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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 91/1

10:00 a.m., January 7, 1991

M. Camdessus, Chairman

Executive Directors	Alternate Executive Directors
M. Al-Jasser	
G. K. Arora	
C. S. Clark	
Dai Q.	
T. C. Dawson	
J. de Groote	J. Prader
E. A. Evans	
R. Filosa	
M. Finaish	A. F. Mohammed
M. Fogelholm	I. H. Thorláksson
B. Goos	
J. E. Ismael	T. Sirivedhin
A. Kafka	
	J.-F. Cirelli
	O. Kabbaj
	L. J. Mwananshiku
D. Peretz	
G. A. Posthumus	
	J.-C. Obame, Temporary
	R. Marino
A. Végh	A. G. Zoccali
	N. Tabata

L. Van Houtven, Secretary and Counsellor
C. P. Clarke, Assistant

Also Present

P. Parizek, Head of Department of International Finance, Ministry of Finance, Czech and Slovak Federal Republic. IBRD: U. Hewer, Europe, Middle East, and North Africa Regional Office. African Department: M. Touré, Counsellor and Director. Asian Department: J. S. Kahkonen. Central Banking Department: T. J. T. Balino. European Department: M. Russo, Director; M. I. Blejer, L. Hansen, J. Odling-Smee, T. van der Willigen, J. F. van Houten. Exchange and Trade Relations Department: J. T. Boorman, Director; D. Burton, B. Christensen, G. R. Kincaid, K. M. Meesook, M. Shadman-Valavi. External Relations Department: G. P. Newman, J. M. Starrels. Fiscal Affairs Department: A. Cheasty, G. F. Kopits. Legal Department: H. Elizalde. Research Department: B. B. Aghevli, P. R. Menon, B. E. Rourke, N. Ul Haque. Secretary's Department: C. Brachet, Deputy Secretary; J. W. Lang, Jr., Deputy Secretary; M. Primorac. Bureau of Statistics: J. B. McLenaghan, Director. Personal Assistant to the Managing Director: B. P. A. Andrews. Advisors to Executive Directors: J. M. Abbott, L. E. Breuer, M. B. Chatah, C. D. Cuong, Z. Iqbal, S.-W. Kwon, J. L. Menda, A. Raza, B. Szombati, A. M. Tanase. Assistants to Executive Directors: B. Abdullah, T. S. Allouba, G. Bindley-Taylor, S. K. Fayyad, A. Fernandez, J. Gold, M. E. Hansen, P. Kapetanovic, F. Moss, M. Mrakovcic, M. Nakagawa, S. Rouai, C. Schioppa, J.-P. Schoder, Shao Z., D. Sparkes, N. Sulaiman, Tin Win, S. von Stenglin, Wang J.

1. EXECUTIVE DIRECTORS

The Chairman welcomed Mr. Mohammed and Mr. Tabata, Alternate Executive Directors, to the Executive Board.

2. CZECH AND SLOVAK FEDERAL REPUBLIC - 1990 ARTICLE IV CONSULTATION; REQUEST FOR STAND-BY ARRANGEMENT AND EXTERNAL CONTINGENCY FINANCING UNDER COMPENSATORY AND CONTINGENCY FINANCING FACILITY (CCFF); AND USE OF FUND RESOURCES - CCFF - FLUCTUATIONS IN COST OF OIL IMPORTS

The Executive Directors considered the staff report for the 1990 Article IV consultation with the Czech and Slovak Federal Republic, together with its requests for a 14-month stand-by arrangement in an amount equivalent to SDR 619.5 million, external contingency financing under the compensatory and contingency financing facility (CCFF), and a purchase under the CCFF with respect to fluctuations in the cost of oil imports (EBS/90/215, 12/20/90; Sup. 1, 1/3/91; and Sup. 2, 1/4/91). They also had before them a background paper on recent economic developments in the Czech and Slovak Federal Republic (SM/90/237, 12/28/90).

Mr. Pavol Parizek, Head of the Department of International Finance, Ministry of Finance, Czech and Slovak Federal Republic, was also present.

The staff representative from the Research Department said that at a meeting on January 3, 1991 of the Group of 24 industrial countries substantial progress had been made in providing assistance to countries in Eastern and Central Europe. For Czechoslovakia, there were commitments of $200 million from Japan in the form of a parallel loan linked to a structural adjustment loan from the World Bank, and $115 million from Austria, Switzerland, and Sweden; additional funds would also be provided by other non-EC members of the Group of 24 industrial countries, including the United States and the Nordic countries. In view of those contributions, the Commission of the EC had decided to proceed with a loan to Czechoslovakia of about $500 million, which would be disbursed in 1991. The first half of the loan was expected to be disbursed in late February or early March, and the second half in the third quarter of the year. Contacts had also been made through the EC Presidency with a number of countries in the Middle East, but no further information was currently available. Overall, committed financing from the EC and the Group of 24 industrial countries was already in excess of $800 million, and additional loan commitments were forthcoming. On that basis, it was expected that adequate financing would be available to meet Czechoslovakia's reserve requirement in 1991, although it was important that such financing be disbursed as early in the year as possible.

The reform measures relating to the liberalization of prices and the exchange system had been introduced on January 1, 1991, the staff representative from the Research Department stated. With respect to energy policy, the important increases in prices of oil and oil products had been put in place. However, the staff had just learned that scheduled increases in the consumer prices of coal and gas for heating had been postponed until March 1, 1991. The delay, which was apparently related partly to the technical difficulties of installing the necessary devices to measure heat consumption, had come as somewhat of a surprise to the staff. The staff would discuss the matter with the authorities shortly. The budgetary impact of the delay in those price increases was expected to be small--about Kcs 1-2 billion, out of total government spending of Kcs 400 billion and a projected surplus of about Kcs 8 billion.

The Chairman said that he shared the surprise of the staff, and he presumed that the Board did as well. A fuller explanation of the delay in implementing those measures, including the precise timing of their implementation, would be welcome. He hoped that the expected measures would be implemented in the near future.

The staff representative from the Research Department replied that the authorities intended to implement the delayed price increases for non-oil energy products by March 1, 1991. The staff would consult the authorities shortly to ascertain whether that deadline would be met. While the delay would not have major implications for the program, it was important that the commitment to increase those prices be fulfilled, in order to support the energy conservation effort and facilitate an efficient allocation of resources.

The Chairman said that he was confident that Mr. de Groote would join management in making very clear to the authorities that the postponed measures had to be implemented without delay in order to maintain the full quality of the program.

Mr. de Groote made the following statement:

> The measures presently being implemented by the Czechoslovak Government have the distinguishing feature that they do not as such represent a stabilization program: the overall balance between supply and demand, evidenced by the absence of monetary overhang and inflationary pressures and by the prospect of a budgetary surplus in 1991, made it possible to launch a structural reform effort without first having to adopt the corrective demand-management measures characteristic in the first phase of most Fund-supported programs. The decision could thus be taken to rapidly step over from a command to a market economy by limiting as much as possible the duration of the transition period. By now, prices are liberalized and all restrictions on foreign trade and on payments for current transactions have been eliminated. The privatization of small- and medium-scale enterprises has started and will be followed in the course of 1991 by the privatization of large state enterprises, through a process of restructuring into smaller competitive units and an imaginative voucher scheme for the acquisition of part of the capital of those enterprises by the public. The competitiveness of the

Czechoslovak economy will be supported by the successive adjustments of the exchange rate in 1990, which amounted to more than 90 percent. It is the firm intention of my Czechoslovak authorities to prevent any slippage that could jeopardize the favorable conditions under which the program of systemic change can be implemented. The economic policy memorandum spells out the modalities of the restrictive policies that they intend to pursue in the budgetary, monetary, and incomes policy areas, as well as their commitment to a stable exchange rate. If these policies were to be insufficient to maintain the adjustment of prices amounting to a correction of about 25 percent, the elimination of subsidies, the liberalization of foreign trade during the first quarter, and an underlying rate of inflation of 5 percent for the rest of the year, additional measures will be adopted swiftly. First priority is indeed accorded to the possibility of achieving the transition to a market economy with only limited pressures on prices. The resolution with which my authorities have started elaborating and implementing their program of structural change immediately after the June elections, and before any negotiations on possible Fund assistance, guarantees that they will react with the same vigor if the circumstances so require in the future.

Another distinguishing feature of the program submitted today for Fund support is that it is founded on a strong policy consensus that has grown out of an intense debate between all representative segments of public opinion. The so-called scenario of economic reform, elaborated soon after the elections, was not produced in a narrow circle of cabinet bureaucrats. On the contrary, it was widely and publicly discussed among economists of various affiliations, in the media, and in Parliament. This discussion has fostered opposition against a gradual approach to such an extent that an overwhelming majority emerged in the Federal Assembly to approve, in mid- September, the Government's proposal for a rapid transition toward a market economy. The election of the main architect of the reform scenario, Finance Minister Klaus, to the chairmanship of the most important political party is another revealing indication of popular support for the Government's strategy. Moreover, the acceptance by the public of the income reductions and the unemployment increases, which will result from the reform in the first phase, allowed a strong incomes policy component to be incorporated in the program. I regard as decisive for the success of the program the agreement of the social partners on a formula, whereby the correction of the price level in 1991 will only be partly compensated by wage increases. The consensus on this point clearly demonstrates the merits of an open and active discussion between all interested parties. It should not be forgotten, however, that the strong support for the program today might be lost if insufficient financial assistance threatened its implementation.

The absence of major macroeconomic imbalances as the reform program is set into operation, and the strong public support the reform program enjoys, allow us to accept as realistic the forecasts for 1991 presented in the document before you. Limiting the transition costs to a 4 percent rate of unemployment, a 25 percent price correction, and a 5 percent decline in real output requires, however, that the financial and external conditions, on which this forecast rests, be fulfilled. The staff and my Czechoslovak authorities have very carefully assessed the financial support required to defend convertibility and to restore reserves to a minimum level. The important contribution by the Fund that I request you to approve today will indicate that the institution agrees with this assessment of the country's financial needs and expects the restoration of medium-term balance of payments viability under the assumptions underlying the program. Among those assumptions, the full contribution of the other potential sources of financing is crucial for the maintenance of convertibility, which itself is indispensable for a better allocation of resources. On the other hand, a further deterioration in the trade relations with the CMEA countries--in particular, with the U.S.S.R.--and an upsurge in oil prices would impose a revision of the country's financial needs. It is the firm belief of my Czechoslovak authorities that the strength of the reform program ensures understanding from all potential sources of financing, including the financial markets, for obtaining the resources needed, even under less favorable assumptions, to implement a radical and rapid transformation of the economy.

