidy Account subject to the understandings set forth in EBD/81/244 (9/22/81).

Adopted September 25, 1981

11. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 81/64 and 81/69 through 81/73 are approved. (EBD/81/235, 9/16/81)

Adopted September 22, 1981

12. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 81/74 through 81/80 are approved. (EBD/81/237, 9/17/81)

Adopted September 23, 1981

13. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/81/299 (9/15/81), EBAP/81/300 (9/16/81), EBAP/81/301 (9/16/81), EBAP/81/305 (9/25/81), EBAP/81/306 (9/29/81), EBAP/81/307 (9/29/81), EBAP/81/309 (10/1/81), and EBAP/81/310 (10/5/81) and by an Assistant to Executive Director as set forth in EBAP/81/308 (9/30/81) is approved.

APPROVED: February 25, 1982

JOSEPH W. LANG, JR.
Acting Secretary

