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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 97/120

10:00 a.m., December 12, 1997

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Decisions Taken Since Previous Board Meeting

Executive Board Attendance

A.D. Ouattara, Acting Chairman
S. Fischer, First Deputy Managing Director

Executive Directors

A.A. Al-Tuwaijri

T.A. Bernes
R.F. Cippà

A. Kafka
W. Kiekens

K. Lissakers

G. O'Donnell
A.S. Shaalan

E. Srejber
G.F. Taylor

J. de Beaufort Wijnholds
K. Yao
Y. Yoshimura

Zhang Z.
A.G. Zoccali

Alternate Executive Directors

S.M. Al-Turki
R. Fernandez
H. Paris, Temporary
C.X. O'Loghlin

W.-D. Donecker
A. Giustiniani, Temporary
L.J.F. Erasmus, Temporary

Z. Akhmetova, Temporary
M. Nemli, Temporary
B.S. Newman
S.D. Melese-d'Hospital, Temporary
M. Budington, Temporary
M.A. Ahmed, Temporary
M.-H. Mahdavian, Temporary
E. Kouprianova, Temporary
B.M. Lvin, Temporary
J. Shields

H.B. Disanayaka
R.P. Watal, Temporary

O. Kwon
J. Guzmán-Calafell
C.A. Lucenti, Temporary

A. Barro Chambrier
H. Ono
H. Ogushi, Temporary
S. Joyosumarto
Phan M.H., Temporary

O.C. Otazú, Temporary

R.H. Munzberg, Secretary
A. Mountford, Acting Secretary
S. Soromenho-Ramos, Assistant

Republic of Korea—Report by Staff
Staff representative: Neiss, APD

Kyrgyz Republic—1997 Article IV Consultation; and Enhanced Structural Adjustment Facility—Review Under Third Annual Arrangement
Staff representatives: Geadah, EU2; Schadler, PDR

Lebanon—1997 Article IV Consultation
Staff representatives: Eken, MED; Puckahtikom, PDR

Also Present
IBRD: P.M. Hansen, Europe and Central Asia Regional Office. J.C. Wetter, Middle East and North Africa Regional Office. Administration Department: A.D. Goltz. Asia and Pacific Department: H. Neiss, Director. A. Singh, Deputy Director. European II Department: J. Odling-Smee, Director; T. Catsambas, J. Dalsgaard, D.J. Donovan, S. Geadah, O. Havrylyshyn, C. Imachev, N. Kapur, J. Mueller. External Relations Department: P.C. Hole, Deputy Director; M.E. Hansen, H.P. Puentes. Fiscal Affairs Department: P.S. Heller, Deputy Director; Chu K.-Y., H.M. Petri. IMF Institute: S. El-Khouri, M.R. Rached. Legal Department: F.P. Gianviti, General Counsel; W.E. Holder, Deputy General Counsel; J.L. Hagan, D.E. Siegel. Middle Eastern Department: M.A. El-Erian, Deputy Director; A. Bisat, S. Eken, A. Fedelino, T.F. Helbling, O.T. Kanaan, V. Sundararajan, M. Zavadjil. Monetary and Exchange Affairs Department: P.T. Downes. Policy Development and Review Department: J.T. Boorman, Director; J. Ferran, Deputy Director; L.Y.M. Leigh, C. Puckahtikom, S.M. Schadler. Research Department: M. Mussa, Economic Counsellor and Director; P.R. Masson, A.J. Tweedie. Secretary's Department: S. Bhatia, P. Gotur, B.A. Sarr. Treasurer's Department: M.G. Kuhn. Western Hemisphere Department: C.M. Loser, Director. Office of the Managing Director: J.A.P. Clément, B. Christensen, P.J. McClellan, L.A. Wolfe. Advisors to Executive Directors: W.F. Abdelati, P.A. Akatu, M. Askari-Rankouhi, T. Brizuela, M.H. Elhage, P.M. Fremann, C.M. Gonzalez, R.J. Heinbuecher, K.M. Heinonen, G.M. Iradian, A.R. Ismael, J. Jonáš, R. Kannan, H. Kaufmann, B. Konan, A. Levy, M.F. Melhem, H. Mori, J.-C. Obame, Y. Patel, E. Rodriguez, L. van Geest. Assistants to Executive Directors: A. Abdychev, N.R.F. Blancher, J.G. Borpujari, P.I. Botoucharov, M.A. Brooke, M. Carlens, J. Chelsky, M.A. Cilento, A.L. Coronel, D.A.A. Daco, C.K.E. Duenwald, J.C. Estrella, D. Fujii, S. Fukushima, W.K. Gruber, J.K. Honeyfield, K. Lai., J.P. Leijdekker, Lu A., A. Lushin, B.M. Lvin, M.Z. Maatan, F. Mercusa, W. Merz, I. Moon, L. Palei, L. Pinzani, Qi J., E.T. Rădulescu, J. Roaf, S. Rouai, J. Salleh, J.N. Santos, O. Schmalzriedt, T.T. Schneider, R.J. Singh, M. Vismantas, Wang X.

1. REPUBLIC OF KOREA—REPORT BY STAFF

The staff, meeting in restricted session, reported on recent developments in the Republic of Korea.

2. KYRGYZ REPUBLIC—1997 ARTICLE IV CONSULTATION; AND ENHANCED STRUCTURAL ADJUSTMENT FACILITY—REVIEW UNDER THIRD ANNUAL ARRANGEMENT

The Executive Directors considered the staff report for the 1997 Article IV consultation with the Kyrgyz Republic and the midterm review under the third annual arrangement under the Enhanced Structural Adjustment Facility (ESAF) (EBS/97/213, 11/26/97; and Sup. 1, 12/10/97). They also had before them a staff paper on recent economic developments in the Kyrgyz Republic (SM/97/274, 11/26/97).

Mr. Cippà and Mr. Abdychev submitted the following statement:

On behalf of the Kyrgyz authorities we would like to compliment and thank the staff, including the Resident Representative in Bishkek, for the thorough report on recent economic developments in the Kyrgyz Republic and express the authorities' gratitude for the constant fruitful cooperation and valuable technical assistance.

The macroeconomic achievements in the past year have been significant. Inflation has declined steadily and now expected to be below the target of 17 percent in 1997, compared with 35 percent in 1996. Real GDP growth will remain impressive, exceeding the targeted

6.2 percent. The exchange rate has remained stable. The quantitative targets during the first three quarters of the year were generally met, and remained largely unaltered for end-December.

Fiscal consolidation has been the primary task of the government. The budget deficit is expected to decline to 5.7 percent of GDP this year, down from 13.5 percent in 1995. To compensate for a revenue shortfall due to relatively low privatization proceeds and grants, expenditures were kept tightly under control with cuts especially in low priority items. The October minimum wage adjustment was postponed to January 1998.

The authorities fully understand the need to strengthen their efforts in fiscal consolidation and tax administration. Some measures in this regard, required for the completion of the mid-term review, were taken. The government has eliminated the tax exemptions on petroleum products granted to Kyrgyzgazmunaizat. Moreover, it has been decided to transfer the deposits of the State Property Fund to the Treasury. Considerable improvement has been made in the area of budget planning and execution. The treasury system is fully operational and responsible for the execution of the budget. A new Law on the Principles of the Budget is expected to be approved by Parliament during the current session.

The budget for 1998 has already been approved by Parliament. It envisages a further fiscal tightening, with the deficit expected to decline to 4.9 percent of GDP. The revenue targets are ambitious and exceed the amount agreed upon with the staff. The government wants to achieve these goals by improving the collection of excise taxes on cigarettes and on alcoholic products, by increasing custom duties collection (by strengthening the customs administration), and by refraining from granting tax exemptions and deferrals. The expected resumption of the privatization program will also increase fiscal revenues. The government is firmly committed to achieve the revenue targets, and it is prepared, in the event of a revenue shortfall, to carry out the expenditure cuts needed to meet the overall deficit objective.

Program targets regarding monetary expansion and domestic financing of the budget deficit are currently observed. By starting repos operations in 1997, the National Bank strengthened considerably its monetary policy instruments. Monetary policy aims at an inflation rate of 12 percent for 1998. The National Bank of the Kyrgyz Republic will discontinue financing the budget deficit in 1998; this decision is included in the budget already approved by Parliament. Gross official reserves have risen substantially to over 2 ½ months of imports.

In the external sector the current account deficit is now projected to decline to 11 percent of GDP in 1997 following the start of exports from the Kumtor mine. The Kyrgyz authorities maintained full current and capital account convertibility, and remain committed to maintaining a liberal trade and exchange rate regime. The Kyrgyz Republic has further moved toward the WTO accession.

The authorities fully agree with the staff on the importance of establishing a strict control over external borrowing. They realize that in a medium-term perspective the country should rely mostly on concessional loans. They decided to include the central bank in the approval process for new external borrowing. This should substantially reduce the risk that credits on non-concessional terms are accepted.

In the area of financial sector reform much has been achieved. Two large state-owned specialized banks, Agroprombank (Agricultural Bank) and Elbank (Savings Bank), were liquidated. The Savings Bank's small depositors were fully paid off, while the deposit accounts of larger deposit holders were transferred to the newly established Savings and Settlements Corporation. Another two large former state-owned banks have been restructured and their performance has substantially improved. The central bank is strictly enforcing the new prudential guidelines on all commercial banks. A new Chart of Accounts based on International Accounting Standards has been introduced. A set of key financial laws have been enacted including the Central Bank Law, the Law on Banks and Banking Activities, the Law on Collateral, and the new Bankruptcy Legislation. Efforts are also underway to create an effective legal and regulatory framework for the development of non-bank financial institutions, including a securities market. All these activities were supported by a World Bank loan. As a result of financial sector reforms and increased confidence by the public, the share of deposits in broad money has risen, and the ratio of foreign currency deposits to total deposits has dropped.

Considerable progress has also been achieved in implementing structural reforms in the legal and regulatory area, and in enterprise restructuring. However, the authorities agree that the pace of structural reforms must be accelerated. In the area of privatization, after the completion of the mass (coupon) privatization, the government has initiated the reorganization and privatization of large enterprises in the energy, transport (aviation), industrial, mining, and telecommunication sectors. In parallel, the authorities have started to reform corporate governance in several large state-owned enterprises. These reforms were supported by the AsDB. In the agricultural sector the government has increased the land use rights from 49 years to 99 years. The government wants to press ahead with land reform by reducing the restrictions on land lease. As regards the energy sector, the Kyrgyz authorities are determined to raise energy prices to improve financial viability of the Kyrgyz energy company. Judicial reforms continue to be at the forefront of the government's struggle to improve the democratic institutions of the society.

The staff has rightly expressed concerns about the deterioration of social indicators. The social costs of the reform have been and remain severe. Poverty remains pervasive. The health of the population is worsening and the rate of unemployment is still at unacceptable high levels. The authorities understand that the success of the reforms mostly depends on an increase of the quality of life and will continue with their efforts to improve the social situation. Thus, social policies will focus on the strengthening of the social safety net and reforms in the health and education system. The Kyrgyz authorities also fully agree on the importance of a comprehensive pension reform which will reduce the financial burden of the Social Fund. This reform will be carried out next year with the assistance of the World Bank and AsDB.

In conclusion, while progress so far has been impressive, much remains to be done. The authorities recognize the crucial role played by the Fund. Further, the financial and technical support during the remaining phases of transition is decisive for keeping up the pace of reform. For this reason, they are approaching the IMF for a successor three year ESAF arrangement. On behalf of the Kyrgyz authorities, I would like to confirm their strong commitment to continue the stabilization program and to deepen economic adjustment efforts to promote economic growth and prosperity of the Kyrgyz people.

Mr. Ogushi made the following statement:

I welcome the Kyrgyz Republic's favorable economic performance after several years of economic reform efforts by the authorities. The result of these reforms can be seen in the positive growth since 1996 and the decreasing trend of inflation. Against the background of the authorities' commitment and the fact that the program is broadly on track, I can support the completion of the review. Let me just comment on some specific points for emphasis.

I welcome the significant reduction of the budget deficit in 1996 as a result of the authorities' active efforts in the fiscal area. It is commendable that the authorities attained this end through drastic expenditure cuts, and I hope that the treasury system, which is now fully operational, will enable better management of expenditure from now on. At the same time, it is also important to strengthen the fiscal position through measures on the revenue side. While I acknowledge that there is relatively limited scope for increasing tax rates generally speaking, I would urge the authorities to step up their efforts to improve tax administration and to eliminate tax exemptions. The supplement paper we received recently shows a shortfall in revenue receipts—a worrisome signal. I would like again to urge the authorities to step up their efforts on the revenue side.

Bold reform of the Social Fund is one of the core measures to strengthen the fiscal position. The staff makes some recommendations in the background paper on the possible reform direction of the Social Fund. I would appreciate it if the staff could elaborate on the authorities' current thinking on the reform of the Social Fund, including their views on the staff's recommendations.