Several members of this Board have questioned me on the impact on the program of the federalization process. The same question was asked on the occasion of the Belgian consultation, and the same answer can be given. In Czechoslovakia, as well as in Belgium, the movement toward a federal system corresponds to a basic cultural and historical reality. Political and social tensions will be eased by the increased responsibility each regional entity has for its own affairs. Public finances will be favorably affected by the greater accountability of regional entities before the electorate for all expenditures related to their own area of competence. The contest for federal funds, in which each region bids against the other, will come to an end. Monetary policies remain entirely in the hands of the central authorities, who also keep ultimate control on taxation and, indirectly, expenditure by local authorities.

In ending, let me say that today's meeting marks a unique moment for Czechoslovakia. Even more important than the contribution you will give to the rehabilitation of the economy is the fact that your decision will consecrate the country's re-entry into the company of modern, competitive, and expanding societies.

Mr. Posthumus made the following statement:

The reform and stabilization program of Czechoslovakia which we are asked to support, is a comprehensive program of liberalization, restructuring and restriction. As such, it is representative of an emerging approach toward the transition of the centrally planned economies in Eastern Europe to market economies. I recognize that the program is different from that of other Eastern European countries in that it does not have to reduce open inflation or potential inflation in the form of a monetary overhang. However, the intended fiscal and monetary policies indicate that the price liberalization process is at least potentially inflationary, and these policies are therefore rightly quite restrictive.

It is very important to realize that on January 1, 1991, there was no complete and abrupt transformation of Czechoslovakia's economic structure. Rather, the Rubicon has been crossed on the way toward a new economic structure. For 40 years, all productive units were owned by the state and all economic activity was directed by the state plan. From now on, almost all productive units will be privatized, and economic activity will be guided by an invisible hand. Czechoslovakia probably has an economic structure that, more than that of many other Eastern European countries, may reasonably accommodate national and international demand for its products. However, as the staff report indicates, nobody knows, precisely because it is the market that decides which part of the economic structure will survive the transformation.

The Czechoslovak program toward reform and stabilization is clear and consistent, and its deserves Fund support. However, let us realize that the most difficult part is still to come: the income loss, the unemployment increase, the bankruptcies, and the lengthy and costly investment process needed to create new employment and income. In spite of all safety nets, for the individuals concerned the immediate effect of all this is negative. This means that the political support for the program will have to be strengthened and rebuilt almost continuously.

I have a few remarks and questions about the policies for 1991.

With regard to price policy, I note that there are still quite a few price guidelines in place. Both the price guidelines and the guaranteed minimum prices may require subsidies to the suppliers, which is of course a fiscal burden, the size of which is uncertain.

On monetary policy, I note that the State Bank intends to set guidelines for the banks, on the level of both deposit and lending rates--in other words, floors and ceilings. While this policy is based on monetary policy considerations, a problem may arise for the financial position of the banks. Banks may have large nonperforming credits on their balance sheets, and the growth of inter-enterprise debts in the form of payment arrears indicates that many of the enterprises, clients of the banks as well, may be in bad financial shape. The process of relieving the banks from these nonperforming loans will take time, perhaps a year or more. In this situation, minimum deposit rates and maximum lending rates may force the banks out of business even before the evaluation of their loan portfolios has been completed. In view of the experiences in other countries in this respect, I would urge the Czechoslovak authorities to act very swiftly in this field.

On exchange rate and reserve management, I support the policies of the authorities. However, it is not clear to me why the exchange rate has been fixed to a basket of five currencies. Perhaps staff or Mr. de Groote could enlighten me. I have not found an indication of which five currencies comprise the basket. If the purpose is to provide an anchor to domestic prices, would it not be logical to select currencies not on the basis of the trade pattern, but on the basis of the strength of the currency concerned--in other words, on the inflationary performance of the country concerned? The latter criterion may point to the deutsche mark, which also implies a link to the EMS; indeed, in future, the EC will probably be Czechoslovakia's largest trading partner.

This is a very large Fund program, indeed. The fact that the stand-by arrangement will itself serve to strengthen Czechoslovakia's foreign reserve position is an important argument for the high level of access. Less clear to me, however, is the contingency element in the request. While it is presented as if it were part of the stand-by arrangement, it is in fact a request under the CCFF. Thus, under the CCFF, both windows are used for compensating excess oil imports.

As far as the compensatory element is concerned, the staff explains the case for an oil import excess related drawing. In addition, an export shortfall is shown for 1991, followed by a recovery of export earnings in the two post-shortfall years. However, the export shortfall is also considered to be associated with a systemic shock, which in my view is the right analysis, indicating that the projections for the two post-shortfall years are not very realistic. Thus, the export shortfall analysis is rather irrelevant from the point of view of compensatory financing, and it could have been left out altogether.

In conclusion, I approve the proposed Fund program as an indication of our strong support for the excellent comprehensive reform and adjustment policy of Czechoslovakia. Our share in financing the balance of payments gap is rather large, however, and I wonder how the estimated future needs of Czechoslovakia will be financed if the Fund returns to a more catalytic role.

Mr. Filosa made the following statement:

There are few countries in the world that have so effectively typified what we now call a small, industrially diversified, open economy. Czechoslovakia, situated as it is in the hearth of Europe, naturally evolved into such an economy soon after its independence. The country was among the founders of the Bretton Woods institutions in the aftermath of the Second World War. Even after its transition to a planned economy, Czechoslovakia remained significantly more open than other command economies and maintained significant trade and financial relationships with various market economies, especially in Europe. At the same time, the country preserved its own strong political identity and embarked upon a number of important economic, social, and political experiments, which, in retrospect, could be seen as having anticipated the events that are now transforming well-established international economic and political relationships.

I have indulged in recalling these aspects of the recent economic history of Czechoslovakia for two main reasons. First, because, on the occasion of the first Article IV consultation since Czechoslovakia rejoined the Fund, I think it is important to pay tribute to a country that has constantly tried to find its own way of interpreting political and economic doctrines and which, by so doing, has significantly contributed to shaping events well beyond its own borders. Second, I recall these events because they might be of help in evaluating the present economic situation of the country and the chances that the transition to a market economy can be successfully completed in a relatively short period of time.

In this last regard, I believe that the tradition of economic openness and the taste for social and economic experiments I have just recalled, together with the smoothness of the movement to the new political system, should ensure a rapid and successful transition to a market economy. Moreover, the absence of an external debt problem and of a monetary overhang, as well as the absence of initial, large macroeconomic imbalances, duly differentiate the case of Czechoslovakia from the cases of other Eastern European countries and fully support the view that the right conditions exist for a successful transition to a market economy. Given this positive background and the well-balanced economic program of the authorities for 1991, which is supported by significant prior actions, I can fully support the authorities in their request for financial assistance from the Fund at this important juncture.

I will focus mainly on four specific macroeconomic issues concerning the authorities' program, namely, price and incomes policy, exchange rate policy, monetary policy, and fiscal policy. I will then comment on the structural aspects of the program.

Starting with price policy, I think it is important to note that the liberalization process will be facilitated by the fact that retail subsidies have already been eliminated. I also welcome the decision to maintain a short list of regulated items, which will be reduced gradually before the first review of the program. I would like, however, to point out that the items that will remain regulated, such as rent and heating fuels, should be subject to increases as soon as the general situation allows, in order to avoid the excessive accumulation of pockets of hidden inflation. This is particularly important in the case of rents, the regulation of which tends to be de facto interpreted by the public as meaning that rents have been frozen. It is clear that if rents were maintained at an unrealistically low nominal level, there would be no incentive for private citizens to purchase residential buildings now owned by the public sector; this, in turn, might have unwanted consequences for the budget in the medium term.

Given the effects on the price level of liberalization, the expected increase in prices of imported inputs, and the fixed exchange rate policy to be pursued after an initial devaluation, the need for implementing a tight incomes policy is apparent if unwanted consequences on the current account are to be avoided under the new regime of convertibility. Indeed, I am convinced that a restrictive stance of monetary and fiscal policy is a necessary, but not sufficient, condition for maintaining viable external accounts, given the uncertainties that surround the relationships between domestic demand and imports and between external competitiveness and exports. In this regard, it is important to stress that the initial overdepreciation of the exchange rate should not be used as leeway for possible slippages in incomes policies, but, as indicated by the staff, as a cushion against possible speculation on the exchange rate. I would also stress that a tight incomes policy will also be necessary in the medium term, in light of the need to increase market shares in world markets and the uncertainties surrounding the response of supply to economic reforms.

Turning now to fiscal policy, I want to commend the authorities for targeting a surplus, despite the significant fall in the ratio of investment to GDP. I am also encouraged that the surplus does not depend on revenues from privatization, and that the authorities have included a small reserve in their budget. Of course, I share the view that major changes in the tax system would not be appropriate at this time, but I strongly encourage the authorities to complete a major reform well in advance of the limit of 1993 indicated in the staff report. Regarding expenditure, I appreciate that all the elements of a social safety net are already in place. There is, however, one contingent element of expenditure to which I would like to draw the authorities' attention, namely, guarantees on loans to state enterprises. According to the staff report, such guarantees will be extended only in exceptional cases. However, it is difficult to see how the Government can discriminate, in practice, between exceptional and unexceptional cases, if effective financial discipline is to be imposed on state enterprises. Moreover, the possible burden on the budget of such guarantees can be very heavy, even if only rather restricted use of such guarantees is made.

The problem of financial discipline leads me to discuss the role of monetary policy, which I understand will be based on a system of credit ceilings to be augmented with guidelines by the authorities on credit and deposit interest rates. I believe that the use of credit ceilings is fully justified in light of the early stage of the move toward the use of indirect instruments of monetary and credit control. The present clearing and settlement system prevents the development of an interbank monetary market. Furthermore, following their introduction, reserve requirements are not yet operative, since the obligatory reserves are provided entirely through direct refinancing from the central bank. A number of useful suggestions have been provided by the technical assistance group of international experts to overcome the drawbacks of the present system. Therefore, I urge the Czechoslovak authorities to take advantage of the many insights provided by the technical assistance group in order to be able to guide inflationary expectations, to prepare for a truly indirect system of credit allocation, and to introduce an adequate degree of financial discipline. In this regard, I note that the growth of large inter-enterprise credits is a source of serious concern. In fact, the existence of such large credits denotes that some enterprises have, or hope to have, privileged access to credit, so that they feel confident to grant loans to credit-rationed enterprises. I am afraid that, unless the authorities refrain from granting special treatment of any kind--including guarantees-- to enterprises, and introduce as rapidly as possible a bankruptcy law, the growth of inter-enterprise credits will not be arrested. The continuation of the phenomenon would pre-empt the implementation of a restrictive monetary policy; in addition, the assessment of the value of enterprises to be privatized would be seriously complicated.