Developments on the monetary front are broadly satisfactory. It is encouraging that the authorities are relying more on indirect monetary instruments, and I hope there will be further improvement in this regard. I note that the authorities intend to maintain the foreign currency auction system until 1998. While I do not have very strong objections to this, I would urge the authorities to develop a well-functioning interbank market and eliminate the auction system as soon as possible.

I am happy to know that the current account deficit, which widened considerably in 1996, is now on a decreasing trend; however, I would echo the staff's concern about the rapid pace of increase of the external debt. It is critical that the authorities strengthen external debt management, as they currently envisage doing.

On the structural front, while some important progress has been made in the banking and budgetary systems, progress in privatization, in particular of medium to large scale enterprises, and in agricultural and legal system reform, has not been proceeding as planned. Progress in this area is urgent. In my view, agricultural reform, including land reform, is particularly important. Growth in 1997 owed a great deal to the favorable outcome of gold mining projects. But I do not think that it is desirable to rely too much on the gold mining project as a driving force of the economy. It is important to cultivate a promising production base in the longer term. As agriculture is one of the most important production bases of the economy, it is critical to press ahead with reform in this area so that private entities can play an important and active role in promoting production.

Finally, I welcome the authorities' interest in a successor three-year ESAF-supported program, but I would note that the new program will only be feasible when the authorities make enough of an effort to implement all of the measures in the rest of the current program and show their willingness to take appropriate measures to further stabilize the economy in the course of the program negotiations. With these remarks, I wish the authorities success in their endeavors.

Ms. Akhmetova made the following statement:

During our discussions on the occasion of the approval of present program, our chair urged the Kyrgyz authorities to keep close watch to avoid deterioration of the living standards of the population. Today's staff report shows that the adjustment efforts undertaken by the authorities so far have not improved the welfare of the Kyrgyz nation. After three years of support from and cooperation with the major international institutions, official statistics (commissioned by the World Bank) now show that nearly 50 percent of the population lives below the official poverty line, and that 23 percent are in "extreme poverty." In the same vein, I find it disappointing for a compact country like the Kyrgyz Republic, with a population of only 4.5 million, there has been a decline in average life expectancy and a sharp increase in child malnutrition.

It is understandable though not acceptable that the Government has been unable to provide enough of the essential social services. Partly as the result of budgetary pressures, real government expenditures have been cut almost in half since 1993.

In light of the recovery and the expectation that real GDP will increase by around 6 percent this year, one ought to expect given the severe poverty conditions, the government's spending program would include sound social assistance projects with adequate funding for social services. But instead, for years there has been difficulty in meeting the program's revenue targets and shortfalls in budget receipts, and deficit reduction has been achieved mostly by cutting government spending. Once more this year, weaknesses in the budget structure and poor revenue collection due to problems in tax administration, the Government is planning to cut expenditures again, primarily by extending the reduction of wages and cutting social security payments. But the staff points out that one-fifth of the population already remain unemployed, while average wages are still stalled at about 80 percent of their 1992 level, far below the level of wages in neighboring countries.

Unfortunately, nobody expects any sudden change for the better, at least until the end of the program. But I would appreciate the staff's assessment of whether the Government possesses adequate administrative capacity to improve the social indicators. Also, is there any possibility of strengthening of control mechanisms guaranteeing that funds from international aid sources are used for their targeted purposes?

The staff report discusses several issues where even though reforms have been implemented as planned, the results have fallen short of expectations. They find that the failure of appropriate governance promulgated at the top to penetrate to the local level has virtually nullified cancelled the positive effects of agricultural reforms at the sectoral level. One should not underestimate the demoralizing effects for almost 60 percent of the Kyrgyz population that live in rural areas, and corrective measures should accordingly be provided when negotiating a successor arrangement with the Fund.

One of the major components of the privatization package has also been suspended by inappropriate administrative actions which hinder the solution of problems with the restructuring of the largest enterprises. This has interfered with the cash flow of these enterprises, with adverse effects both for the partners, and even more important, for budget revenues.

Even though some of Kyrgyzia's neighbor countries are now being criticized for the slowness of their structural reforms, it is also essential to avoid the negative consequences of poorly targeted reforms that only aim at speed so as to qualify for another batch of "generous" external assistance, which inevitably turns into another burden of growing indebtedness.

With these remarks, I wholeheartedly wish the Kyrgyz authorities success in their difficult endeavors.

Mr. Mahdavian made the following statement:

Over the past three years, the Kyrgyz economy has been undergoing macroeconomic stabilization and adjustment reforms, with significant progress in implementing the structural reform agenda. The overall macroeconomic developments have been in line with projections under the ESAF-supported program. The Kyrgyz authorities have made commendable efforts in creating a solid base for economic growth and advancing the transformation to a market economy. Real GDP began to pick up substantially in 1996 and is expected to maintain its strong performance over the medium term. The rate of inflation is expected to decline sharply in the current year in line with the program target. Monetary and credit policies have been restricted, and a sizeable reduction in budget deficit has been achieved. This performance could not have been achieved without the sustained implementation of adjustment and reform measures. Indeed, the authorities' adherence to the Fund-supported ESAF program has been exemplary, as evidenced by the observance of all performance criteria and quantitative and structural benchmarks.

In the fiscal area, the progress made in strengthening the overall fiscal position is impressive. While the government has strived to boost the tax revenue, the bulk of fiscal adjustment has been achieved through expenditure restraint and the tax buoyancy could not be established. In light of the expected decrease in the proceeds from privatization and grants, the authorities should move swiftly with their plan to implement the excises on cigarettes and alcohol and to strengthen the tax administration. Discretionary tax exemptions could lead to distortion and drain off the tax revenues. Thus, we welcome the authorities' intention to revoke tax exemption. The elimination of tax exemption, coupled with strengthening tax administration, should enhance the prospect for the increased budget revenue in 1998. Nevertheless, we agree with the staff that there are risks to fiscal consolidation from ambitious budget revenue targets for 1998. Thus, we urge the authorities to identify areas of expenditure cuts to ensure the realization of the overall deficit of 4.9 percent of GDP in 1998.

Monetary management has benefited from reliance on market-based instruments, tightening of credit, and refrainment from financing the budget. This policy has contributed to lower inflation and maintenance of a stable exchange rate. It is reassuring that the focus of monetary policy will maintain the consolidation of the gains in inflation reduction and exchange rate stability. We are encouraged by the strong reform measures adopted for strengthening the banking system in 1996/97. The authorities have taken many commendable actions in this regard. The experience of Kyrgyz Republic illustrates how authorities can avoid erosion of public confidence and pressure on the foreign exchange market by adopting balanced adjustment with appropriate sequencing in the economic reform process.

Although the Kyrgyz Republic has made good progress in economic stabilization, additional efforts are needed to reduce the high unemployment and increase the standard of living. This requires further strides on structural reforms. One area of urgency is the long-delayed comprehensive reform in the country's pension system. The authorities should prepare a plan to reform the pension system by raising the retirement age, reducing pensions and limiting the maximum pension. We are encouraged to learn that this reform will be carried out next year.

In conclusion, we support the completion of the review under the third annual ESAF arrangement and welcome the authorities' willingness to approach the Fund for a successive ESAF-supported program.

Mr. Watal made the following statement:

The Kyrgyz authorities are to be congratulated for the progress that has been made since the last review. In our opinion the achievements in the stabilization and structural reform are quite satisfactory. Our chair is also glad to note that the GDP is expected to increase by over 6.2 percent this year. The economic activity has increased in all the sectors, even though as stated by the staff, some of the gains may have been missed in the official statistics. The inflation has also declined sharply and seems to be well within the program target of 17 percent. The budgetary reforms are also on track. The import coverage by gross official reserves are projected to grow to 2.7 months by the end of the year. At the same time the authorities have maintained a floating exchange rate system within a narrow range, vis-a-vis the dollar and they do not envisage restricting depreciation of the som. The progress in privatization of state enterprises and their restructuring have also been significant and noteworthy.

It is time that the economy should take advantage of the new economic opportunities and wean itself away from assistance through grants. The authorities' must also tighten areas of policy implementation which are still weak. Our chair agrees with the thrust of the well written and clear staff appraisal of the Kyrgyz economy.

We would like to make a few short comments for emphasis. Firstly, the problem of under reporting of economic activity has been coming up consistently in the staff reports. What are the effective measures been taken by the authorities to improve the reporting of economic statistics?

From Mr.Cippà and Mr. Abdychev's helpful statement, it is clear that the authorities are taking measures to keep the fiscal policy largely on track and the budgetary payment arrears for 1997 have been settled. But the supplement report indicates that revenue projections are at some risk which is worrisome. The adjustments that have been suggested would help to attain the targets and would enable the authorities to keep within the boundaries of the program. However it has been mentioned in the report that there has been a sharp deterioration in social indicators. Would staff elaborate further on the implication of protection of budgetary allocations on health, education etc. Would this be a sufficiently strong measure to reverse the adverse trend, because in our view the 1998 budget that is envisaged also seems to maintain a status quo in these sectors. We would also like to know whether removal of tax exemptions granted to the gas monopoly and adjustment of electricity and heating prices has in any manner adversely affected supply of energy during the winter months?

Kyrgyztan, being a small country with a small economy, will continue to depend on the support from bilateral and multilateral partners. The improvements in the current account deficit are largely due to gold exports and as staff has explained in the report the economy would have to still depend on disbursements from multilateral agencies. We would agree with the staff that the authorities must borrow on concessional terms to avoid the deterioration of the debt-to-GDP ratio in the medium term. In this context would staff comment whether there is a favorable spinoff on the business climate because of the program performance? and what are the prospects of any future foreign direct investments in sectors which have promise; like crystalline silicon, agro industries and the power sector. It is heartening to note that trade and foreign investment remains the highest priorities of the government. With the agriculture sector picking up the authorities should concentrate on strengthening the agro industries. The Kyrgyz Agricultural Finance Corporation has started its operations and we hope that rural credit is reaching far flung areas but it is a source of concern that the legal status of land use rights has not been made clear. Private ownership of land has not yet evolved. Long term leases up to 99 years still means that the state continues to have the final ownership rights. Since agriculture is an important sector the structural reform of this sector must be given highest priority. It would also be good to foster economic diversification and make the economy less vulnerable to future uncertainties.

In conclusion, we share the optimism of the staff and the authorities about the future of the Kyrgyz economy and support the interest of the authorities in a successor three year ESAF at an appropriate time. We also endorse the proposed decision and the recommendation made by staff for the completion of the mid term review under the third ESAF annual arrangement.

Mr. Al-Turki made the following statement:

It is heartening that the Kyrgyz Republic has sustained the economic recovery that began in 1996. Growth has picked up and inflation has slowed ahead of the program targets. However, growth is still narrowly based, unemployment remains high, and poverty is rising. For a sustained and broad-based recovery, substantial macroeconomic and structural improvements are essential. The authorities' readiness for further adjustment and reform is therefore reassuring.

I am in broad agreement with the staff appraisal and will only have a few remarks for emphasis.

The program's continued priority for reduction of the fiscal deficit is critical. The marked drop in domestic financing of the budget is welcome. Reliance on spending cuts rather than revenue growth for the fiscal adjustment is also appropriate. That said, a stronger effort is clearly warranted on both revenue and expenditure fronts.

On the revenue side, I am encouraged by the ongoing administrative improvements and tax reforms, including the equalization of rates with neighboring countries. Here, I endorse the report's caution against ad hoc tax exemptions. Regarding spending restraint, the focus on wage moderation, civil service reform, and better targeting of social benefits are appropriate. The discontinuation of budget financing by the National Bank from 1998 is also a move in the right direction. However, given the budget's overestimation of revenues, readiness for contingency cuts is indeed critical.

I agree with the report's priority for pension reform. In that connection, the actions that staff has recommended include increases in the retirement age and limits on early retirement. I am unclear on implications of these actions in the context of the economy's high unemployment. Staff comments will be welcome.

In monetary management, the authorities' transition from direct credit controls to indirect market-oriented instruments is commendable. Given the still sizable inflation rate, I welcome the continued monetary tightness. As noted in Mr. Cippa and Abdychev's helpful statement, the authorities' considerable progress in financial sector reform is already evident in the economy's resulting de-dollarization and increased use of banks. Completion of this process, including early institution of an efficient regulatory framework and bankruptcy laws, is a priority.

Acceleration of structural reform is also critical for the economy's longer term prospects. Here, avoidance of further delays in the envisaged early restart of the privatization drive and restructuring of public enterprises is crucial. Also, as this chair has stressed before, ownership of land as a fully marketable asset is essential for a successful privatization of agriculture. While the increase announced in land use rights is reassuring, additional actions that the report suggests are clearly a priority.

Before closing, I would like to than staff for the very well written reports prepared for today's discussion.

With these remarks, I support the proposed decision and wish the authorities further success.

Mr. Lvin made the following statement:

I want to commend the staff for preparing very clear and transparent papers, and Mr. Cippa and Mr. Abdychev for their very helpful statement. Since I mostly agree with what the staff recommends, I wish to make only a few remarks on issues not covered by previous speakers.

The recent economic developments in the Kyrgyz Republic are very positive. The staff reports continuing economic growth for the second year in a row. What is remarkable about this growth is that it is apparently not artificially fueled by short-lived policies. Moreover, the noncombination of biases, which is so common for output statistics in transition economies, would imply that actual recovery is much stronger than that recorded. By the same token, it is also known that poverty data in the transition economies generally tend to underestimate the full amount of family incomes, including on both monetary and non-monetary components. Thus, the overall picture of Kyrgyz reform must be even better than it appears. As far as social indicators are concerned, I wonder to what extent poverty data in the Kyrgyz Republic is really comparable to that of its neighbors in terms of coverage and reliability.

A full assessment of the fiscal and debt situation of the Kyrgyz Republic would perhaps require a wider range of indicators than those used by the staff. Most indicators are now presented as GDP ratios, and it is upon these ratios that we are expected to make our judgment about successes and weaknesses in program performance. On the one hand, it may be reasonable to assume that the actual product generated by the economy at large is substantially larger that it appears, due to the magnitude of the gray economy. Therefore, the budget deficit and external debt might seem somewhat exaggerated by the presented estimates. On the other hand, it can also be argued that reliance on the GDP-denominated data underestimates the actual measure of the factors that we try to measure. For instance, this approach implies that the budget deficit and the debt could be eventually financed outside of domestic savings. In practice, it is only monetized and potentially-monetized savings and output that must be realistically taken into account; and the still low level of monetization of the Kyrgyz economy must remind us that fiscal imbalances which may look unsustainable even in an economy with large monetary penetration must be a dangerous drain on the limited monetary and marketable pool of resources in the Kyrgyz Republic. It is in view of this consideration that we are concerned with what might be perceived as a recurrent vicious circle of budget drafting and execution, so characteristic of many transition economies. Budget revenues are usually calculated to be unrealistically high, which inevitably leads to either unchecked inflation—fortunately this option seems to be over in these countries—or to various budget cuts and arrears. Unfortunately, my own country is still too familiar with this phenomenon, and that is why I strongly urge the Kyrgyz authorities to break out of this circle as soon as possible. It is obvious that it would be much more transparent, orderly, and efficient to distribute eventual unexpected revenues surpluses rather than cutting expenditures and forcing budget recipients into the chain of subsequent arrears. Such discretionary policy of cutting expenditures tends to entail bad governance, as well. However, he Kyrgyz Republic is rightfully called a forerunner in the area of reforms and it can be expected that, with the treasury system fully in place, its budget process will be much more rationalized.

The staff seem to praise the revenue sharing scheme now being approved in the Kyrgyz Republic. I am somewhat skeptical about its desirability because it is known that such schemes tend to involve some moral hazard for the local authorities. It would be much more appropriate to not to share the same revenues, but to share revenue sources between the local and central authorities. It would also be a much more transparent system. At the same time, the personnel reductions in the central administration, amounting to 12 percent in 1997, are a major achievement to be strongly commended and duplicated in many of the Kyrgyz Republic's neighbors, even though they are not yet reflected in actual savings.

In the monetary area, I particularly welcome the phasing out of clearly outdated mechanisms like credit auctions, overdraft and emergency credits.

In the external sector, I wish to note that, while exports increased by an impressive 56 percent, it is worrying that, in the future, all non-gold exports are expected to remain almost stagnant. It is not what we would expect in a country with such a liberalized trade system. I would like to hear the staff's comments on this.

On external assistance, I noted that paragraph 16 of the staff report states that enterprise restructuring programs failed to foster a marked increase in investor interest. I wonder whether these program added to the external—although concessional—public debt of the Kyrgyz Republic, and if so, whether they are an example of something which should have been avoided.

Finally, I strongly commend the staff for preparing an excellent analysis of the Kyrgyz pension system. It is notable that this system suffers not from actuarial unsoundness, as is in the case in many developed and transition economies, but rather from medium-term liquidity problems. An understanding of this special characteristic must be reflected in appropriate prescriptions. Therefore, in the course of successor Fund arrangements, which I strongly support, this issue be given much more priority. With these remarks, I support all of the proposed decisions.

Ms. Budington made the following statement:

I would like to thank staff for the very thorough report on recent economic developments and on performance under the program. Indeed, we continue to see improvements in macroeconomic developments with higher growth, the steady decline in inflation and further reduction in the budget deficit. The reforms in monetary and fiscal management that are being implemented with IMF and MDB support have enhanced the capacity of the central bank to achieve its monetary objectives, supported greater fiscal control, and prepared the groundwork for improved efficiency and confidence in the financial sector. The country has also made substantial progress on the trade front in preparation for accession to the WTO. But the deterioration of social indicators is troubling evidence of the need for continuation and deepening of the reform effort—including measures to ensure the social priorities are well-supported.

We concur with the proposed decision and the priorities highlighted in the staff's appraisal. I would therefore like to make just a few specific observations.

First, on the fiscal accounts, the authorities have demonstrated a strong commitment to bringing the fiscal deficit down through both revenue and expenditure action. Still, continued improvement in revenue performance—through both enhanced administration and removal of exemptions/deferrals—is critical to achieving a sustainable medium-term position and meeting priority expenditure needs. Slippage on collection of excises and right-to-trade fees, as well as the use of discretionary tax exemptions this year, have contributed to difficulties in meeting revenue targets. Improving performance in these areas will be particularly important in context of the very ambitious revenue forecasts included in next year's budget.

Second, staff have rightly emphasized the importance of early progress in pension reform. The system has been a major contributor to the arrears problem in the past and the current efforts to keep to a balance, while certainly commendable, provides only a temporary fix. Funded by a very high 39 percent payroll tax, the current system both contributes to the size of the informal economy and crowds out other potential uses for this substantial revenue source. The authorities' efforts to focus on this problem in the coming year, with IDA and ADB support, will therefore be critical.

Third, the government's efforts to strengthen controls on non-concessionary external borrowing will also be important in context of the rapid increase in these commitments in the past several years and the need for a prudent stance as the country continues to work toward a sustainable external position.

Finally, the Kyrgyz Republic has been a leader in its liberalization efforts and has made substantial progress in removing the structural impediments to economic efficiency. Nonetheless, investment levels remain fairly low at about 14.5 percent. As the authorities recognize, an ambitious agenda of structural reforms are needed to promote increased investment and private sector development. As part of this agenda, further attention to addressing regulatory and legal impediments to investment (including a concerted effort to improve implementation of new laws), follow through on planned privatizations, and acceleration of agricultural reforms including the passage of the proposed Land Code and Mortgage Law next year, will all be central to this effort.

Mr. Phan made the following statement:

I am pleased to note that the Kyrgyz Republic has over the past two years obtained a significant recovery in output following the introduction of stabilization policies. The GDP growth structure in 1997 has been diversified as compared to the previous year thanks to the start of production from the Kumtor gold mine and the acceleration of private sector activity, particularly in agriculture, trade and services. Inflation has declined sharply in 1997 as a result of the sustained tightening of monetary and credit policies. The authorities are commended for having maintained all the program's quantitative targets for end-December and implemented several prior actions relating to fiscal and external debt management for end-November.

Against this back ground, the authorities are encouraged to pay due attention to social developments as social indicators show that the proportion of households in poverty has risen and unemployment remains high. Well-targeted measures should be worked out with the aim of improving the population's living standard and the quality of public health and education services.

Regarding fiscal discipline, a significant improvement in fiscal performance is highly welcome with the evidence of halving the cash budget deficit in 1996 and sharply reducing domestic financing of the budget. In addition, the cumulative tax revenue targets for 1996-97 have been realized and significant reforms to budget planning and execution have been implemented. However, it is necessary for the continued efforts in improving revenue collection, since the improved fiscal performance has mainly relied on expenditure cut.

The authorities are encouraged to accelerate structural reforms by proceeding with the privatization program immediately upon completion of the investigation on past privatization practices together with stronger actions as committed in financial sector and budgetary reforms. As pointed out in the staff paper, the completion of the mass privatization program in mid-1997 represents a major milestone in the government's privatization program.

However, there are still a large number of major and small scale enterprises awaiting divestiture. Further efforts are required if privatization is resumed in December as planned to ensure the success of the overall strategy. Significant reforms to the banking system during 1996-97 has resulted in the emerging of the core of a small-but sound-commercial banking system. These banks need further reforms to promote their role as financial intermediaries.

Regular operations of the interbank market should be maintained. The authorities should also increase the efficiency of the public sector, and ensure adequate management and use of the country's natural resources in order to achieve sustainable growth over time.

Last but not least, as experiences in many developing and transition countries have shown, a very cautious external borrowing strategy is necessary. Therefore, the government's decision not to guarantee enterprise borrowing, and to strengthen controls and procedures over external borrowing is highly welcome.

With these remarks, I support the proposed decision and wish the Kyrgyz authorities every success.

Mr. Lucenti made the following statement:

The macroeconomic performance of the Kyrgyz Republic during 1997 has been quite important. Inflation, output, exchange rates, current account, and interest rates, all showed significant improvements. In addition, all the performance criteria and most benchmarks have been observed. Since we broadly share the staff appraisal, this chair supports the proposed decisions. I would like to make some brief comments on some aspects of the staff's report.

On fiscal policy, the authorities should continue with their effort to improve tax administration, and to overcome the difficulties they have experienced in revenue collection in the last two years. Regarding the 1998 budget, I welcome the authorities' commitment to be ready to reduce expenditures if the overestimated revenues do not materialize. I agree with the staff that the authorities should identify, as soon as possible, those expenditures, other than health and education, that can be cut, should the need arise, without incurring in payment arrears.

On the external debt issue, I believe that the country is still on-time in avoiding that the external debt becomes a serious problem in the near future. The debt to GDP ratio increased from almost zero to 52 percent in only seven years. In this regard, I also welcome the government's measures to strengthen procedures and controls over external borrowing.

On monetary policy, paragraph 42 of the staff report, assesses that the staff concurs with the authorities in postponing elimination of foreign exchange auctions until a properly functioning interbank market is established. I just wonder why the establishment of this market was not envisaged on the original ESAF program and if it was, why did it not work?

Finally, on structural reform, I understand that the privatization program for medium to large-scale enterprises was placed on hold pending the outcome of an investigation. Could the staff update us on this issue, and what would be the impact on the 1998 budget if privatization cannot be resumed in December, as it is stated on the staff report? If this is the case, is there any contingency plan to overcome the probable revenue shortfall?

With these remarks I wish the authorities every success in their tasks ahead.

The staff representative from the European II Department made the following remarks in response to comments and questions from Executive Directors:

A question was raised on the current thinking of the authorities with regard to pension reform and the social fund. The authorities recognize two things: First, that reform is needed to balance the finances of the pension fund; and second, that the current contribution rates are too high. Beyond that, they have not made any commitments as to what measures they will be taking with regard to pension reform. The staff has been pushing for an increase in the retirement age and a decrease in pensions to working pensioners; but the authorities are reserving judgment on these recommendations until next year, when the World Bank and the ADB will be formulating a program together on the pension system. We had been hoping that this would be done by the middle of the year, but now we understand that there might be some delays.

Mr. Al-Turki wondered about the effect of an increase in the retirement age on unemployment. An increase could make the unemployment problem somewhat worse, but not very much if it were gradual. The staff is recommending an increase in the retirement age of half a year per year. The effect on unemployment would probably be overshadowed by developments in the rest of the economy. Another factor is that a good portion of retirees who draw pensions do not leave the labor force. That is why we have so many people who are called working pensioners.

Ms. Akhmetova asked about the effects of the reform effort on social indicators, including unemployment, life expectancy and child malnutrition. In this regard, one has to remember that real GDP was cut by about 50 percent in the Kyrgyz Republic over a few years. That has led to a very sharp decline in the standards of living of the population. Had there not been reforms, the situation would have been much worse, as the Kyrgyz Republic would not have been able to obtain the substantial foreign assistance which softened the impact of the reforms themselves and of the breakup of the Soviet Union. Another factor to take into consideration is that many of these reforms were targeted to health and education. Allocations for these sectors have been somewhat protected in the budget. If one looks at the budgetary allocations and then adds to them what is included in the PFP, the ratio of spending to GDP has been more or less stable, despite the sharp decline in real wages over the period. The World Bank is very involved in the health sector, and the ADB in the education sector. The quality of data on these social indicators could be improved, but the most recent data we have shows that there may have been some improvement in some areas in the last year. The early numbers show there has been a small, non-significant increase in life expectancy.

There are still many difficulties in the agricultural sector, and the reforms that have been implemented have not achieved their potential, despite yielding some impressive results. A good part of the increase in agricultural production last year was as a result of the reforms, and the ability of farmers to decide what to plant and where.