Finally, concerning banking supervision, I understand that draft legislation has already been prepared. I welcome Mr. de Groote's opening statement, according to which monetary policy will remain entirely in the hands of the central authorities. I also hope and recommend that the same will apply to banking supervision.

Turning now to structural issues, it is indeed encouraging that the law on small enterprise privatization has already been approved by Parliament. As for large enterprises, I would like to ask the staff in which cases the restructuring of large state enterprises into smaller joint stock companies be will implemented. It is true that breaking up large enterprises into small and nonintegrated enterprises would increase the degree of domestic competition significantly; however, I would not push this process too far, since Czechoslovak firms will have to face an increased degree of international competition from relatively large firms, especially in Europe.

I also have some comments on the banking system. It is clear that without the emergence of a full-fledged banking system, acting on purely commercial terms, no financial discipline can be imposed on the real sector of the economy. I would therefore strongly urge the authorities to accelerate the process of reform in this crucial sector, and encourage the creation of new banks in order to increase the degree of competitiveness in the system. The most important issues that must be solved are the assessment of bank portfolios and bank recapitalization. I think that these two issues must be resolved soon. In fact, without proper recapitalization, and in the face of a tight monetary policy, banks would have two alternatives: they could avoid recalling loans to insolvent enterprises in order to disguise their own fragility, in the hope of eventually being rescued by the central bank; or, alternatively, they could be forced by the lack of fresh funds to implement an indiscriminately tight lending policy. The dangers involved in either case are clear.

In conclusion, I want to reiterate my appreciation for the comprehensive, well-balanced, and far-reaching program that the authorities of Czechoslovakia have prepared in order to ask for Fund assistance in this bold initiative.

Mr. Dawson made the following statement:

We welcome the first Article IV discussion on Czechoslovakia since it rejoined the Fund, and we welcome its request for Fund support for its adjustment program. The fact that such a strong program has reached the Board in such a short period of time testifies both to the determination of the Czechoslovak authorities to transform their economy and to the staff's hard work. Overall access is high but, we believe, justified by the strength of the adjustment program, the impact of higher energy prices on the Czechoslovak economy, and the desirability of contingency planning.

As is widely recognized, programs of this nature are subject to considerable risks. This is especially so in the current environment of uncertain energy prices and the far-reaching changes underway in CMEA trade. With this caveat, we believe the program before us contains the essential policy ingredients for transforming the Czechoslovak economy into an open, competitive, market-based system. These include an appropriately restrictive macroeconomic policy framework, the establishment of market prices to guide resource allocation, and improvements in the incentive structure to encourage the development of a modern and competitive productive sector. Clearly, many of the reforms initiated under the stand-by arrangement will need to be broadened and refined as time goes on, but the adjustment program appears to be off to a strong start. I would like to mention briefly some of the aspects of the program that we consider most noteworthy.

The macroeconomic policy framework is suitably restrictive, with fiscal, monetary, and incomes policies working together to limit inflation as prices are adjusted in the first months of the program.

On the fiscal side, we welcome the marked decline in both government revenues and expenditures as a sign of government's reduced role in the economy. The staff report notes that part of the revenue decline is simply a reflection of a slack economy. Nevertheless, we believe that the Government should aim for further reductions in the share of government revenues and expenditures in GDP. Although subsidies have been cut substantially, there appears to be considerable scope for further reductions, particularly in agriculture and housing. We also hope that the tax reform slated for 1992/93 will achieve a significant reduction in the overall tax burden. In this connection, we commend the authorities' steps to limit taxes on the productive sector as a means of improving incentives.

With regard to monetary policy, we welcome the authorities' commitment to manage interest rates flexibly and to increase them as necessary to counteract any pressure on prices or the balance of payments. For the future, we look for increasing sophistication in monetary management and a move away from credit ceilings toward greater reliance on indirect instruments. Here, we agree with the staff on the importance of restructuring inter-enterprise credit, so that interest rates will become an effective tool for allocating credit, and on the importance of an independent central bank, so as to ensure effective monetary management.

The move to convertibility, the liberalization of trade, and the freeing of most domestic prices on January 1 will go a long way toward establishing market-determined price signals, which are needed to guide production and investment and to force improvements in the efficiency of domestic enterprises. While these are major steps in the right direction, we look forward to a substantial reduction in the list of controlled prices by the first review and a reduction in export licensing requirements. We have some reservations about the continuation of barter agreements with the U.S.S.R., as this may delay improvements in competitiveness. We hope, therefore, that these will indeed be only temporary expedients to cushion the fall in output and secure needed raw materials.

We also strongly support the other program incentives to improve the efficiency of domestic production. We share the authorities' view that privatization is the best way to impose financial discipline on enterprises and improve their productivity and efficiency. We welcome the prospect that small state enterprises will be privatized in early 1991, and we hope that the legal framework for the privatization of large state enterprises will be completed shortly as well. The practical difficulties of privatizing these larger enterprises are no doubt considerable, but the transformation of the economy requires moving ahead in this critical area as quickly as possible. The need to subject firms to a hard budget constraint and to ensure that credit is allocated according to economic criteria will also require the elimination of inter-enterprise credit and the establishment of a properly functioning banking system with appropriate prudential supervision.

Turning to the external sector, I note that the staff report places considerable emphasis on both the need to reconstitute reserves and the fact that the new unified exchange rate has been set at an overdepreciated level to discourage speculative pressures on reserves. We hope that strong policies and a realistic exchange rate will prevent such pressures from emerging. In the event that unforeseen pressures do arise, we would expect the authorities to react by tightening policies, rather than by using reserves in exchange market intervention.

The staff report also points to the need for substantial external financing over the medium term, and the expectation that private capital inflows will fill a large portion of this financing need. Clearly, good policy performance will be an important determinant of Czechoslovakia's ability to attract the necessary capital on favorable terms. The country is fortunate in beginning this adjustment program with relatively low levels of external debt. In our view, foreign direct investment can play an important role in containing the amount of external debt contracted in the future, in addition to providing needed technical and managerial expertise to domestic producers. Thus, we strongly support the authorities' intention to give active encouragement to foreign participation in the privatization process, and we hope the overall investment climate will be conducive to foreign investment.

The request before us is also noteworthy in that it represents the first occasion for the Fund to assist a country adversely affected by the crisis in the Middle East through the new oil element of the CCFF. The large oil price impact and Czechoslovakia's strong adjustment policies, including those in the energy area, justify maximum access available through the oil element. We do expect, however, that the delayed price increases mentioned by the staff representative from the Research Department will be implemented promptly. Given the systemic change affecting export performance, we agree with the staff that the CCFF financing should be considered as compensation for the oil import excess, rather than for the export shortfall.

We are also pleased to see the inclusion of a contingent element to protect against the possibility of still higher import costs for petroleum and natural gas. With the benefit of hindsight, this seems only prudent, given the importance of these two items in Czechoslovakia's import bill and the uncertainty of future price developments. In the future, we hope to see more programs that include contingency elements.

In conclusion, we believe the proposed program is worthy of the Fund's strong support.

Mr. Cirelli made the following statement:

Let me begin by commending the staff for having been able to propose to the Board the adoption of such a comprehensive program only three months after Czechoslovakia rejoined the Fund. We have certainly broken a record.

In a challenging moment, Czechoslovakia is following the road of forceful, comprehensive, and radical action aimed at completely transforming its economic system, while trying to reduce, to the extent feasible, the transition period and the heavy costs attached to it. This ambitious target is more than commendable, and one can only be struck by the strong commitment shown by the authorities. Certainly, these courageous efforts deserve the support of the international community and, first of all, the Fund. Therefore, I have no difficulty in supporting the proposed decision and, in particular, the large access granted to this program, as well as the first application of the oil element of the CCFF, which was recently adopted by the Board.

With respect to the program, in order to succeed in the tasks they have undertaken, the authorities can count on some positive factors. Indeed, in comparison with some Eastern European countries, economic disequilibria are relatively small in Czechoslovakia: inflation has been contained so far; external accounts are broadly balanced; and, according to the staff, the buildup of monetary overhang has been avoided. I would be interested in knowing why Czechoslovakia has been able to avoid such a buildup, which is present in all the countries of Eastern Europe.

On the other hand, Czechoslovakia has one of the most centrally planned economies in the region, with the State having a quasi-monopoly in all sectors. Domestic prices are, like elsewhere, totally distorted, and the deterioration of the external environment should be very steep in 1991, particularly with regard to traditional trade patterns.

Given these features, I share the authorities' views that the worsening of the external environment and the large terms of trade losses that are expected to occur reinforce the need to act rapidly, in order to integrate as soon as possible the Czechoslovak economy into the international economy.

First, this program is remarkable in its comprehensiveness and consistency. Appropriate restraint, demand-management policies, and a strong incomes policy have been put in place following the liberalization of domestic prices, convertibility of the current account, and foreign trade liberalization. In this latter area, further progress should still be considered. All economic areas have been investigated.

Second, accompanying this in-depth action, measures aimed at limiting the cost of transition have also been decided. I will only recall two examples. On the internal side, the adoption of a social safety net is certainly welcome. As recalled by Mr. de Groote in his opening statement, the continued adherence by the population to the reform process is certainly a key element in the success of such a program. On the external side, transitory measures, such as the adoption of an import tax on consumer goods, will also cushion the economy from the impact of the move to current account convertibility.

Third, like other speakers, I would stress the need to pursue the implementation of the structural reforms swiftly in order to secure the bold process that has already been launched. Two issues are especially crucial, the first of which is the reform of the financial sector, which is necessary in order to put the financing of the productive sector of the economy on a sound footing. In this regard, what can be expected this year in that field, and what would the consequences be for the budgetary objective of the recapitalization of commercial banks that was mentioned in the staff report? The second crucial issue is that the privatization process will also constitute an indispensable complement to price and trade liberalization. Therefore, it is important to grant to enterprises complete autonomy for decisions as early as possible. This process would be better achieved through the transfer of ownership of enterprises to the private sector. I am pleased to learn that the privatization of small and medium enterprises has already started, following the law passed in October. The privatization of large enterprises is envisaged in 1991. On the occasion of the next review, the staff should focus somewhat on the privatization scheme.

Two areas should certainly be of particular interest in the months to come: the fight against inflation, and exchange rate policy. With respect to the fight against inflation, the staff report rightly underscores the need to avoid the creation of an inflationary process following the price liberalization and the exchange rate adjustment. To that effect, the firm implementation of restrictive wage and financial policies is certainly needed. The budgetary policy contemplated for this year is particularly impressive. But the distribution of budgetary competencies between the Republics and the Federation could complicate the attainability of the objectives set for the program. There is also a need to improve the effectiveness of current macroeconomic tools. Special attention should be given to monetary policy in order to render its conduct more efficient. Special attention should also be given to inter-enterprise credit, which constitutes a way to avoid the restrictive stance adopted by the authorities. I share the view of the staff report on this point. Adopting as soon as possible the law allowing bankruptcy for loss-making enterprises is essential in order to impose financial discipline on enterprises from the outset.

Once the inflation process has been fueled, the examples of other countries have shown that inflation is resilient and difficult to put to an end. Therefore, given the ambitious target for inflation set in the program after the initial correction, it is indispensable that required policies be effectively put in place. I take great comfort in the reaffirmed commitment of the authorities to take further measures if required by the situation.

With respect to exchange rate policy, the stability of the nominal exchange rate could provide a useful anchor, complementary to that of wage policy. Should pressure be exerted on the exchange rate, the use of interest rate policy should be implemented actively in order to prevent losses of reserves. It is also essential that positive interest rates be set rapidly in order to attract deposits in domestic currency, as well as to foster domestic savings, which are crucial, given the important investment effort Czechoslovakia has to make in the future. The Fund's intervention will be essential in making a large amount of reserves available at the outset of the program. The close monitoring of reserves, as envisaged in the staff report, is fully warranted.

I would like to make two brief remarks on the financing of the program. First, contrary to the past, the balance of payments outlook for 1991 appears rather bleak, despite the over-depreciation of the exchange rate, and large financing gaps are expected. Uncertainties still remain regarding the full financing of the program. Preserving access to international capital markets will be crucial, as the medium-term prospects point to continued financing needs. Meanwhile, exceptional efforts will be required from public creditors, in particular. Some countries, and especially the EC, have already responded to Czechoslovakia's efforts. I hope that the international community will be forthcoming and will provide support at a time when Czechoslovakia faces one of its most important challenges.

Second, regarding the use of the oil element of the CCFF, I would be grateful if the staff could indicate the basis on which gross or net oil imports were taken into consideration in calculating the amount of compensation. Specifically, if the gross figure was used, what was the line of reasoning?

With these comments in mind, I support the proposed decisions.

Mr. Peretz made the following statement:

Like other speakers, I warmly welcome the bold approach chosen by the Czechoslovak authorities. In my view, the scope of this approach justifies the high level of Fund access proposed, provided, of course, that the authorities strictly comply with the program in practice. I say I welcome the bold approach, but in truth, for a country facing so many challenges, I doubt whether there is a viable alternative. Of course, going for a rapid transition to a market economy will not be easy. Financial policies will inevitably have to be kept tight for some time. A satisfactory supply response--and thus popular support for the program--will depend crucially on a sufficiently rapid pace of structural and institutional reform.

I take this to be the main lesson to be learned from the Polish example. The lessons I draw from the Polish experience are: first, the benefits of going for a "big bang" approach, with adequate financing, which is essential for confidence but may well turn out to be unnecessary; and, second, the cost of allowing structural and institutional reforms to lag behind macroeconomic adjustment. Perhaps I could add as an aside that I think it would be very helpful to have, as quickly as possible, a staff paper evaluating the experience of the approaches to reform adopted in Poland and Hungary as background to our discussions of other Eastern European programs that will come before the Board in the next few months; indeed, such an evaluation would inform our assessment of the study of the economy of the U.S.S.R.

Turning to the main elements of the Czechoslovak program, let me say first that I see the exchange rate anchor as central to its credibility. Owing to administered price increases in recent months, measured inflation is already high; accordingly, financial policies must be kept very tight to ensure that price liberalization does not trigger a price spiral. In this context, the authorities cannot rely on wage policy alone, which applies--correctly, in my view--only to the public sector, and is in any case only a temporary expedient, whose costs will start to outweigh its benefits the longer it is kept in place. The authorities must use the normal instruments of monetary and fiscal policy to keep inflation down--here, the exchange rate anchor will provide a key guide to policy.

The difficulties of maintaining financial stability will be compounded by the succession of shocks Czechoslovakia faces this year, including the impact of its own domestic reforms, changes to the CMEA trading arrangements, and higher energy prices. Czechoslovakia has no choice but to adjust fully and rapidly to these shocks, and this is implicitly recognized by the high threshold built into the contingency facility. Even if, as is entirely possible, the fall in output and employment is larger than projected, the authorities will need to resist any temptation to relax policy prematurely.

Operating monetary policy will not be easy. Domestic price signals will be confused by the effects of liberalization and administered price increases. Retaining capital controls--and I have some doubts about the wisdom of this--means that the external position may not be a fully reliable guide for domestic policy. Real interest rates will need to be kept positive. But measuring real rates is a complex calculation. I am not clear in this context how the authorities intend to measure "underlying" inflation; while there is a case for excluding the immediate effects of price liberalization, I see no reason why second-round effects or subsequent administered price rises should be. Perhaps the staff could comment on this. Interest rates will, of course, have to be adjusted promptly anyway to counter any drain on reserves.

As for fiscal policy, the authorities have rightly set themselves demanding budgetary targets. In practice, the fiscal outturn will depend heavily on unemployment levels and enterprise profitability, and, if slippages do emerge, I see that there is scope for getting back on track by cutting agricultural and housing subsidies, and for better targeting of last year's measure of universal compensation for the elimination of food subsidies. Both of these changes would, in any case, be desirable in their own right.

As I have already said, the authorities would do well to accelerate the implementation of institutional reforms, especially measures to strengthen competition, improve financial intermediation, and attract inward investment. Many elements of the reform program are closely interrelated, and slippages in one area will have knock-on effects in others. The imposition of hard budget constraints on state enterprises, a proper legal framework, including enforceable bankruptcy laws, the dismantling of monopolies, and a fully functioning banking system and capital market are urgent priorities to ensure a correct structure of incentives and efficient allocation of resources. Restructuring the banking network is likely to involve some expense, but should not be delayed until sufficient privatization proceeds have accrued. This is an area in which foreign investment and technical assistance could play a particularly important role. In this regard, I was disappointed that the World Bank's financial sector adjustment loan is not expected to be approved until early next year. Perhaps the staff could reassure me about the authorities' immediate intentions.

I hope that the various special transitional measures can be phased out at the earliest opportunity. The remaining export licenses and price regulations, and the tariff on imported consumer goods, can only be justified as safeguards during an initial period. Could the staff explain the justification for the slow phasing in of full international prices for coal? I hope that a firm timetable has been set.

Moreover, provided that domestic policies are strong, as they will need to be, I see considerable benefits in going for fuller current and capital account convertibility as an early priority. I believe this will be one of the best ways to reassure foreign investors. It would also help accelerate development of effective and efficient domestic financial markets, which will be essential for the functioning of the economy and for the operation of monetary policy. It would also help to ensure that the external position and the exchange rate anchor provide correct signals for domestic monetary policy. In all these areas, if temporary measures are allowed to become entrenched, they will be difficult to abolish and will hinder a swift transition to an efficient market economy. The staff should, I believe, examine all these restrictions again at the midterm review.

On trade issues, I can understand why the authorities have continued certain bilateral trade arrangements with the U.S.S.R. to preserve the security of oil supplies through existing pipelines. But reliance on barter trade risks shielding sections of Czechoslovak industry from competition and so retarding the reform process. One way around this difficulty would be to enhance pipeline capacity from elsewhere for alternative oil supplies. Here, too, I would appreciate the staff's comments. I would also welcome a comment on the implications--both for Czechoslovakia and more widely--of another aspect of the bilateral trade agreement with the U.S.S.R., which appears to secure Czechoslovakia an unexpectedly advantageous exchange rate for its transferable ruble surplus. Do we know why the U.S.S.R. has agreed to this, or whether similar arrangements will be made for other Eastern European countries?

Bearing in mind the low level to which reserves have fallen, I am broadly satisfied with the staff's assessment of Czechoslovakia's external financing requirements this year. The initial stand-by arrangement and CCFF drawings will be sufficient to see Czechoslovakia through the immediate period of vulnerability ahead. I also welcome the indication that most of the $1 billion financing being organized by the Group of 24 industrial countries is now in place. All these facilities are needed to maintain confidence in the program as a whole, and in the exchange rate anchor in particular. The best way to ensure that these facilities go to bolster reserves and are not spent is to provide stabilization resources that are sufficiently large to inspire confidence. Again, the Polish experience seems to be relevant.

Finally, Czechoslovakia's need for external financing in the medium term underlines the importance of a rapid and successful transition to a market economy. It will have to rely increasingly on direct investment, trade credits, and private capital markets.

Fortunately, Czechoslovakia is not highly indebted, and the approval of this stand-by arrangement should be a significant catalyst. But the private capital required will be forthcoming only if reforms are rapid and bear fruit. The authorities must make their first priority preserving the confidence of the international community. I believe, however, that there is every prospect of success, and that what we decide today could turn out to be a classic Fund operation--a substantial but temporary drawing, combined with bold and effective policy adjustment. If the authorities stick to this course, there is every prospect that in a few years' time--a shorter period, perhaps, than was required for the post-War reconstruction of Western Europe--all drawings from the Fund will have been repurchased.

With these remarks, I fully support not only the stand-by arrangement and the request for compensatory financing, but also the attachment of a contingency facility and the waiver of the limit on access under Article V.

Mr. Kafka made the following statement:

It is fitting that the first Board meeting of 1991 should review the attempt by one of our newest, as well as oldest, members to consolidate and continue its economic program. There is every reason to hope that Czechoslovakia offers exceptionally favorable conditions for its program's success. Czechoslovakia enters into its program with an economy that has managed to maintain agricultural production at a relatively satisfactory level, has a relatively low external debt, and has avoided the degree of overhang of liquidity that has emerged in the other Eastern European countries. This is, indeed, rather remarkable. It is incumbent upon the international financial community to offer Czechoslovakia its unstinting support. We therefore support the proposed request for a stand-by arrangement, with an attached contingency element, as well as the request for compensatory financing in respect of the excess in oil import costs.