A number of institutions, including the Fund, are actively involved in giving technical assistance to improve data reporting and the statistical base of the Kyrgyz Republic, especially to address the issue of the shadow economy. A lot of work has been done in this area, and it has yielded improvements in the consumer and producer price indexes, as well as in other areas.

The supply of energy in the winter months should not be affected by the removal of the exemption enjoyed by the gas monopoly. The value of the exemption has far exceeded the amount spent on installing gas meters, and therefore its removal improves the budgetary situation without affecting whether the population gets the energy supplies or not.

Foreign direct investment in the Kyrgyz Republic is low compared to some of the other transition countries, and it has been concentrated in a few large projects. A new gold mine is being developed, and a few factories have been set up, including a Coca-Cola factory. In general, however, we have not seen as positive a response as for some of the other transition economies, especially the mineral-rich economies or the ones closest to Europe.

The establishment of the interbank market was foreseen under the current program, but it did not develop as quickly as had been anticipated. There was also the technical difficulty, for which the IMF is giving technical assistance, in computing an official exchange rate based on interbank market transactions. It should be possible to move fully to an interbank market from current central bank auction system during the course of 1998. In this context, the central bank has been carrying out two auctions per week, and it will move to one auction per week as of January 1, 1998. Once the interbank market has developed, the central bank will completely eliminate them.

The investigation of the privatization process has been completed, and privatization should restart any day now. In fact, the authorities expect some revenues to come out of the privatization program in December. That will help the budget a little bit this year.

Mr. Cippà made the following concluding statement:

On behalf of my Kyrgyz authorities I thank Executive Directors for the interest they showed in Kyrgyzstan, their valuable comments and advice, and the support they expressed for the continuation of the Third Annual Arrangement under the current ESAF. I shall convey these comments to my authorities and I am sure that they will make good use of it. I will in particular stress that the Board is concerned about the slow implementation of structural reforms and about the growing external debt. As Mr. Geadah already answered comprehensively all questions raised by Directors, I shall make only a few additional comments:

First of all let me elaborate on the deterioration of the social indicators and the persisting high unemployment. It is undeniable that the social costs of the transformation are high. However, I want to be clear on one point. My authorities are fully committed to the transition of the Kyrgyz economy.

In this respect they are convinced about the usefulness of reforms. The transition is not in discussion and the reforms are minimizing the costs associated with it. Without these reforms the social situation would probably be much worse than it is now, as already stated by Mr. Geadah, and for sure it will be unsustainable over the longer term. I think it would be wrong to associate the decline of the living standard of the population with the activity of the Fund, which indeed was a key element in obtaining substantial external support which could alleviate in part the harshness of the transition. This is also my authorities' view, as they are strongly committed to continue the cooperation with the Fund, which is of benefit to the country. Kyrgyzstan will need even for the years to come the strong support of the Fund and the international financial communities. To further implement macroeconomic stabilization and structural reforms the Kyrgyz authorities are requesting a successor ESAF arrangement.

The strategy followed by my authorities is threefold. First they are fully committed to a comprehensive reform package to further improve the economic and institutional framework, to accelerate privatization as well as to reform the agricultural sector with a view to release the full potential of a market driven economy. Second, they will focus on the strengthening of the social safety net and the reforms of the pension system to increase the financial viability of the social system. And finally, the authorities lay much weight on the improvement of the education system. They are convinced that every investment in the education system will generate a high rate of return in the sense of future growth and prosperity.

Let me also say a few words on privatization. As can be taken from the Memorandum of Economic and Financial Policies, my authorities intend to restart the privatization program upon completion of the investigation on privatization procedures. In the meantime, this investigation has been completed. It revealed that the SPF (State Property Fund) made mistakes and violations in its work which caused considerable damage to the state. The necessary measures have been taken to correct the situation and the authorities intend now to continue decisively with the privatization process. Currently the government is elaborating the new privatization program for 1998-99 which is soon to be adopted. Moreover, the authorities intend to continue intensively with the enterprise restructuring based on the recently adopted new Bankruptcy Law.

I would like also to repeat my authorities' strong intention to continue the fiscal stabilization through strong performance on the revenue side as well as the decisive expenditure policy.

Let me conclude in reiterating my authorities' gratitude to the international community for their continuing support for the Kyrgyz transition process. I thank again, also on behalf of my authorities, the Fund management, the staff, and the Resident Representative, for their extremely valuable support and assistance.

The Acting Chairman made the following summing up:

Executive Directors agreed with the broad thrust of the staff appraisal. They commended the Kyrgyz authorities for the progress achieved in macroeconomic stabilization since the beginning of the ESAF program. Several indicators, in particular the robust growth of about 6 percent for the second year in a row, significant reduction in inflation, stabilization of the exchange rate, buildup of foreign reserves, and substantial drop in interest rates were evidence of the success of the authorities' appropriately tight demand management policies.

Directors noted that the budget deficit had been cut in half in 1996 and further curtailed in 1997, and that monetary growth rates had decelerated during the course of 1997. They also welcomed the progress in the implementation of key structural reforms in the financial sector, budgetary procedures, institution building, and enterprise restructuring, and the completion of the coupon privatization program.

Nevertheless, Directors expressed concern that the structural reforms had fallen short of expectations in several areas. They regretted the lack of pension reform, the suspension of the privatization program, and deficiencies in the legal and regulatory framework. Directors underscored the importance of reforms in these areas to laying the foundation for durable and sustainable growth. They urged the authorities to implement a comprehensive reform of the pension system, which could include an increase in the retirement age, limits on early retirement, and measures to limit the level of pension benefits to the resources available. They also urged the authorities to accelerate the privatization of large enterprises, and to address more decisively the remaining obstacles to transformation of the agricultural sector and the application of laws and regulations.

Directors reiterated the importance of maintaining the liberal trade regime. They also stressed that achieving external viability over the medium term would require adoption of a prudent borrowing strategy focused mainly on concessional loans and an improvement in the monitoring and management of such debts. In this context, Directors welcomed the authorities' decision to include the central bank in the approval process for all future external borrowing.

Noting that the tight fiscal situation toward the end of the year had necessitated the adoption of contingency measures to meet the overall fiscal deficit target, Directors urged the authorities to further strengthen the efficiency of the tax and customs collection administrations, combat smuggling, and avoid eroding the tax base through the granting of tax exemptions. They stressed that prudently formulated budget plans, together with the ongoing strengthening of budgetary procedures, would put an end to the incurrence of domestic payments arrears.

Directors expressed concern about the realism of the revenue projections in the 1998 budget and recalled the revenue shortfalls in recent years. They stressed the need to identify appropriate contingency measures in early 1998 to ensure the realization of budget plans. Directors also emphasized the importance of further fiscal consolidation as a centerpiece of the Kyrgyz Republic's future adjustment strategy, and welcomed the authorities' commitment not to resort to the central bank to finance the budget deficit as of 1998. Noting with regret the deterioration of some key social indicators, Directors underscored the importance of improvements in the quality of health and education services provided to the population. In view of the high level of unemployment, they called for a strengthening of the social safety net.

Directors expressed their satisfaction with the role of tight monetary and credit policies in bringing down inflation and stabilizing the exchange rate. They welcomed the significant modernization of the monetary policy instruments at the disposal of the central bank and urged the authorities to persevere in this process. Directors agreed with the staff's proposal to postpone the elimination of foreign currency auctions until a properly functioning interbank market is established and, to this end, approved the retention of the multiple currency practice until December 31, 1998.

Directors welcomed the authorities' interest in a successor ESAF arrangement, and noted that forceful pursuit of the remaining structural reform agenda and prudent macroeconomic policies would be needed to provide a credible basis for such an arrangement.

It is expected that the next Article IV consultation with the Kyrgyz Republic will be held on the standard 12-month cycle.

The Executive Board took the following decision:

Exchange Measures Subject to Article VIII

1. The Fund takes this decision relating to the Kyrgyz Republic's exchange measures subject to Article VIII, Sections 2(a) and 3, in light of the 1997 Article IV consultation with the Kyrgyz Republic conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies), as amended.

2. The Kyrgyz Republic maintains a multiple currency practice as described in Section 27 of EBS/97/213, which is subject to approval under Article VIII, Sections 2(a) and 3. In view of the circumstances of the Kyrgyz Republic, the Fund grants approval of the retention of this multiple currency practice until December 31, 1998, or the completion of the next Article IV consultation, whichever is earlier.

Decision No. 11620-(97/120), adopted
December 12, 1997

Enhanced Structural Adjustment Facility—Review under Third Annual Arrangement

1. The Kyrgyz Republic has consulted with the Fund in accordance with paragraph 2(c) of the third annual arrangement for the Kyrgyz Republic under the Enhanced Structural Adjustment Facility (ESAF) (EBS/97/43, Sup. 1) and paragraph 3 of the letter of the Prime Minister of the Kyrgyz Republic and the Chairman of the National Bank of the Kyrgyz Republic dated March 13, 1997 attached to the arrangement.

2. The letters from the Prime Minister of the Kyrgyz Republic and the Chairman of the National Bank of the Kyrgyz Republic dated November 26, 1997, together with the attached supplement to the Memorandum on Economic and Financial Policies for 1997, and December 5, 1997 shall be attached to the third annual ESAF arrangement for the Kyrgyz Republic, and the letter dated March 13, 1997 from the Prime Minister of the Kyrgyz Republic and the Chairman of the National Bank of the Kyrgyz Republic, together with its attached Memorandum of Economic and Financial Policies for 1997 for the Kyrgyz Republic, shall be read as supplemented and modified by the letters dated November 26, 1997, together with its attached supplement, and December 5, 1997.

3. The Fund determines that the midterm review contemplated in paragraph 2(c) of the third annual arrangement for the Kyrgyz Republic has been completed and that the Kyrgyz Republic may request the disbursement of the second loan specified in paragraph 1(b) of the third annual arrangement.

Decision No.11621-(97/120), adopted
December 12, 1997

3. LEBANON—1997 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1997 Article IV consultation with Lebanon (SM/97/270, 11/25/97). They also had before them a background paper on selected issues in Lebanon (SM/97/276, 11/26/97).

The staff representative from the Middle Eastern Department made the following statement:

> Since the publication of the Staff Report on the 1997 Article IV Consultation with Lebanon, the staff has received the following information on recent developments which is consistent with the staff appraisal contained in SM/97/270:
>
> The 1998 draft budget has been subject to intensive debate among the President, the Prime Minister and the Cabinet, the Speaker of the Parliament, and the Parliamentary Finance Committee during the past few weeks. The draft budget targets a deficit level of about LL 3,000 billion (excluding foreign financed capital expenditure) and a ratio of the deficit to expenditure of about 37 percent—consistent with the fiscal targets in the Staff Report. It is expected that parliamentary discussions on the 1998 budget will begin soon and that the budget will be approved at the latest by end-January 1998.

Regarding expenditure measures, the discussions have focused on expenditure reductions over and above those proposed in the 1998 draft budget, particularly in discretionary spending of ministries, outlays on overtime work, and spending on consultants. Moreover, the Cabinet and key members in the Parliamentary Finance Committee also agreed on a hiring freeze and on achieving important medium-term savings through substantial reductions in the number of government employees in the medium term and the rationalization of the administration through the merging of ministries and various other government agencies. The budgetary implications of these proposals are being assessed, given that incentive packages might involve short-term costs.

Concerning revenue, the government is committed to put the measures proposed in the 1998 draft budget in place, but remains willing to substitute them with measures that are equivalent in quality and yield if desired by Parliament. In addition, the government plans the introduction of a turnover tax, which is estimated to yield LL 200-250 billion in 1998 (about 1 percent of GDP). The Lebanese authorities have asked for urgent FAD technical assistance in the design and implementation of the turnover and services taxes.

The government also plans to increase the ceiling on foreign currency debt (excluding debt contracted for the foreign financed part of the reconstruction program) from $1 billion to $3 billion. Such an increase would allow for a restructuring of the public debt; the government intends to increase both the shares of foreign currency debt and of medium- and long-term debt in total debt over a period of 3-5 years to reduce both the budgetary interest burden and the vulnerability of the economy to sudden changes in financial market sentiments.

Against the background of the ongoing budget negotiations and international financial market turmoil, the demand for LL assets has remained weak, with corresponding implications for the treasury bill markets and dollarization, and pressures on the central bank's foreign exchange reserves have persisted. The central bank has continued to use swap operations to contain the trend toward increased dollarization of receipts from maturing treasury bills and bonds (foreign currency deposits as a share of broad money (M3) increased from 50 percent at end-June to 56 percent at end-October). The swap operations have involved the exchange of treasury bills and bonds with short remaining terms to maturity with new 12-month treasury bills and with 24-month treasury bonds. Initially, these swap operations were restricted to commercial banks, leading to a temporary secondary market segmentation. The central bank also started to engage in swap operations with the general public in November, offering swap rates varying from 4 percent on 12-month treasury bills to 5 percent on 24-month treasury bonds. This general secondary market interest rate increase was sufficient to ensure not only the refinancing of bonds maturing during November, but also to achieve a small surplus in the subscription of new treasury bills (LL 93.5 billion). By end-November, the central bank had undertaken swap operations for a total of LL 1,776 billion.