The 1991 program represents a continuing commitment by the authorities to move as quickly as possible toward a market-oriented economy. The institutional adjustments proposed for 1991 are courageous, timely, and appropriate, particularly the privatization of small state enterprises and the beginning of the restructuring of large state enterprises, as well as the open attitude toward foreign capital. Of critical importance will be the establishment of the securities exchange and the passage of the bankruptcy law. The institutional restraints placed on state enterprises with respect to budgetary support, credit from the state and commercial banks, and the financing of budgets via inter-enterprise arrears are also welcome. A fiscal surplus is to be achieved through expenditure cuts, except for the necessary safety net, despite lower rates of tax. A tight monetary policy is to continue. At this juncture, a temporary incomes policy and price guidelines can be justified. In the absence of market-based monetary instruments, credit ceilings and administrative controls will have to be utilized, but we urge the authorities to continue to work toward reserve money management and other indirect monetary instruments in the current year.

The unification of exchange rates, following some average overall devaluation of the exchange rate at end 1990, and the decision to conduct all CMEA trade in convertible currencies from the beginning of this year, are welcome. We also urge that the exchange rate be subject to review in light of changing trading patterns and movements in the level of international reserves.

In the external sector, the liberalization of trade and payments arrangements, both on current and capital transactions, are breathtaking and comprehensive.

We are not convinced that economic change and transformation will be as smooth and uneventful as indicated in the staff's medium-term outlook. Much will depend on developments in the rest of Eastern Europe and the world economy in general. One part of the necessary financing is expected to reflect debt repayments by the U.S.S.R.; the staff may wish to comment on this aspect.

Nevertheless, the authorities have designed a strong program, have acted decisively in implementing strong measures, and seem to have attained the critical precondition for change, i.e., political support.

Mr. Goos made the following statement:

I am most impressed by the comprehensiveness of the reform effort envisaged under the program before us, which reveals a remarkable resolve of the authorities to move to a market economy as rapidly as possible. This resolve has also been demonstrated in a commendable manner by the reform measures taken last year, which no doubt bode well for the success of the authorities' adjustment effort.

Yet, it is clear that the task ahead remains daunting and is bound to cause substantial frictions in production and employment in the transition period to a market system. Therefore, I fully appreciate the authorities' desire to maintain, in a number of policy areas, some safeguards against undue speculative developments and disruptions. I am glad to note, however, that these safeguards are meant to be used only as transitory expedients, notably when it comes to the maintenance of some price, import, and export controls. I would also hope that the bilateral payments agreements to be renegotiated between Czechoslovakia and other countries will be strictly limited in both extent and duration. It is clear that currency convertibility, which is to be introduced under the program, can develop its full potential only if economic agents are allowed to respond to market signals as freely as possible.

Another highly critical aspect in this regard is privatization. While welcoming the swift course of action envisaged for smaller enterprises, I am somewhat concerned that the emphasis placed in the case of the larger units on "fair value" and "orderly transformation" might entail undue delays in the development of a meaningful private sector and, hence, the resumption of efficient and sustainable growth. The importance of the latter for sustaining the support of the general public for the reform strategy can hardly be over-stressed. Therefore, I feel that, at least in case of doubt, the authorities should emphasize rapid privatization over undue considerations of fairness in establishing the sales prices for large enterprises. Such an approach also seems advisable in view of the presumably limited professional and managerial capacities available in Czechoslovakia for evaluating the enterprises to be divested and for running them effectively in the interim period.

I noted with concern the recent buildup of apparently sizable inter-enterprise payments arrears, the causes of which are not quite clear to me. Is there a risk that those arrears might discourage potential buyers of state enterprises? I wonder how this problem is going to be tackled under the program.

The eventual success of the reform effort will no doubt depend critically on the maintenance of strict financial discipline and restrictive incomes policies, and I generally welcome the policy stance envisaged in those areas. However, I am concerned that the program might underestimate the inflationary pressures arising from price and trade liberalization, including the restructuring of CMEA trade, as well as from the 20 percent import surcharge on consumer good imports and the recent substantial depreciations. After all, according to the staff report, raw material import prices alone are expected to rise by up to fourfold this year. This raises questions about the adequacy of interest rate policy, which, even on the more optimistic inflation assumptions of the program, would remain strongly negative in real terms on average this year. I certainly appreciate the staff's reasoning that the initial surge in prices would soon recede to the much lower underlying rate of inflation--namely, 5 percent. However, in view of the uncertainties surrounding such expectations, I feel strongly that it might be more advisable to match as closely as possible the maturity profile of interest rates with the expected inflation performance during the course of the year. I fail to see why it would be impossible or inadvisable--as suggested in the footnote on page 18 of the staff report--to set interest rates on instruments with three-month maturities at a level of 25 percent, or preferably somewhat higher, if the expected increase in the price level for the first quarter was also 25 percent, even though this would imply an interest rate of 150 percent on an annual basis. The reference in the staff report to an annual rate of 150 percent is rather irrelevant in this context. At any rate, I feel that in the current unsettled circumstances, a very flexible stance of interest rate policy--erring, at least in the beginning, on the side of caution--would carry a high premium in containing domestic imbalances and avoiding a vicious price-wage-depreciation circle.

I should caution against the introduction of variable interest rates on longer-term maturities, as envisaged for the bank loans to enterprises that are to be renegotiated. Such variable rates not only tend to hamper the effectiveness of interest rate policy as a tool for demand management, but also carry the seed for the spreading of indexation to other sectors of the economy as well.

Before concluding, I should endorse, in particular, the staff's advice on an expeditious reform of the banking system and the maintenance and possible strengthening of the independence of the State Bank. An effective market system for banking and finance is indeed one of the most important prerequisites for a functioning private sector.

Finally, I should like to welcome the authorities' desire to safeguard Czechoslovakia's access to Fund resources in later years, and, therefore, to refrain from drawing on the Fund if that would bring the level of gross official reserves above $3 billion. Indeed, this seems to confirm my concern, which I have expressed previously, that the arrangements envisaged for approval today would exhaust about half of the Fund's total leeway for financial assistance to the country. The crux of the matter is, of course, that the likelihood of a need for further substantial Fund assistance would decrease if official reserves reached the level of $3 billion, and would increase if official reserves did not reach that level. At any rate, it appears that in view of the substantial financing gaps in the years ahead, the balance of payments outlook will remain heavily dependent on the confidence of bilateral and private creditors, as well as on foreign direct investment. This reinforces the need for vigorous implementation of the program and strict adherence to the reform objectives.

With these observations, I can endorse the staff appraisal and the proposed decisions.

Mr. Tabata said that, having read the staff report, he was confident that Czechoslovakia would overcome the many hardships that were expected during the transition period, and would attain its objective of an efficient market economy. During his visit to Prague in May 1990, he had been left with the same impression--that the future of the economy of Czechoslovakia was promising. The reason for his optimism about the prospects for economic reform in Czechoslovakia was quite simple: the authorities had a very clear understanding of modern economic theories, and would put that understanding to good use by implementing appropriate policy measures.

In particular, he had been extremely impressed by the method of wage determination employed in Czechoslovakia, Mr. Tabata continued. Most members of the Board had recognized that flexibility of the real wage was of the utmost importance when external shocks, such as oil price increases, occurred. In Czechoslovakia, real wages had declined by 7 percent in 1989 and by 8 percent in 1990, and were expected to decline by 10 percent in 1991. Undoubtedly, those declines would reduce both inflationary pressures and inflationary expectations. Such a result was consistent with the Japanese experience following the second oil hike in 1980; indeed, the decline in real wages had been one of the main factors in the success of the adjustment process in Japan. Therefore, he strongly supported the authorities' efforts to refrain from increasing real wages.

While he continued to have confidence in Czechoslovakia's economic prospects, Mr. Tabata went on, he had a number of concerns, the first of which was the relationship between the real growth rate, the rate of increase in broad money, inflation, and the income velocity of money. According to the staff's estimate, in 1991 the real growth rate would decline by 5 percent, prices would increase by approximately 30 percent, and broad money would increase by 6 percent. Under those circumstances, velocity would be expected to increase substantially. However, while velocity had already increased somewhat in 1990, it was extremely difficult to imagine--given the estimated changes in the real growth rate, broad money, and inflation--that it would increase substantially in 1991, even taking into account that new nonmonetary financial assets would be created as a result of the privatization of large state enterprises. A more plausible scenario suggested that either the real growth rate would decline by much more than 5 percent, or that it would be necessary to increase broad money or ease monetary policy in the second half of 1991.

His second concern was related to the risks associated with an expansion of interenterprise credit, which would be the natural response to the implementation of a tight monetary policy and a downturn in economic activity, Mr. Tabata considered. During the 1950s and early 1960s, when the Bank of Japan had adopted a tight monetary policy, including the application of credit controls on commercial banks, interenterprise credit had expanded and had become one of the main indicators of the degree to which tight monetary policy had affected the economy. However, the most important question concerned the role of a buffer in an economy that underwent an expansion of interenterprise credit. If bankruptcies were to develop in such an economy, the chain of bankruptcies would surely grow. In Czechoslovakia, the capital position of private banks was extremely weak, and they would therefore be unable to safeguard the financial stability of the economy. If the Government tried to perform the role of buffer by financing the chain of bankruptcies, considerable sums of money might be necessary; if those sums were financed by the central bank, that would provoke an inflationary situation.

Successful privatization of large state enterprises depended on whether they had clean and healthy balance sheets, Mr. Tabata said. It was uncertain, however, whether the concept of depreciation had any real meaning in a centrally planned economy. Capital equipment, for example, which had been purchased ten years previously and whose real value was already close to zero, was still listed on the asset side of the balance sheet at 100 percent of its original value. Similarly, enterprises showed no reserves for depreciation on the liability side of their balance sheet. Under those circumstances, it might be difficult to proceed with the depreciation prior to privatization. Nevertheless, it was necessary to allow for depreciation by augmenting the reserves of the affected enterprises; if that were to be financed by the government, however, it would also generate inflationary pressures.

Following the request of the Czechoslovak Finance Minister, the Japanese Finance Minister had conveyed that Japan would consider providing an untied loan of approximately $200 million, in the form of cofinancing with a World Bank structural adjustment loan, Mr. Tabata stated. Finally, he supported the proposed decisions.