Nevertheless, the central bank had to continue intervening in the foreign exchange market. After a loss of US$1.2 billion in gross official foreign exchange reserves and US$1.7 billion in net official foreign exchange reserves between end-June and end-October, gross reserves stood at about US$6.2 billion (equivalent to 10 months of imports) at end-October, covering 65 percent of monetary and quasi-monetary LL liabilities and 51 percent of treasury bills and bonds outstanding. According to press reports, gross official foreign exchange reserves declined by another US$270 million in November. Net foreign assets of the banking system have been more stable during the year as a whole.

In the secondary Eurobond market, the spread on Lebanon's 10-year issue of October 1997 did not widen as much as those on other emerging market country debt with similar maturities, and amounted to about 350 basis points at end-November.

Mr. Shaalan made the following statement:

Economic developments in recent years attest to the progress achieved by Lebanon. The most important phases of reconstruction have been successfully completed, thereby restoring the country's infrastructure base and creating a necessary ingredient for the private sector to rebound. In spite of the regional uncertainties and the demands of reconstruction, the economy grew at a brisk pace for a number of years, and the macro indicators exhibited considerable strength. Reserves are at a comfortable level, equivalent to some ten months of imports, the balance of payments is in surplus, and inflation is down to the single-digit level after years of serious inflationary pressures. On the structural side, the financial sector has been deepened and widened, and its supervision has been strengthened by the Bank of Lebanon. This is evidenced by the strength of the banking sector. The budget process, as well as tax administration, have been streamlined.

Notwithstanding these favorable developments, the management of the conflicting claims of reconstruction and stabilization have proved to be more challenging than expected. The successful rehabilitation of the country's seriously damaged infrastructure was implemented in a difficult regional environment and with limited external assistance. In spite of the revenue efforts mounted in recent years and most recently in August 1997, the demands of reconstruction exerted pressures on the public finances and the debt dynamics. While the primary balance has shown steady improvement in recent years, interest payments have increased substantially. In this connection, discussions with the staff on a "soft landing" scenario to enable the economy to sustain a high growth level, low inflation, and reduce the debt burden over time have proved to be useful. The authorities recognize that the transitional period will be difficult, especially in view of the fluid regional and international situation.

Consistent with the soft landing scenario, the Lebanese authorities attach the highest priority to pursuing a medium-term fiscal program that aims at putting public finances on a durably sustainable path. With the recognition that the scope of fiscal adjustment is substantial, policy in the period ahead will aim at broadening the tax base, improving tax administration, strengthening the budget structure, containing the growth in expenditures, and reversing the deteriorating debt dynamics. Of significance is the fact that there is a consensus on the political level and among most segments of Lebanese society on the need to strengthen fiscal policy in a lasting manner. It is in this environment that the Lebanese Cabinet has recently agreed on a comprehensive package of fiscal measures and public sector reform aimed at reducing the overall fiscal deficit by about 5 percent of GDP in 1998. The measures which are detailed in the staff supplement comprise, inter alia, a 1 percent turnover tax, and a 5 percent service tax on hotels and restaurants. These measures are intended to set the stage for the eventual introduction of a general sales tax. Additionally, increases in fees and charges are also contemplated. The efforts at containing expenditures are also to be accelerated. The acceleration will include cancellation of all carryover expenditure from previous budgets, and a hiring freeze coupled with reform of the civil service in the context of a six-year plan to reduce its size by more than one third. To streamline government administration and in the process reduce expenditures further, a number of ministries and various other government agencies will be merged. The political consensus and announcement of this fiscal consolidation and reform package have sent a reassuring message to the currency markets in recent weeks. It is hoped that these measures will be passed by Parliament shortly.

The exchange rate nominal anchor policy pursued by the Bank of Lebanon since 1993 has been successful in reducing the inflation rate from over 100 percent in 1992 to below 8.5 percent in 1997 and has made the exchange rate for the Lebanese pound relatively resilient to recent shocks. Moreover, this policy has been instrumental in attracting capital inflows and increasing reserves, and continues to be implemented by means of a supportive interest rate policy, primarily through interventions by the Bank of Lebanon. While the nominal anchor policy has served the country well, the authorities will continue to monitor the balance of costs and benefits of its maintenance.

The combination of the relatively high interest rates and the observed real appreciation of the Lebanese pound has not constrained private sector growth mainly due to three factors. First, the impact of the CPI measured real appreciation on the performance of the real economy and the external sector has been limited, due to the continuing high dollarization of the economy. Second, productivity increases, in particular in export-oriented service sectors, resulting from the rapid adoption of modern information and communication technologies as well as the rebuilding of physical infrastructure, have been offsetting the loss of competitive-ness resulting from the real appreciation. Third, the effects of high real LL interest rates on domestic demand have been mitigated by the high degree of capital mobility and the dollarization of private sector lending. On the measurement of the appreciation, as we all know, the base period issue is a vexing and difficult issue when making such calculations. By shifting the base period to 1983, for example, the real effective exchange rate for 1997 would show a small depreciation.

On the external front, the large current account deficit has been mainly associated with continued high import levels for reconstruction. This deficit has, however, narrowed considerably over the last few years, as a result of relatively declining import activity as reconstruction outlays declined, and a healthy export growth. As the staff points out, it is important to note, in this regard, that the external current account deficit is overstated due to understatement of exports and private transfers and due to the difficulty in distinguishing between current and capital flows. This is well illustrated in Table 5 by the rather high level of the item "other capital" in the balance of payments, which is estimated by the staff at some 12 percent of GDP. The authorities believe that a significant portion of this entry is unrecorded border export activities and transfers.

Following continued strong capital flows, the overall balance of payments has remained in substantial surplus since 1991. Gross public external debt while rising remains under 20 percent of GDP, and if official reserves are taken into account the public sector would be in a net creditor position vis-á-vis the rest of the world. It should also be noted that spreads and margins on Lebanon's external debt did not widen, reflecting the resilience of the Lebanese economy.

The Lebanese banking system is basically sound. With the recent enactment of the law on fiduciary institutions, financial sector supervision was considerably strengthened by extending the regulatory competence of the central bank to nonbank financial institutions and brokers. Capital adequacy ratios have been steadily improving in recent years; the average risk adjusted capital-asset ratio of the banks rose from 8 percent in early 1993 to about 15 percent by June 1997. A comparison of various indicators of the depth and efficiency of the financial sector in Lebanon and selected other countries, as illustrated in the charts on pages 108-113 of the background paper, points to the relatively high development of Lebanon's banking sector. In addition to the impact of greater macroeconomic stability, financial deepening was underpinned by regulatory reforms which aimed at strengthening the soundness of the banking system.

Bank exposure to various risks has been contained in recent years. Exposure to foreign exchange risk, as measured by the difference in assets and liabilities denominated in foreign exchange, has been reduced from 50 percent of capital in 1992 to 14 percent by June 1997 (the prudential limit is 40 percent). Credit risk associated with the foreign exchange risk exposure of borrowers is limited as most borrowers are, implicitly at least, partially hedged by the dollarization of the economy. Associated risks in the real estate market are manageable as banks typically finance only up to 30 percent of construction or acquisition cost, while the remainder is self-financed. Improved credit risk management is also reflected in a steadily declining share of problem loans in overall loans, which was halved during 1991-97 to 13 percent as problem loans from the war period were being absorbed. Furthermore, provisioning against problem loans as well as other risks increased steadily, and total capital has exceeded the total of nonperforming loans since 1996.

The remaining few regulatory or institutional obstacles are currently being addressed to develop a modern banking sector. An efficient payments system is being put in place (including electronic transactions, computer-readable checks, etc.). Increased capital requirements have set in motion a consolidation process that will result in a system of fewer and stronger banks.

The authorities intend to focus increasingly on building social infrastructure. In this respect, increased spending on social sectors will enhance the socio-political sustainability of the adjustment and reform process, and support the development of human resources, Lebanon's most important asset.

In conclusion, the Lebanese authorities recognize that their most immediate financial challenges remain the high level of the fiscal deficit and interest rates. They are determined to address these challenges through major public sector reform that aims at enhancing revenues and containing expenditures, while benefiting at the same time from gradually declining reconstruction needs. The envisaged fiscal consolidation would constitute a prerequisite to support the orderly implementation of more exchange rate flexibility.

Mr. Al-Tuwaijri made the following statement:

The Lebanese authorities continued to make progress in recovering from the damage inflicted during 15 years of hostilities. As the staff notes, the basic infrastructure has been restored, the fiscal administration has been strengthened, and financial market regulations and supervision have been enhanced.

Understandably, the enormous task of rebuilding the economy came at a cost, namely, a high fiscal deficit and a substantial build-up in debt obligations. Debt servicing currently accounts for more than one-third of government spending. Therefore, a substantial front-loaded fiscal adjustment is essential at this stage. In this connection, the 1998 draft budget is a major step in the right direction. The measures to strengthen revenue performance and reduce expenditures will not only contribute to a meaningful reduction in the deficit, but will also improve the structure of the budget.

On the revenue side, I welcome the measures to broaden the tax base. For these measures to be successful, however, it is essential to strengthen collection efforts throughout the country. On the expenditure side, the planned reduction in civil service employment is welcome. Here, I would like to emphasize the importance of fully achieving the 1998 fiscal target.

An improved fiscal position would reduce the burden on monetary policy which is geared toward maintaining the exchange rate as a nominal anchor. This could clear the way for lower interest rates thus putting into motion a virtuous circle of lower fiscal deficits and lower interest rates. The strengthened position of the banking sector should also increase flexibility in conducting monetary policy. The progress made over the past few years in addressing the bad loan problem and raising the banking sector's capital adequacy is noteworthy. I also welcome the strengthening of prudential regulations and supervision. A solid banking sector and a vibrant financial market are essential for Lebanon's growth and financial stability.

Turning to the external sector, I agree with staff that the exchange rate based nominal anchor policy has been instrumental in stabilizing expectations. In this connection, the impact of the real effective appreciation of the exchange rate on competitiveness is likely to be offset by increased productivity due to infrastructure rehabilitation and structural reform. The impact of high interest rates on growth is also mitigated by the dollarization of the economy. It should be clear, however, that sustainability of the exchange rate anchor depends on an immediate strengthening of the underlying macroeconomic and structural policies.

While Lebanon's reserves are high and its external debt is relatively modest, the financing needs of the country argue for close monitoring of developments in size, composition, and structure of debt. In this regard, the recent refinancing of a Eurobond issue at a lower interest rate and longer maturity is welcome. Extending the maturity of debt will reduce the economy's vulnerability to shifts in sentiment. However, as the authorities rightly pointed out, extending the maturity of domestic debt will increase financing costs and lock in current high interest rates. A switch from domestic to foreign borrowing, also involves a tradeoff. While foreign debt carries lower interest rates and longer maturities than domestic debt, a build up in foreign obligations could reduce the authorities' room for maneuver over the medium-term. At this stage, however, the benefits of some additional foreign borrowing appear to outweigh the costs.

In conclusion, Lebanon has made commendable progress under very difficult circumstances. However, the economy continues to face substantial challenges. I am confident that the authorities will do their utmost to address these issues and help the economy realize its promising potential. It is important for the international community to continue supporting these efforts.

Mrs. Paris made the following statement:

I first want to commend staff for a very clear report and Mr. Shaalan for his no less helpful statement.

Once again, we are confronted with Lebanon to a case where it is quite difficult to form a definitive judgement, this difficulty being reinforced by the puzzling confidence the Lebanese authorities constantly show in troubled times.

The economic situation is in fact quite worrisome: unsustainable fiscal deficits, a very high debt, high current accounts deficits and the challenged exchange rate policy are a matter of concern. Indeed, Lebanon manages to face its financing needs by running down the Government's deposits with the banking system and other means. But the difficulties encountered recently in rolling over treasury bills is a clear sign of warning.

I don't share the Lebanese authorities views that recent financing difficulties are temporary, but on the contrary, that they proceed from a reassessment from investors, as in other places of the world, of the reality of the Lebanese risk. Ten months of reserves could not be enough to resist a change in market sentiment. I would like to know from staff if we have accurate information about net reserves, including forward commitments of the Central Bank.

It is therefore an absolute priority to achieve a strong and quick fiscal adjustments and I welcome the recent measures and Mr. Shaalan's comments about the growing consensus among the Lebanese society of the necessity to do so. The emphasis put on the revenue increase is welcome but I must say I am concerned by the rise in import tariffs: this is contrary to the spirit of the association agreement Lebanon is negotiating with the European Union, and it should clearly be transitory before the implementation of a general sales tax.