The staff representative from the Research Department commented that it appeared that the $200 million loan from Japan that Mr. Tabata had referred to would be negotiated in 1991, and that some funds under that loan would be made available later in the year. It was possible that the loan would be disbursed in two tranches, with the second tranche to be disbursed in 1992.

The Chairman asked Mr. Tabata when the funds to which he had referred would become available.

Mr. Tabata said that it was uncertain when the loan would be disbursed; however, funds might be made available to Czechoslovakia during the course of 1991. The timing of disbursement was dependent on the negotiation between the Japanese Export-Import Bank and the Government of Czechoslovakia.

The staff representative from the Research Department remarked that, the task of projecting the inflation rate during the program period would have been much simpler if price adjustments associated with the changes in import prices and the exchange rate had taken effect immediately on January 1, 1991. However, that had not been the case. The initial price adjustment was likely to take place over an extended period--perhaps as long a few months--although it was difficult to be precise. It was therefore important to distinguish between the initial price correction necessitated by both the devaluation and the shift in the pricing of CMEA trade to higher world prices, on the one hand, and the underlying inflation rate that would follow those events, on the other hand.

The underlying inflation rate had been targeted at about 5 percent, the staff representative observed, although it was not possible to determine in advance how long it would take before the inflation rate stabilized at that level. As for the initial price corrections, the staff agreed with Mr. Goos that the estimate of 25 percent was on the conservative side; however, the authorities had felt that it was wise to use a conservative price target for the formulation of policies. If a higher target for inflation had been assumed, and if financial policies were designed to be consistent with that higher target, then the result could well be a self-fulfilling prophecy. Therefore, it was prudent to try to restrain the initial price adjustment to 25 percent, even though there was a possibility that that figure might not prove realistic, and that prices might turn out to be somewhat higher. If the effect of the reforms on the domestic economy was more severe, as Mr. Tabata had indicated, it might become necessary to adjust credit policy in the subsequent period to safeguard against a larger than expected decline in output.

The formulation of interest rate policy would also have been simplified if the initial price correction had been completed on January 1, in one day, so that interest rates could be set at a level consistent with the underlying inflation rate, the staff representative remarked. However, it would not be prudent to set interest rates, even short-term rates, at a level that incorporated the initial price adjustment. In this context, there was an important difference between assuming that the initial price adjustment of 25 percent would be completed in one month or in three months. With a one-month adjustment period, nominal interest rates would have to be extremely high--over 1,000 percent in annual terms--to maintain positive real interest rates, as the staff report had indicated. While such positive real rates might be manageable for some enterprises in the short run, for most enterprises, of course, that would not be possible. Inevitably, there would be many bankruptcies and enormous economic costs. Interest rates had been raised on January 1, and the authorities were committed to raise them again should it become necessary to protect the external position. One alternative to holding domestic currency was to hold foreign currency; however, to the extent that the exchange rate was fixed, that was not an attractive option, because foreign interest rates were substantially lower than domestic rates. Indeed, domestic interest rates provided a rather large margin over the foreign interest rates that were available to domestic residents. In addition, capital controls were in place; consequently, foreign interest rates were not widely available to domestic residents, although there might be some leakage through that channel.

The relative merits of pegging the exchange rate to a basket of currencies rather than to a single currency had been discussed at the recent seminar on exchange rate policy (SEM/90/7 and SEM/90/8, 11/21/90), the staff representative said. Pegging to a basket would provide some protection against the impact of a large realignment of major currencies. On the other hand, pegging to a single currency was, of course, a more transparent indication of a fixed exchange rate. The authorities had weighed those arguments carefully, but the balance of the argument had turned in favor of pegging to a basket, partly because of noneconomic factors that mitigated against pegging to the deutsche mark--which was the natural currency for Czechoslovakia to peg to. The five currencies that comprised the basket were the deutsche mark, the Austrian schilling, the pound sterling, the Swiss franc, and the U.S. dollar.

The process of dismantling some of the large enterprises would begin fairly soon, the staff representative commented, particularly in those cases in which the enterprise had considerable monopolistic power and dismantling was advisable from an economic perspective. An obvious example was the construction sector, in which the World Bank would concentrate in the context of the structural adjustment loan that was currently being negotiated.

To the extent that the export shortfall had been associated with systemic changes, the financing of it was more appropriately provided under the stand-by arrangement, the staff representative said. Nevertheless, it was critical to demonstrate that there was in fact a shortfall. The staff report analyzed the case in some detail, because, to the extent that there might have been an excess on the export side, there would not have been a need for financing on the import side. While the estimated export shortfall had not been used in the context of additional financing, the information provided indicated that there had indeed been a large shortfall. The technical issue of net versus gross measurements was rather subtle and complicated. In general, the issue did not arise, because exports of oil would be included in the measurement of total exports, and any excess of oil imports would be netted against total exports. In Czechoslovakia, the problem arose because the export shortfall had been excluded; therefore, it made a difference whether a net or a gross measure was used for oil imports. While the staff had used a gross figure in the present case, it had not focused on that issue, because the difference between the gross and net figures was small. If a net figure had been used, the estimated excess would have been only marginally larger. Access was already at the maximum level, however, so the staff had been comfortable using the more conservative measure. Nevertheless, in other cases, it would be necessary to look more carefully at that issue, because it could significantly affect the level of financing. A case could be made for using a net figure if the export shortfall was excluded, because the relevant cost for an economy was actually measured in net terms, not gross. Indeed, the staff might have to return to the issue in the context of Czechoslovakia, as more recent projections for oil prices indicated that the estimated excess might decline substantially by the time the second purchase under the CCFF was disbursed.

An agreement had been reached in principle on the settlement of about $800 million of Czechoslovakia's expected trade surplus with the U.S.S.R. in 1990, although the exchange rate to be used was still to be determined, the staff representative stated. The proposed exchange rates ranged from 0.8 to 1.3 transferable rubles per U.S. dollar, but negotiations were continuing. While that range was more favorable than was indicated by the cross rate, it was less favorable than the rate quoted by the International Bank for Economic Cooperation (IBEC). A similar range had also been used in other cases; for Hungary, for example, the rate used was 0.9 transferable ruble per U.S. dollar. Negotiations on the exchange rate to be used in 1991 and beyond to convert both accumulated surpluses with the U.S.S.R. and the resources made available in the context of longer-term capital investments in both countries had not yet been finalized. Those negotiations would be extremely difficult, because of developments in the U.S.S.R. In that area, it was hard to be more precise at present other than to point out that the authorities were negotiating on a nearly continuous basis; indeed, a senior Czechoslovak official was presently in the U.S.S.R. negotiating certain aspects of those exchange rate arrangements. The existing pipeline made it very attractive for Czechoslovakia to import oil from the U.S.S.R.; at the same time, the pipeline made it equally attractive for the U.S.S.R. to export oil to Czechoslovakia. The pipeline constraint was a serious one--although there was an Adriatic pipeline through which some imports were available, but only in small amounts--and a new pipeline could not be built in the short run. Much of the problem could be solved once the situation in the U.S.S.R. was clarified.

There was only limited monetary overhang in Czechoslovakia, because the authorities had avoided the large financial imbalances that had been present in some of the other centrally planned economies, the staff representative considered. In Czechoslovakia, fiscal and monetary policies had been much more prudent over time than they had been in other Eastern European countries. The velocity of money had increased sharply in 1990, as inflation had been about 22 percent, while broad money had increased by only a few percentage points. The increase in velocity had eliminated a large part of any monetary overhang that might have existed. Some monetary overhang was still present, and that had been incorporated into the financial program.

The reform of the financial sector, as had been indicated by a number of Directors, was a critical issue, the staff representative said. The issue of bad debt, in particular, was very difficult, and the recapitalization of banks had to be implemented. The authorities were currently considering the appropriate measures, with the technical assistance of the Central Banking Department, and the staff expected that action would be taken in early 1991. There would be a nominal cost to the budget, but in practice the cost would not be large. One instrument being considered was to use the resources from privatization to issue bonds, which could then be exchanged for bad debt. The cost, which was actually limited to the interest cost, could be passed on to the funds that were made available through privatization; to the extent that that was possible, there would be no budgetary costs. If recourse was not made to the privatization funds, then some budgetary cost would have to be included. There were still no specific understandings reached on how the recapitalization would be financed.

Coal was strategically a very important commodity for Czechoslovakia, and its price adjustments would therefore be phased in more slowly than those for other products, the staff representative from the Research Department stated. Nevertheless, coal prices were expected to be adjusted within the program period. There was much less scope for adopting a gradual approach for other products, such as oil and oil products, because they were imported.

Mr. Posthumus observed that several speakers had referred to the barter and trade arrangements, some of which were already in place and some of which were still being negotiated. Like those speakers, he would also be concerned if those arrangements were still in existence in two or three years, but it would not be a cause for concern if they were not eliminated before the end of 1991, as the CMEA trade and payments system had collapsed rather abruptly. It was conceivable that, in the absence of at least some of those arrangements, some of the trade within the former CMEA area would be terminated. If some time was allowed so that an assessment could be made of the impact of the movement to trade in convertible currencies and at international prices, some CMEA trade might survive. While it was not very popular to talk about gradualism, a certain degree of gradualism in the present case--perhaps one year--might be a very useful guide for the partners in the former CMEA zone.

Mr. Peretz said that there appeared to have been an agreement under which the U.S.S.R. would convert its accumulated trade debt to Czechoslovakia at the rate of one transferrable ruble to one U.S. dollar, a very favorable rate. If that was correct, he wondered why the U.S.S.R. had agreed to it, and whether the U.S.S.R. would use the same rate for its trade debts with other Eastern European countries.

The staff representative from the Research Department replied that the exact exchange rate to be used by Czechoslovakia and the U.S.S.R. had not yet been decided, although it was to be in the range of 0.8 to 1.3 transferable rubles per U.S. dollar. The figure that had been used in the case of Hungary was about 0.9.

The Chairman said that it appeared that the Soviet authorities wished to proceed on a case-by-case basis, without committing themselves to a single exchange rate.

The staff representative from the Research Department said that Czechoslovakia seemed to be a test case; inevitably, the exchange rate agreed for Czechoslovakia would set the stage for negotiations between the U.S.S.R. and other countries.

Mr. Végh made the following statement:

With a great deal of interest, we read the staff report and listened to Mr. de Groote's opening statement on this ground-breaking experience in the dismantling of a command economy. It is a program that deserves the support of the Fund, and we fully agree with the proposed decisions.

In this spirit, we would like to offer a few observations on the fiscal, monetary, and exchange measures that are being adopted.

First, on fiscal matters, the authorities are well advised to postpone a major reform of the tax system, and to give priority to the strengthening of the present system and its adaptation to the new political conditions. We are worried, however, by the significant dispersion of rates in the turnover tax, which runs contrary to the tendency of modern tax reforms to move toward more neutral structures, with a large tax base and little or no differentials in tax rates. This improves both tax administration and the efficiency of resource allocation.

Second, on monetary policy, the existence of credit and interest rate ceilings could be a severe limitation on the flexibility required for the successful operation of the market mechanism in the initial phase of the program. Excessive intervention by the Government could result in two different types of errors, both quite dangerous for the program: negative interest rates, with all their damaging consequences; and very high positive interest rates, which, associated with a fixed exchange rate, could induce a significant inflow of hot money, with an initial impression of success and a source of instability in the near future. For these reasons, we would recommend a more liberal and market-oriented approach to interest rate policy.

Third, on currency convertibility and exchange controls, we believe the authorities should move more rapidly and drastically toward the elimination of such controls and the harmonization of internal and external convertibility. Some of the measures proposed are cumbersome, difficult to administer, and will stand in the way of one of the main goals of the program, that is, full integration of the economy into the world market and, especially, the European Community. In this context, we are concerned about the reliance on price and trade licensing regulations, which, if maintained beyond the short run, could seriously distort resource allocation.

Finally, we would caution against excessive initial optimism, which tends to underestimate the costs of the transition process and harbor potentially unfulfilled expectations with respect to output and employment. In addition, the assertion that the rate of inflation will reach 30 percent a year, with the exchange rate fixed at a very high level, increases in prices of some imported raw materials of 400 percent, and a 20 percent import surcharge, in addition to widespread price liberalization, might warrant some additional clarification.

We would also appreciate some further comments by the staff on the likelihood and magnitude of a possible crisis in the banking system. Reading the staff report, one gets the impression that the balance sheets of the banks must be very weak and that old assets--namely, loans to state enterprises at low fixed interest rates--must be worthless to a great extent. Sooner or later, liabilities in the form of bank deposits will have to be assumed by the Federal Government, with considerable fiscal and perhaps monetary effects. Could the staff comment on this point?

Mr. Clark made the following statement:

Like earlier speakers, we welcome this first opportunity to review developments in, and prospects for, Czechoslovakia. We fully support the determined efforts of the authorities to implement a major program of economic adjustment and reform, and are impressed with its comprehensiveness. The magnitude of Fund resources, as well as the front-loaded nature of the disbursement profile, is somewhat unusual. Nevertheless, in light of the program's scope and ambitiousness, as well as the special circumstances faced by Czechoslovakia--which have been noted by other speakers--we can support the proposed decisions.

I would like to raise some questions and concerns regarding the assumptions underlying the program, which to me appear overly optimistic. As a result, it seems to me, there is a larger than usual probability that Czechoslovakia may not be able to meet the program's objectives.

The Czechoslovak program is somewhat different from that of Poland or Hungary, in that the starting point of the program is considerably more comfortable than was the case in these two countries. Czechoslovakia has the benefit of starting the transformation process from a position of domestic balance, with a relatively low inflation rate and virtually no foreign debt. Consequently, financial policies in this program need to focus mainly on ensuring that destabilization or, more precisely, an acceleration of inflation, does not ensue after liberalization takes place. This is in contrast to the cases of Poland and Hungary, where one of the key tasks has been the need to stabilize a deteriorating macroeconomic environment, while at the same time undertaking key structural reforms.

Some of the benefits of this have already been evidenced in the relatively modest decline in output last year of only 3 percent. This may not be much greater than the decline in output that may occur in Canada during the current recession. The rate of inflation has also remained quite moderate, despite significant price reforms and several depreciations.

Nonetheless, despite the rather encouraging circumstances, the optimism of the forecast underlying this program, and that embodied in the medium-term scenario as well, seems rather unjustified. Czechoslovakia will be undergoing a fundamental change in its economic system, which will involve, among other things, the creation of new institutions and the learning of behavioral patterns instrumental to the functioning of market economies. Moreover, this will be taking place in the context of a major deterioration of the external environment facing the country, which by itself will impose a heavy adjustment burden.

Consequently, I find that a forecast that includes a decline in GDP of 5 percent, followed by a recovery of 2 percent in the following year and 4 percent and 5 percent growth in the subsequent years, is not only overly optimistic, but is also, it seems to me, not within the range of the plausible. I note that the Minister of Finance himself, Mr. Klaus, was quoted in the New York Times of January 1, 1991 as saying that the expected decline in economic activity in 1991 would be between 5 percent and 10 percent. This alone would lead me to conclude that a realistic estimate would be much closer to a decline in output of 10 percent, or even greater, rather than the lower end of the range cited by the Minister.

The rather modest forecast for the decline in output is particularly striking when contrasted with what occurred in Poland last year as it undertook a similar program of transformation--GDP declined by about 20 percent. In addition, I note that in Hungary, GDP is expected to decline by 6.5 percent in 1990, despite the fact that the measures introduced during the past year were considerably less ambitious than those planned in Czechoslovakia, and that Hungary is far more advanced down the path of reform.

It appears that the staff shares my view that the assumptions are indeed overly optimistic, as the staff report notes on many occasions that there is considerable down-side risk to the forecast. This leaves a rather strong impression that the economic assumptions represent a "best-case scenario," rather than the midpoint of a realistic range. I appreciate the immense difficulties and uncertainties involved in developing economic assumptions. However, I believe that the Board and the authorities would be better served if the assumptions were somewhat more realistic and, therefore, more achievable.

The forecast for inflation is also somewhat lacking in credibility; not perhaps the forecast for inflation in the first quarter, but mainly the assumption of rapid stabilization at a very low level in the subsequent three quarters. Although a major increase in prices should be expected in the period immediately following price liberalization, given the extent of changes that will continue to take place, it is unlikely, in my view, that inflation will stabilize so quickly; at least, not without a much tighter monetary stance, which would imply a considerably greater decline in output than that suggested by Mr. Klaus, the Minister of Finance.

One would expect a certain learning curve on the part of both enterprises and consumers and, therefore, a more extended adjustment than three months before prices settle. I would expect this to be particularly true in the case of the enterprises, which will face difficulties in determining a competitive price without previously being exposed to market conditions. Moreover, the process of privatization will probably also lead to some price instability as new management reviews pricing practices. Consequently, price pressures should be anticipated throughout the year and particularly in the latter part of the year, when privatization of the larger enterprises is to begin. Finally, I would note that even without major transformations and structural changes, much more developed economies than Czechoslovakia have found it difficult to keep inflation at an annual rate of about 5 percent.

Lastly, I was struck by the apparent lack of realism in the medium-term projections. Although major strides in the transformation process are to take place this year, as I have noted, the larger enterprises will only begin to be privatized in the later part of the year, and this process is to continue well into the following year. This will certainly affect a major share of production and output. It seems rather unrealistic to me to expect a recovery of 2 percent while this process is taking place.

Could the staff review the reasons why it chose to adopt such optimistic assumptions as the basis for developing the program? I would think that repeated modification of program objectives, which is the result of unrealistic assumptions to begin with, serves no one's interests and, in the long run, can only reduce the credibility of the Fund and raise questions about its analytical ability.

I understand that these are difficult programs, and that the staff, like the countries themselves, are in uncharted waters.

The experience to date suggests that the transformation process is difficult and painful, much more so than originally anticipated. I believe that the chances of success could be increased if the process of change is undertaken with realistic expectations.

Mr. Finaish made the following statement:

Czechoslovakia is embarking on a program of economic transformation, inevitably involving substantial short-term costs before the reform process takes hold and begins to yield the expected benefits in terms of productivity and a higher standard of living. Notwithstanding the medium-term character of the transformation program, the year 1991 is likely to be critical, since performance in the early phase of reform will be crucial in shaping the expectations of economic agents and in deciding the pace of further reform.

There is no question that the program assumptions and projections incorporate a very large element of uncertainty. This is surely a complicating factor. But an important mitigating consideration is that the authorities appear to recognize the risks involved, as reflected in the policy contingencies built into the program as a response to potential deviations from program assumptions.

Prudent fiscal and incomes policies that support the nominal exchange rate anchor constitute, in our view, critical elements of the macroeconomic framework, and the authorities cannot afford slippages in those areas. Interest rates are likely to be significantly negative in the early period, but this should not be a matter of undue concern as long as yields on domestic currency deposits are competitive with those on foreign currency deposits, and as long as inflation converges over time to yield positive real interest rates on domestic financial assets.

Although Fund support for Czechoslovakia is likely to be needed for some time to come, the amount of resources being extended at this early stage is quite large relative to quota. This seems to be recognized by the staff and the authorities, as reflected in the undertaking not to draw on Fund resources beyond amounts that would bring gross official reserves above $3 billion. In this regard, one would normally expect such a triggering mechanism to be based on exogenous variables, such as external flows, and not on something like gross reserves, which can be controlled to a considerable extent by the authorities themselves.

According to Table 6 of the staff report, the staff projects a decline of 32 percent in import volume in 1991. This is quite a decline. On the other hand, in paragraph 47 of the economic policy memorandum, it is stated that in view of "pent up demand for imports," net international reserves will decline substantially in 1991. How can one reconcile this pent up demand for imports with a projected 32 percent decline in the volume of imports? I recognize that imports from CMEA countries will fall substantially, owing to supply constraints, and that price effects are likely to dampen the demand for imports from non-CMEA countries, but the magnitude of the decline in import volume projected by the staff is still somewhat surprising.

My second question is about the oil price data used for calculating the excess in oil imports for the purpose of the request under the CCFF, and for setting the baseline under the contingency mechanism. I understand that the estimates of oil prices in 1991 are based on the Fund's indicative prices as of the time when these calculations were made. This is reflected in Table 9 of the staff report, where the basket price is estimated at $31 a barrel for the first quarter of 1991. As we know, prices have declined significantly in recent weeks. I wonder whether the Fund's indicative prices of oil, which I understand are revised every month, have been updated since the calculations were made for Czechoslovakia's request. More to the point, could the staff clarify the general policy in this area, if indeed a general policy does exist? This of course is not a new issue, and it has arisen in the past in the context of export shortfall calculations. However, with the current volatility of the oil market, this issue could become more serious. I am not necessarily advocating a procedure whereby we keep revising the calculations up to the date of Board consideration of a CCFF request. Nevertheless, the policy should be transparent in order to ensure uniformity of treatment.