Finally, and though it makes no doubt that the exchange rate policy pursued since 1993 has served Lebanon well, the time has come when more flexibility is warranted. Costs of maintaining a nominal anchor to the dollar may have been subdued in the past; but I don't think this is sustainable in today's context. I would be interested in hearing from staff how they think Lebanon could in the most appropriate way monitor such an exit strategy.

I would also like to hear from staff if they fully concur with the assessment that the banking sector is sound.

Mr. Otazú made the following statement:

Despite positive developments on the structural front, noted by staff and Mr. Shaalan, particularly in the areas of budget administration, the financial market deregulation and the infrastructure reconstruction, the Lebanese economy, in the second half of 1997, became more vulnerable which is a cause of great concern. The challenges facing the authorities to revert the very high budget deficit and restore basic infrastructure remain formidable. In the same words of the Lebanese President, Mr. Elias Hrawi, "economic problems need quick solution".

To ensure the macroeconomic stabilization, reducing the deficit from the current level of 20 percent of GDP or the equivalent of nearly 50 percent of expenditure for the last three years rightly represents the central priority of the authorities'strategy. I am skeptical however regarding the prospects for strong fiscal consolidation given the vulnerability of the country's financial system, and the unsettled international environment. Therefore, I envisaged a strong and fast fiscal adjustment in expanding revenue sources and in keeping back expenditures. This is indispensable and urgent and it is very important for its impact on the Treasury Bills in the financial market and in the interest rate level. Nevertheless, it is essential that the policy mix contribute to reducing interest rates given the incidence that interest payments account for 3/4, or 75 percent of total revenue.

Revenue measures are needed to expand the tax base, including the emphasis given by staff in paragraph 23 of the paper to faster incorporation of a general sales tax, taxation of the service sector overall and reinvigorating the taxation of property ownership.

Efforts to tighten expenditure containment are also crucial in particular the hiring freeze and merger of ministries and other government agencies. I also encourage the authorities to improve transparency, enhance budget control and put in place real auditing on public enterprises. A comprehensive fiscal strategy covering revenue and expenditure is all the more important given reconstruction demands and the need to lower interest rates and reduce crowding out of public sector activities.

Monetary and exchange rate policy has been successful in anchoring expectations and enabling a reduction in inflation. As discussed during an Islamic Banking Conference in Bahrain, where Finance experts from Europe, the United States, Russia and China took part, a BBC correspondent in the Gulf said that lack of liquidity remains the main obstacle to the growth of Islamic banking. How this affects the Lebanese financial system? However, a policy of very high interest rates has its limitations in terms of export competitiveness and should reduce growth performance. Could staff clarify the extent of dollarization of the Lebanese economy and the strategy to maintain competitiveness, keeping in mind that the markets of Lebanon's natural trading partners are closed? In this regard, I note the Associated Agreement with the European Union providing preferential market access. Its potential impact for external performance remains however unclear including the prospects for accession to the WTO. Could staff shed some additional light on this process?

Efforts in rebuilding a basic infrastructure have advanced significantly. In this regard, greater use of privatization, under a clear and transparent rules, could not only help to speed the rebuilding effort, but as importantly create room for needed investment elsewhere, particularly in education, health and other social programs. In this regard, "I am confident that one way to help the Lebanese help themselves is especially in attracting private investment".

The unemployment rate is disquieting and the strategy for dealing with it in the context of a sharp deterioration in income distribution is far from clear. Moreover, while the reconstruction effort is creating more jobs and the level of unemployment, particularly among youth, remains very high and would be socially destabilizing. Could staff or Mr. Shaalan comment on the employment and income distribution prospects?

Finally, I would like to wish the Lebanese authorities success in their difficult endeavors.

Mr. Ahmed made the following statement:

Recent economic performance in Lebanon has been marked by a number of positive developments. Despite the regional uncertainties and the pressing demands of reconstruction, economic growth has been robust, the external position has been strong—with a surplus on the balance of payments and a comfortable level of reserves—and impressive progress has been made toward reducing inflation. In the structural area, the budget process has been modernized, and financial market regulation and supervision have been enhanced.

However, as Mr. Shaalan remarks in his statement, despite these favorable developments, managing the conflicting claims of reconstruction and stabilization has proved to be more onerous than expected. Reflecting the pressures of the construction demands, the difficult regional situation, and limited external assistance, the budget deficit has remained at a high level and has contributed to a worsening of the public debt dynamics. Indeed, developments in the second half of 1997 suggest that the economy has become more vulnerable to unfavorable shifts in investor sentiment—a risk that is heightened by the conjuncture of a tense regional political situation and an unsettled state of the environment for international investment.

It is against this background that we welcome the growing consensus amongst major segments of the Lebanese society on the need to take significant and immediate steps to strengthen fiscal policy—a consensus which has been given concrete expression in recent agreement in the Lebanese Cabinet on a comprehensive package of fiscal measures and public sector reforms. The package of measures is strong and well-balanced. We acknowledge the emphasis on expenditure containment measures, particularly as it relates to reductions in discretionary spending by ministries and mergers, and the start that is being made to realize important medium-term savings through a substantial reduction in the number of government employees. The measures on the revenue side of the budget are also structurally sound, with the turnover tax paving the way for the eventual introduction of a general sales tax. We hope that Parliament approves these measures soon. In doing so, it will be important to resist pressures to erode the effectiveness of the measures in terms of quality and yield. While the package of fiscal measures appears to have sent a reassuring message to markets, achieving the much sought-after "soft landing" scenario will require strict implementation in the coming year and over the medium term.

With fiscal policy on a more solid footing, the authorities would have a room to ease the burden on monetary policy and to allow greater flexibility in management of the exchange rate, as needed. There is no doubt that the authorities' exchange rate-based nominal anchor policy has served Lebanon well in terms of stabilizing expectations and inflation. But, there is merit in the view that the balance of benefits of this policy needs to be weighed carefully, especially amid growing signs that the policy could have potential costly implications. Having said that, we concur with the authorities that successful and lasting fiscal consolidation is an essential pre-requisite to support the orderly move to a more flexible exchange rate system.

High private sector-led growth is a key element of the authorities' growth and investment strategy, and continuing reforms of the regulatory and institutional framework will be needed to underpin the creation of an enabling environment for private sector initiative and enterprise. We commend the authorities for the depth and quality of the reforms in the financial sector and, in particular, the banking system, which appear to be fundamentally sound and well supervised. We join staff in cautioning the authorities against resorting to ad hoc measures to stimulate private investment—such as the granting of significant exemptions and concessions for new investors. As the staff report notes, experience elsewhere suggests that such ad hoc measures not only could prove unavailing, but are also costly in terms of foregone revenue.

In conclusion, Lebanon's renewed commitment to strong and lasting fiscal consolidation and structural policy reforms is to be welcomed.

Mr. Nemli made the following statement:

The Lebanese authorities have made good progress in reconstructing their economy and restoring macroeconomic stability despite extreme uncertainties in the political environment, both domestic and regional, and difficult initial conditions. The authorities' task was to build on achievements already made and address persistent macroeconomic imbalances, especially the unsustainable twin fiscal and external account deficits and the high indebtedness. Regrettably, 1996 and 1997 have seen further expansion of these imbalances rather than their improvement.

Lebanon has financed its large fiscal deficits mainly by domestic borrowing, which has naturally led to the unfavorable debt dynamic of a large domestic debt stock and high interest rates. To reverse this dynamic and manage a soft landing called for a substantial fiscal adjustment, but unfortunately the fiscal situation deteriorated in 1996 in 1997., Paradoxically, the financial market conditions in Lebanon have improved despite these adverse developments, as a result of the high credibility earned by the authorities' earlier successes with macroeconomic stabilization and reconstruction. This credibility caused the markets to be favorably impressed by the authorities' announcement of a sizable fiscal consolidation target for 1997. But in July the government began to find it difficulty to roll over maturing bills. While external factors and domestic politics have contributed to this difficulty, it basically reflects lost confidence when the authorities failed to meet their announced fiscal targets for 1996 and 1997. The resumption of dollarization, the decline in government deposits, and the erosion of foreign exchange reserves in the last half of 1997 also show that the credibility bonuses earned by the authorities' previous successes are gone. We cannot agree with the authorities' view that this new round of adverse financial market sentiment is temporary, and that the staff is exaggerating the threats to the prospects for a soft landing.

Since their most urgent task is to reverse the unsustainable dynamics of debt through substantial fiscal adjustment, we are encouraged to learn that the authorities have already enacted various revenue measures to stem the budget shortfalls of 1997 and plan to implement a large, front-loaded adjustment in 1998. The very low level of tax revenues shows how urgent it is to broaden the tax base, all the more so because of Lebanon's heavy dependence on customs revenues. Imports related to reconstruction will continue to decline, and customs duties will disappear with the imminent establishment of the free trade area between Lebanon and the European Union. Extension to domestically produced goods of the excise taxes now levied in the form of customs duties, the introduction of a general sales tax, the strengthening of tax administration, and spending cuts would all be important elements fiscal adjustment. I agree with the staff that the planned fiscal adjustments should be viewed as a minimum.

The authorities' plan to continue the current policy of an exchange rate-based nominal anchor makes a substantial fiscal adjustment even more crucial. The very high productivity increase resulting from the successful reconstruction of Lebanon's economy has helped limit competitiveness losses due to real currency appreciation. But it is unlikely that this high rate of productivity increase can be maintained during the later stages of economic reconstruction. If the nominal anchor policy is not appropriately supported by a substantial fiscal consolidation, the threat of a crash landing instead of a soft-landing becomes very real.

Last, I want to warn the authorities against resisting interest rate increases. Such resistance could prove very costly when higher rates are needed to avoid undue reserve losses and a further worsening of market sentiment.

I wish the authorities every success.

Mr. Disanayaka made the following statement:

During the last few years following achievement of peace, the Lebanese authorities have been engaged in a delicate balancing act in trying to achieve two somewhat conflicting objectives of macro-stabilization on the one hand, and reconstruction and rehabilitation on the other. Their track record so far seems to convince us that they have been able to meet these twin objectives with reasonable success. As Box I on page 10 shows, the authorities have been able to achieve substantial progress in the infrastructure rehabilitation under the Phase I of the Horizon 2000 Program. The authorities are now diverting their attention to Phase II of the Program which targets rehabilitation of the social infrastructure, in particular education, health and sanitation. Concurrently with this rehabilitation program, the authorities have been undertaking important structural reforms to streamline and strengthen the budget process, and revenue administration as well as to develop the financial sector. The progress achieved in improving the soundness of the banking system as discussed in Box 3 on page 20 is particularly commendable. Such efforts are of great significance at this juncture when the financial systems of many emerging markets are undergoing a period of severe stress. The Lebanese authorities have thus laid the foundation for an accelerated recovery of their economy, creating a conducive environment for a robust private sector growth. In fact the authorities have increasingly involved the private sector in the reconstruction and rehabilitation work. This has had the twin advantage of reducing cost to the budget and at the same time expanding private sector participation in the economy. The medium-term plan of the authorities attempt to streamline public administration and regulatory structures so as to make the delivery of public services more efficient. Financial sector too would be further deepened through a planned program for development of capital market. All these measures would, while streamlining the public sector, contribute towards enhancing the role of private sector on which the future growth of the economy is largely expected to depend.

For the successful implementation of above macro-strategy Lebanese authorities have well realized the crucial role their monetary exchange rate and fiscal policies have to play. In fact these policies together form the backbone of their macro-stabilization and reconstruction strategy.

The tight fiscal and prudent monetary and exchange rate policies followed by the authorities in recent years have helped them in achieving a reasonable rate of growth with low inflation. The exchange rate-based nominal anchor policy, in particular, has contributed to financial stability. However in view of the costs associated with too tight a nominal anchor policy we would support the staff recommendation that the authorities should not hesitate to bring some flexibility to the policy in case such a step is deemed necessary, particularly after the further fiscal consolidation measures envisaged have been implemented. As an intermediate step, further nominal appreciation of the Lebanese pound against the US dollar should be arrested.

Turning to the fiscal policy, the deteriorating fiscal situation in 1996 and 97 has made the soft landing approach prepared by the authorities and the staff at the last year Article IV consultation discussions unachievable. A revised medium-term macroeconomic program has therefore been prepared in its place. In keeping with the broad objectives of this strategy and with a view to bring the 1997 budget back on track, the authorities have moved fast to launch a set of front-loaded adjustment measures. Duties on many products have been increased and discretionary expenditure on several items have been cut. These measures are expected to improve the overall budget deficit by one percent of GDP and to contain the ratio of net public debt to GDP at 93 percent of GDP in 1997. We commend the authorities for the prompt action taken to make this course correction. A similar front-loaded fiscal adjustment is contemplated for the 1998 budget, to bring the deficit down to 15 percent of GDP and to further improve the debt dynamics. The authorities plan to continue this strong consolidation program for the rest of the medium term. Accordingly they hope to bolster revenue effort through the introduction of a GST within the plan period. We hope Fund would be able to extend the necessary technical assistance they need for launching this tax. The staff has suggested further measures to strengthen the consolidation program envisaged by the authorities in view of the uncertainties prevailing over achievement of some of the proposed targets. Broadening the tax base, strengthening tax administration further and enhancing the participation of the private sector in the reconstruction work are some of the staff proposals. We would encourage the authorities to give careful thought to these suggestions as they would certainly reinforce their fiscal consolidation effort.

We are encouraged by the efforts the authorities are taking to improve their debt management. In particular we support the authorities' policy not to undertake any net borrowing from the international market for budgetary support. We would encourage them to make every effort to make the best use of the rather substantial resources the donor community has already pledged to make available to them during the period 1997-2000. We are also glad to note steps the authorities are taking to improve the transparency in the management of public resources through such measures as auditing of all public enterprises.

In conclusion, Mr. Chairman, we would encourage authorities to steadfastly maintain the tight fiscal stance and prudent debt management in the medium term. This would ease the pressure on the monetary policy and bring confidence to the financial market. It would also, as I mentioned earlier, facilitate bringing more flexibility to the exchange rate policy, when such a step is deemed appropriate.

With these comments, we wish the authorities well in their efforts.

Mr. Barro Chambrier made the following statement:

The authorities deserve to be commended for the positive developments that took place in the Lebanese economy during the past five years after the end of the war. The achievement is particularly remarkable in terms of efforts to rehabilitate the basic infrastructure.

Despite the progress achieved by the authorities to improve economic and financial situation of Lebanon, the macroeconomic trends are still weak and the Lebanese economy remains under severe financial pressure. I therefore welcome Mr. Shaalan's statement that: "the authorities attach the highest priority to pursuing a medium-term fiscal program that aims at putting public finances on a sustainable path."

It is however regrettable that fiscal consolidation targeted in the 1997 budget did not occur. The fiscal position deteriorated further partly due to higher interest payments, large carryover of expenditure from previous budget, and salary increases; moreover, government debt accumulated rapidly while public debt dynamics continued to worsen.

In that context, I believe that it is of the utmost importance that the authorities strictly adhere to their medium-term macroeconomic scenario based on external viability and large private sector investment and production for a sustainable growth.

With respect to fiscal policy, I wish to encourage the authorities to strengthen measures in order to accelerate fiscal consolidation by further reducing the deficit in 1998 and beyond. In this regard, it is noteworthy that with early slippages and unanticipated expenditures in early 1997, this task will require bold decisions; efforts will be needed to strengthen control on current outlays and to change the profile of government expenditure with priority being given to social sectors and poverty reduction. On the revenue side, the authorities' agenda being implemented includes imposition of new fiscal measures and increases in some existing excise and custom duties. Furthermore, it is critical that revenue procedures and processes are being reviewed for more transparency in the income tax administration and collection. All these measures which are expected to increase government revenue and contribute in the deficit reduction should be strictly implemented in the framework of the 1998 budget.

On the debt management, I encourage the authorities to pursue a cautious approach, and I also welcome the efforts to extend the average maturity of debts. I note that the staff are recommending the retirement of debt through sale of government assets. Could the staff give more details in their recommendation; such as what type of assets to sell and how much could the authorities expect to receive?

I believe that Lebanon should build on the growing consensus among the population to reverse the current trend on the fiscal situation and the public debt dynamics. I share the staff views that only a fiscal tightening will gradually ease the pressure on monetary policy.

On monetary and exchange rate policies, I found the staff recommendation for the future a little bit vague. I fully share the view that the current exchange rate-based nominal anchor policy has contributed to the financial stability. I also understand that the conditions must be set for more flexibility in the exchange rate policy. From the staff report, I fail to see if the recommendation was in favor of maintaining the exchange rate base nominal anchor or of allowing for more flexibility given the adverse consequences on the competitiveness of the current policy. Staff comments will be appreciated.

Turning to structural policies, I welcome the progress achieved in improving the banking system soundness. While encouraging achievements occurred in this area, I still remain concerned by the high amount of non-performing loans in banks' portfolios. In this context, I agree with the authorities that greater efforts need to be made in order to extend the central bank and the banking control commission's supervisory capacity to all financial agents and also for a forceful implementation of new regulations regarding the promotion of credit to the private sector, as well as the deepening and the widening of the financial market. I, therefore, welcome the information system developed to assess creditworthiness of companies and bad risk.

Finally, I would like also to draw the attention of the authorities on the risks involved in providing interest rate subsidies to small and medium size enterprises given the distortionary impact of such measures. It would be appropriate to strictly limit this policy that could undermine Lebanon's well earned reputation as a liberal economic system.

With these remarks, we wish the Lebanese authorities well in their efforts.

Mr. Melese d'Hospital made the following statement:

I would like to thank the staff for a comprehensive and enlightening set of papers. As I am in broad agreement with staff's analysis, I will limit my comments to a few areas which I feel deserve emphasis.

The Lebanese authorities deserve praise for their strong efforts and numerous successes in areas of reconstruction and structural reform, and for their adroit management of financial pressures. At the same time, the Lebanese economy has an "Achilles heel" in its unsustainable fiscal and external positions, including fiscal deficits of 20 percent of GDP over the past three years and current account deficits in the 30-40 percent of GDP range (proj. 31 percent in 1997). Until recently, capital inflows from abroad comfortably financed both private and public borrowing needs, and the central bank was in a position to accumulate substantial reserves. However, over the past few months, the bank has been forced to sell reserves and engage in swaps at elevated interest rates as concerns surfaced about political tensions and public finances. At the current juncture, only fast implementation of a strong, front loaded package of fiscal measures can prevent the further erosion of Lebanon's policy credibility and preserve the important gains the authorities have made to date in other areas.

Such a package will inevitably consist primarily of revenue measures. Roughly 80 percent of expenditure is absorbed by debt financing and fixed wages, with much of the balance committed to infrastructure reconstruction efforts. Measures such as accelerated civil service reform and greater reliance on BOT arrangements for private provision of infrastructure will be vital for Lebanon's medium-term external and fiscal viability, but may not produce substantial immediate gains. Further, the authorities have made increased funding for the social sectors a budgetary priority, quite rightly so, and it would be unfortunate if such efforts were to be reversed in a short-term scramble for cash.

Revenue measures should include: new taxes to widen the tax base; and improvements in tax administration and revenue collection. The best of current proposals for widening the tax base is a GST covering the service sector (Lebanon currently has none). In addition to raising important amounts of revenue, such a tax would reduce the economic distortions resulting from the current over-reliance on customs duties. Some thought should also be given to taxation of property, which in addition to its revenue raising aspects could play a role in ensuring that resources are put to their highest use during the period of reconstruction. While taking steps to widen the tax base, it will also be incumbent on the authorities to mend holes in the tax base, notably in the areas of tax exemptions and concessions.

Finally, I would like to draw attention to the importance of maintaining Lebanon's international image as a liberal and dynamic economic system, both in support of overall policy credibility and as a beacon to international trade and investment. In this light, I strongly urge the authorities to avoid measures which could be construed as signaling a turn toward protection, such as quantitative restraints or excessive customs/duties on imports. Such measures are almost certain to do more harm than good to the overall health of the Lebanese economy.

Ms. Kouprianova made the following statement:

At this point of the discussion I will be brief.

I would like to associate myself with the comments made by other speakers on the fiscal policy. I join others in considering fiscal adjustment efforts as crucial for the upcoming period. The authorities' objective to reduce the fiscal deficit by about 5 percent of GDP in 1998 is ambitious, but provided that all envisaged fiscal measures are implemented the authorities have every chance to succeed in achieving this objective.

As for the exchange rate policy, I join those speakers who think that more flexibility in the exchange rate is warranted.

I wish the Lebanese authorities every success in their policy endeavors.

The staff representative from the Middle Eastern Department made the following remarks in response to questions and comments from Executive Directors:

There were a number of questions related to the external sector and to the exchange rate policy. I will address these first.

On the accuracy of information on foreign exchange reserves, it should be noted that we receive information on gross and net reserves from the central bank of Lebanon quite frequently, and that the central bank does not conduct forward operations or other off-balance-sheet operations in the foreign exchange market.

On the exchange rate policy, as most Directors indicated, the nominal exchange rate policy of Lebanon has served the country extremely well, especially given the fact that most of the shocks to the economy have been of a nominal nature, and caused by confidence issues related to the fiscal policy. The net effect of the real appreciation of the Lebanese pound on the competitiveness of exports is difficult to assess. However, the growth in the volume of exports during the past two years would indicate that the appreciation has not significantly hurt the export sector. The fiscal policy situation, on the other hand, dominates the financial market expectations in Lebanon. Therefore, without some track record of fiscal adjustment, it will be extremely difficult to anchor expectations. Indeed, without fiscal adjustment, more exchange rate flexibility could potentially lead to very unstable financial market conditions.

Taking into account the reserve cushion, an orderly exit from the current regime would still be possible if accompanied by strong fiscal adjustment. It is also worth noting that very recent developments on which we have received information suggest that there is some breathing space and that the authorities' recent interest rate policy and swap operations have had a favorable impact on financial market confidence: the decline in official reserves has slowed down, and the latest treasury bill auction was oversubscribed. Of course, we are monitoring the situation very carefully. We agree with the authorities that, in the current circumstances, it could be very costly to move to a flexible exchange rate regime. However, as indicated also in Mr. Shaalan's statement, the frontloaded strong fiscal adjustment in the 1998 budget will provide opportunities to move to more flexibility in an orderly fashion.

Related to the competitiveness issue, a question was posed on the extent of dollarization and its impact on the effect of the exchange rate movements on the economy. Approximately 55 percent of the deposits in the banking system and 85 percent of credits extended to the private sector are denominated in foreign currency.

On the prospects for a trade agreement with the EU, I can report that, as indicated and discussed in the background paper, the authorities have undertaken initial discussions with regard to the association agreement with the EU. However, they are still carefully assessing its potential impact, especially with regard to the budget.

The Lebanese authorities are also interested in joining the WTO, but it is not a priority on their policy agenda, given the already open and liberal trade system. However, they are interested in a free trade arrangement with neighboring countries. This is very important because, for Lebanon to fully reap the benefits of an association agreement with the EU, trade liberalization vis-à-vis other trading partners should also take place.

Ms. Paris observed that the staff had been cautious with regard to its assessment of the banking system. I would like to indicate that the analysis presented was undertaken during the course of the Article IV consultation by the staff of the consultation mission. We relied on data obtained from the authorities and information gathered during our discussions with officials as well as financial sector representatives. The most important thing that we could conclude from our study is that there has been a continuous improvement in the soundness of the banking system, and that supervision has been strengthened over the period considered. There are a lot of small banks in the system which have limited potential for diversification of credit risks and operate with high production costs. In the Lebanese system, credits are limited to short-term loans in the form of overdraft facilities. Because of this, there are no mechanical rules concerning the classification of loans into problem loans or non-performing loans, and therefore there are no clear rules for adequate provisioning in the system. This is an area which the authorities are also concerned about.

We also noted in the background paper that the capital adequacy ratio is quite high in Lebanon. However, we have to be careful in looking at the weights that are attached to the risks, because the risk factors that are assigned to the various components of the banks' balance sheets are on the low side of the range recommended by the Basle agreement.

Mr. Ahmed asked a question regarding fiscal incentives and about the study that was mentioned in the staff paper. The study was undertaken by the United Nations, and it assessed the experience of a number of countries—including Colombia, Egypt, India, Mexico, the Philippines, and South Korea—with regard to free export processing zones. The staff also referred to a technical assistance report on Egypt. The conclusion of the U.N. study was essentially that these export processing zones have not fulfilled the host countries' expectations. More specifically, technological transfers have been minimal, the direct increase in access to export markets has been limited, and the products that were produced in those zones generated relatively low value-added. Indeed, the study did not see a major expansion in exports from these areas. At the same time, the capital costs of these projects have been quite high for the hosting country, including because it had to grant subsidies and tax holidays, which involved some losses in fiscal revenue.

We do not expect that many government assets could be sold, except some land and very few public enterprises. However, it is difficult to estimate the amount of revenue that such sales could generate. We raised this issue with the authorities, but we were not given a firm estimate. In general, I would expect that the amounts would be very limited.

Finally, there are no official estimates on unemployment, but according to a recently published U.N. report, it is estimated to be in the range of 12 to 14 percent. We also do not have comprehensive data on income distribution. The authorities are working to put together a database on income distribution and poverty-related issues and have undertaken surveys in this regard. They consider, as does the staff, that it is important to build a database on income distribution because the emphasis on social issues in Lebanon has increased, and because there will be more resources channeled to social sectors under the second phase of the reconstruction program.

Mr. Disanayaka asked the staff to clarify its statement on whether the banks were complying with the Basle-recommended capital adequacy ratio.

The staff representative from the Middle Eastern Department explained that there were recommendations and there were ranges within which one could assign risks to different assets, and these risks varied from one country to another. For instance, in the case of the treasury bills held by the banking sector in Lebanon, the risk weighing was zero, whereas in some countries, it could reach 10 percent. In Lebanon, although the overall capital adequacy ratio was within the guidelines, the staff had not analyzed the exact weighing of each of the different categories of assets.

After adjourning at 1:00 p.m., the meeting reconvened at 2:30 p.m.

Mr. Shaalan made the following concluding statement:

I would like to thank my colleagues for their thoughtful comments. I believe that the Lebanese authorities would have very little problems with most of the recommendations made around the table today.

I will confine my comments to two areas, the fiscal situation and the external sector, which are connected in many ways, as evidenced by today's discussion.

First, the authorities firmly believe that a strong macro framework is needed to underpin the exchange rate anchor which they have been pursuing for several years now. One can really appreciate its role by reflecting on the developments on the exchange rate front during the years of the civil war. The rate, which historically had been a floating rate, had hovered at about 2½ Lebanese pounds to the dollar until the beginning of the civil war, when it began depreciating very sharply. If I am not mistaken, it reached a level of over 2000 Lebanese pounds in about a decade. As would be expected, that period was characterized by sharply increasing inflationary pressures, and it became important to stabilize the rate. Hence, the exchange rate peg was introduced. The authorities have pursued this policy until now and it has served the country extremely well, including the reduction in inflation from well over 100 percent to the single digit level at present.

The authorities do not intend to maintain the exchange rate anchor indefinitely. They firmly believe that they should pursue a flexible exchange rate policy once they have brought the fiscal situation under control. As I explained in my buff, the fiscal situation was adversely affected by the reconstruction demands. Once that is brought under control, the authorities hope to introduce a flexible rate, as well as reduce the interest rates as inflation continues to come down and as the fiscal deficit is brought under control.

Mrs. Paris raised a number of questions with regard to the current account deficit, and noted that it was too high. It is high, but Lebanon has always had a high current account deficit, financed by capital inflows. The current deficit, as the staff points out, is largely financed by non-debt-creating flows. Other capital inflows at 12 percent of GDP, are on the high side We do not know how much are current receipts and how much are capital inflows.

I would like to confirm again, with regard to the net reserves and the forward cover, that Lebanon does not pursue a policy of forward transactions in the exchange markets. It has not done so historically, and does not do it now.

The fiscal package, which is the cornerstone of the reform agenda, has been extensively discussed at all levels of government. There is serious interest within the three or four leading political groups, as well as from the public generally, in the need to restore fiscal discipline. It is in that vein that the fiscal measures taken for 1998 constitute about 5 percent of GDP. There is every hope that this will be implemented fully.

The U.S. chair referred to Lebanon's traditionally open, liberal trade system, but noted the recent talks on implementing quantitative restrictions on imports. There was some discussion in the summer on imposing such restrictions on agricultural imports, but to my knowledge, it did not result in the implementation of any restrictions on trade.

I would like to thank my colleagues again. Their comments are highly valued, and they will be communicated to the authorities.

The Acting Chairman made the following summing up:

Executive Directors agreed with the thrust of the staff appraisal. They commended the authorities for the significant progress made in restoring the country's infrastructure and administrative capacity, and in strengthening financial market regulation and supervision. Directors noted the recent declines in inflation and in nominal interest rates, and were encouraged by the recent steps toward administrative reforms, including in the budget process and revenue administration.

Directors expressed concern, however, about Lebanon's very sizable budget deficit and the increasingly uncomfortable public debt dynamics, which they saw as a major threat to macroeconomic and financial stability. In this regard, they urged the government to implement strong and front-loaded policies toward fiscal consolidation. They welcomed the measures in the proposed 1998 budget, noting that, if fully implemented, they would contribute to a fiscal adjustment path that would stabilize the debt dynamics and be compatible with medium-term macroeconomic stability and growth. Directors also emphasized the need to improve the structure of the budget to ensure the sustainability of Lebanon's fiscal consolidation. Measures should include steps to contain expenditures as well as strengthen revenues; in particular, they saw a need to widen the tax base through the introduction of a general sales tax covering the service sector, to consider a taxation of property, and to strengthen tax collection and administration.

Directors recognized that the current exchange rate-based nominal anchor policy has contributed to overall financial stability, but noted the growing indications of the costs of this policy and its potential effects on competitiveness. They recommended a careful monitoring of this policy and its implications, and underscored the importance of implementing an immediate significant fiscal consolidation so as to facilitate an orderly transition to greater exchange rate flexibility as needed.

Directors also expressed concern about the temporary difficulties in the treasury bill market, and the recent pressures on official foreign exchange reserves, and increases in dollarization. They noted the use of interest rate policy in the secondary market to avoid undue reserve losses and a further deterioration in market sentiments, but emphasized that this policy needed to be underpinned soon by a forceful fiscal consolidation effort to ensure a sustained improvement in market sentiments, especially in the context of the unsettled international investment environment.

Directors emphasized the role of ongoing structural reforms as well as of a sound macroeconomic policy mix in enhancing the environment for higher investment, growth and employment creation. They encouraged the authorities to accelerate the process of opening significant portions of the reconstruction program to the private sector, to consolidate the recent progress made in deepening and widening financial markets, and to move ahead expeditiously with the administrative reform project with a view to both reforming the civil service and streamlining administrative procedures for setting up and running business in Lebanon. They cautioned against the temptation to resort to ad hoc measures to promote private sector activity, including growing use of concessional credit facilities and protectionist measures that also undermine Lebanon's well-earned reputation as a liberal and dynamic economic system. Indeed, they commended Lebanon for maintaining an open trade and payments system.

Directors welcomed the growing emphasis placed on social sector issues. Increased spending on social sectors, in the context of the authorities' envisaged fiscal adjustment, would be key to reducing poverty, improving income distribution, and enhancing the sociopolitical acceptance of the medium-term adjustment and reform process.

It is expected that the next Article IV consultation with Lebanon will be held on the standard 12-month cycle.

4. REPORT BY DEPUTY MANAGING DIRECTOR—COMMITTEE ON THE BUDGET

Under other business, the Deputy Managing Director made the following statement:

Before adjourning the Board, I would like to brief Executive Directors on the discussion at yesterday's meeting Committee on the Budget.

By way of background, Directors will recall that the Committee met several weeks ago to discuss the work priorities for the medium term. The priorities outlined in that paper were broadly supported and formed the basis for the medium-term budgetary proposals outlined in the staff paper that was discussed yesterday by the Committee. The staff paper summarized the prospective work load for the medium term and estimated that an additional 35 staff positions would be required to meet additional needs. Most of these demands were for the strengthened surveillance initiative and for associated technical assistance needs. However, some efficiencies were expected from our ongoing program of information technology and also from a doubling of the Separation Benefits Fund budget for the next three years. These gains would reduce the need for additional staff to some 15 staff positions. Three staffing options were presented for consideration. Option 1 would increase the staff numbers by 15 staff positions over the next three years with most of this increase front loaded in FY 1999. Option 2 would increase the FY 1999 ceiling by some 7 staff positions but then the ceiling would be reduced by 5 staff positions in FY 2000 and a further 5 staff positions in FY 2001 as a result, the authorized staff ceiling would be slightly lower in FY 2001 than in the current financial year. The redeployment of a number of staff positions would also be required under this option. Option 3 would continue to implement the current medium term proposals by reducing the staff ceiling by some 15 staff years over the next three years but postpone the downsizing by one year. Management considered these three options and supported the implementation of Option 2 on the basis that it continues the consolidation strategy that has been in place for four years but also goes some way to meeting the increase in the Fund's workload during the past year and particularly during the last few weeks as a result of the crisis in Asia.

I am pleased to report that the meeting was very fruitful. Speakers recognized the significant increase in the intensity of the work and there was broad support for Option 2 which would be a reasonable compromise in the circumstances indeed several speakers indicated support for Option 1. No speakers indicated support for Option 3 although there were two or three chairs that did not indicate a preference for any option. Also, some would have wished to look at the implications for the institution of a reduction in staff in FY 1998, although I do not think that these chairs were actually proposing such a staff reduction. In reaching this conclusion, speakers commented on a number of issues including:

The relationship between authorized and effective staffing levels. Some Directors thought that the level of vacancies (estimated to be about 3.7 percent of the authorized staff ceiling) could be reduced as a means to provide additional staffing resources. However, the staff noted that this level was quite low historically, and that little reduction was likely to be possible given the policies governing the filling of vacancies internally and the need to recruit most new staff from overseas. Therefore, it remains appropriate that the Board's focus should be on a level of authorized staff.

There was general support for the proposal to double the budget for the SeparatIon Benefits Fund and a number of Directors agreed with our view that replacing weaker performers with staff with improved skills would help to increase overall staff efficiency. There was also support for our attempts to improve promotion opportunities for the best performers in the economist stream, and to provide increased recruitment opportunities.

The question of measuring administrative expenses in real terms was discussed by several speakers including the use of the Washington, D.C. Consumer Price Index and the Fund's basket of commodities index. The staff agreed to include both measures in future papers.

On technical assistance, several speakers argued that the level of technical assistance should not be cut indeed, that it should be increased if at all possible. On the other hand, a few speakers suggested that the policy of charging for technical assistance should be revisited. It was not evident from the discussion that there is a majority view on the Board in favor of changing the current policy.

One or two speakers noted the importance of disseminating to the public information on the Fund's work.

There was general agreement that the policy of redeployment now in place was working well and, several speakers stressed that this should be continued for the medium term.

A number of speakers stressed the need to improve the cooperation between the World Bank and the Fund in the area of financial reform.

Concerning Information Technology, there was some discussion of the productivity benefits that will accrue over time, and the importance of using those savings as part of the budgetary plans. As mentioned in the paper for the Committee, additional information on the IT strategy will be provided in the forthcoming budget outlook paper.

Some speakers considered that the paper would have been more useful if it had included an option based on the medium-term proposals of a year ago. As I mentioned, however, Option 3 presented in the staff paper is very similar to last year's proposal except that the proposed downsizing was postponed by one year. The Managing Director's Statement will include the original base option.

A number of speakers called for additional information to facilitate the discussion of the budgetary outlook for the next three years. Staff replied that additional information on the broad strategy will be included in the forthcoming MD's Statement. Our preparation of more detailed budgetary plans for resource allocations will take into account the guidance given by the Executive Board on the broad outlook strategy, and will be included in the FY 1999 Administrative and Capital Budgets that will be finalized before April 1, 1998.

Finally, there was agreement that the difficult situation in Asia may require further changes in the work load connected with this region. We are monitoring the situation closely, and, if necessary will reconsider the budgetary impact of any further developments in Asia, or unexpected events elsewhere. In this context, the Managing Director's statement on the medium-term budgetary outlook will be discussed in about 4 weeks (January 14, 1998) and this will provide an opportune time to revisit this matter. In the interim, the Statement will be finalized and will be circulated within a couple of weeks. The Managing Director's statement on the budgetary outlook in the medium term will include some additional information as requested by speakers at yesterday's Committee meeting.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/97/119 (12/10/97) and EBM/97/120 (12/12/97).

5. RWANDA—EMERGENCY POST-CONFLICT ASSISTANCE

1. The government of Rwanda has requested a purchase of an amount equivalent to SDR 5.95 million (10 percent of quota) under the Fund's policy on emergency post-conflict assistance.

2. The Fund approves the purchase in accordance with the request. (EBS/97/219, 12/2/97, and Cor. 1, 12/2/97)

Decision No.11622-(97/120) adopted
December 9, 1997
Effective December 12, 1997

6. REPUBLIC OF PALAU—MEMBERSHIP—GOVERNORS' VOTE

The Executive Board approves the report of the Secretary (EBD/97/118, Sup. 1, 12/11/97) on the canvass of votes of the Governors on Resolution No. 53-1, with respect to the membership for the Republic of Palau, approved by the Executive Board (EBM/97/110, 10/7/97) for submission to the Board of Governors. The Governors' vote on the Resolution is recorded as follows:

Total affirmative votes	1,453,979
Total negative votes	0
Total votes cast	1,453,979
Abstentions recorded	0
Other replies	0
Total replies	1,453,979
Votes of members that did not reply	39,352
Total votes of members	1,493,331

Decision No.11623-(97/120), adopted
December 11, 1997

7. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 97/19 are approved.

8. EXECUTIVE BOARD TRAVEL

Travel by an Executive Director and by Advisors to Executive Directors as set forth in EBAM/97/194 (12/9/97) is approved.

APPROVAL: February 15, 2000

SHAILENDRA J. ANJARIA
Secretary