Mr. Dai made the following statement:

We welcome the discussion on the first Article IV consultation with Czechoslovakia since it rejoined the Fund. It is evident that the economic reform process of the country has come at a critical moment and that major reform measures are being implemented in an uncertain international environment.

Czechoslovakia has been pursuing a radical and rapid transformation of its economy, which is generally in line with Fund-supported doctrine, including a package of liberalization, privatization, stabilization, and a social safety net. It is generally acknowledged that some social cost is unavoidable in the transition, and social stability is a prerequisite to ensure the success of economic reform. We note from Mr. de Groote's helpful opening statement that the Czechoslovak Government's bold program of rapid economic transformation is founded on a strong policy consensus. Moreover, the absence of monetary overhang and inflationary pressures, coupled with a budget surplus, allow the authorities to have more room to maneuver. In general, Czechoslovakia is in a much better position than some other neighboring countries as the reform program is set into operation.

Notwithstanding the considerable reform progress that was made in the past year, output fell by 3 percent, consumer prices went up by 22 percent, and, in particular, the external position deteriorated substantially. Forecasts for 1991 indicate that the overall economic situation is expected to deteriorate further, with a current account deficit of $2.5 billion, which is equivalent to about 7 percent of GDP. The current level of gross reserves of three weeks of imports is too vulnerable in the face of the uncertain international environment.

Despite the acceptance by the public of income reductions and unemployment increases, the deterioration of the external position, if not redressed, could become an obstacle to the progress of the country's economic reform. It is inconceivable that the maintenance of convertibility and a stable exchange system would be possible when the external position is so vulnerable, with gross reserves under severe constraint. The emergence of such a major macroeconomic imbalance gives rise to the urgent need for external financial support. The total amount of immediate financing needed appears quite substantial. Pending financial assurances from other potential sources, Fund support is indeed crucial to the progress of the economic transformation program of Czechoslovakia at the present juncture.

In view of the circumstances, we would support the Czechoslovak authorities' request for a stand-by arrangement and for purchases under the CCFF, as presented in the staff report.

With regard to the conditionality associated with the stand-by arrangement, I note that prior actions are required, namely, liberalization of all prices, removal of restrictions on trade and payments, and approval by Parliament of the 1991 State budget. Are these prior actions specific to Czechoslovakia's case, or are they part of a newly established standard for conditionality, specifically applied to planned economies? Second, what is the prospect for financial assurances from other sources in the medium term, as the scenario shows the gross financing need will amount to $4 billion annually over the 1992-1996 period, while the proposed Fund support together with the World Bank loans would only fill a portion of the financing gap.

In the transition period from a planned to a market economy, price reform always appears to be the most difficult part of the overall economic restructuring. The authorities started the price reform with the introduction of three categories of prices. Then, administrative controlled prices continued to be liberalized for most items, both at the producer and retail levels. The resultant price correction of more than 20 percent seems acceptable in the current state of the economy. It is my belief that price reform should take place in conjunction with a whole set of other economic reforms, such as in the fiscal, social security, and enterprise areas, if price reform is expected to bring about real benefits to the economy. More importantly, the price correction should be within the limit of endurance of the economy and the public. It is encouraging to note from the staff report that agreement has been reached with labor and enterprises on incomes policy, as inflation is estimated to rise by another 25 percent in the coming year.

With respect to macroeconomic policies, at the beginning of their bold economic reform process, the Czechoslovak authorities were determined to implement tight monetary and restrictive fiscal policies. This orientation of cautious macroeconomic measures is essential for the success of the overall economic reform. While the tightening of macroeconomic policies is being pursued, reforms in the fiscal and monetary systems should also proceed in coordination with other reforms. To this end, we agree with several of the staff's policy proposals. However, the continuing decline in output growth is a cause for concern. I wonder how sustainable this trend will be, and what would be the appropriate timing of adjustment for macroeconomic policies to revive economic activity.

It is true that a comprehensive social safety net is a condition to expedite reform. Although we note that some measures have already been taken in this area, it is still not certain whether or when further actions will be taken. In addition, we would be interested to learn how the authorities will deal with the difficult interrelationships involved in the establishment of a social security system while maintaining a restrictive fiscal stance. Will the safety net also need financial support from external resources?

Mr. Obame made the following statement:

The staff report before us has comprehensively brought to light the drastic changes under way in Czechoslovakia, as well as the authorities' determined efforts to embark on a fundamental reform of their economy in order to improve, through market-oriented mechanisms, its efficiency and the living standards of the population. However, there is no doubt that the challenges facing the authorities will be exceptionally difficult following the end of the arrangements under the CMEA and the effects of the crisis in the Middle East.

We welcome the prompt involvement of the Fund and other multilateral institutions in Czechoslovakia to support the authorities' efforts.

Since we concur with the staff appraisal, as well as with most of the views expressed by previous speakers, I will limit myself to only two points for emphasis, relating to the inflation figures and the medium-term prospects.

First, on inflation, we note that the liberalization of prices, together with the changes in the CMEA arrangements, will lead to a substantial increase in domestic prices. For instance, it is assumed in the staff report that the price of many raw material imports might increase by more than 400 percent, even without taking into account the impact of the exchange rate adjustment. Under these circumstances, the inflation figures projected by the staff would seem to be rather optimistic compared with the underlying rate of inflation of 5 percent projected for 1991. We wonder whether the implementation of restrictive financial policies alone could help to achieve such an ambitious objective.

Since the authorities' agreed wage policy is expected to limit the growth in nominal wages in 1991 to an amount significantly below the rate of increase in the cost of living index, we wonder whether such a policy is realistic and could be sustained without a continued social consensus in case of much higher inflation rates than those expected. However, we are very much reassured by Mr. de Groote's very helpful opening statement, in which he notes that the whole program is founded on a strong policy consensus. In any case, further clarifications from the staff would be appreciated, especially considering that some measures relating to energy prices have already been delayed.

On the medium-term outlook, I think that it is recognized that the balance of payments projections would need to be considered as very tentative, given the uncertainties surrounding data and the outcome of the policies to be implemented. With this in mind, and given the likely lack of competitiveness that Czechoslovakia will experience in the first phase of its adjustment process, perhaps the export projections are too optimistic. Should this be the case, Czechoslovakia's financing needs might be much higher. Thus, the question of financing assurances might arise, although we note that, so far, the external financing seems to be well committed.

Finally, it would have been interesting if the staff had considered another scenario, under which Czechoslovakia's integration in the world market would be less rapid than that presently envisaged. We support the proposed decisions.

Mr. Thorláksson made the following statement:

This chair is in broad agreement with the staff's analysis of the economic situation in Czechoslovakia and can endorse--particularly with a view to the fairly comprehensive prior actions--the proposed decisions regarding the stand-by arrangement and the CCFF.

The proposed access is undoubtedly unusually high. We are willing, however, to go along with it in light of the strong economic program, the extraordinary balance of payments need, and the authorities' commitment to introduce further policy measures should it become necessary.

The usual high cost of the transformation from a planned to a market-oriented economy is augmented, in this case, by external adversities. The change in the trade system from a barter arrangement among the CMEA countries to trade in convertible currencies at world market prices has a huge negative impact on the external balance of Czechoslovakia. This transformation occurs in addition to the effects of the increases in international oil prices that justify the use of the oil element of the CCFF.

We also concur with the proposal regarding upfront disbursement of Fund resources. The low level of foreign exchange reserves ought to be built up, inter alia, in order to establish the credibility needed for the maintenance of exchange rate stability following the adjustment of the exchange rate at the outset of the program. In this context, we are pleased to note that a stabilization fund is not considered necessary. However, this implies that the financial assistance now being assembled for Czechoslovakia should preferably take the form of balance of payments support that can easily be disbursed. Hopefully, the heavy financial involvement of the Fund will strengthen its catalytic effect and facilitate Czechoslovakia's access to the international capital markets.

The economic program is both comprehensive and fundamental. It contains measures that ensure financial stability and, simultaneously, it extensively restructures the economic system. I do not want to comment on specific macroeconomic and structural policies, as they are adequately described in the staff report and have already been discussed by the lead speakers.

Allow me, however, to make some observations on fiscal policy. I am pleased to note the radical cut in government expenditures of more than 10 percent of GNP. I especially welcome the priority given to reducing the subsidies that now distort the price structure, and I concur with the staff that strict budgetary constraints should be imposed on enterprises in order to reinforce their market orientation. This should be done before the implementation of full-scale privatization. I also agree with the staff that the privatization of enterprises will require some time, but, as noted by other Directors, it is a process that should be initiated as soon as possible.

Furthermore, I welcome the provision of a social safety net. I share the authorities' view on its necessity, although its implementation will lessen the restrictive impact of fiscal policy and, therefore, should be limited to those who are most adversely affected by the structural reforms.

With regard to the revenue side, I agree with the authorities on the need for a major tax reform and on the broad objectives for that reform. The structure of the present tax system is not compatible with a privatized market economy and will hardly be able to provide the required government revenues, as these, especially those originating from taxes on income and profit, are dependent on the privatization process and its tempo. Moreover, the tax structure is currently far from being free of distortions and does not have the neutrality needed to enhance competitiveness in the markets for capital and products, which, in turn, is necessary for the development of the Czechoslovak economy.

From this point of view, I think it would be advisable to introduce a comprehensive, or at least a partial, tax reform before 1992-1993, which, admittedly, may be difficult for administrative reasons.

It is comforting to note that there are many positive features in Czechoslovakia--inter alia, only a small monetary overhang, a relatively low level of external debt, and, not least, a strong political commitment to radical economic and political changes--all features that provide a good base for the economic program we are about to approve. It is undoubtedly also an advantage for the country that it can benefit from the experience of the transformation process in Poland and in the former German Democratic Republic. On the other hand, one should not underestimate the immense task of turning a deteriorating centrally planned economy onto a path of prosperous growth. To that end, Czechoslovakia will require strong political determination and external financial assistance.

I welcome the active role of the Fund in this endeavor.

Mrs. Sirivedhin made the following statement:

I join other chairs in welcoming this first Article IV consultation with Czechoslovakia.

From the staff report and Mr. de Groote's helpful opening statement, it can be said that the authorities have embarked on a program that is both strong and comprehensive, and which deserves the support of the international financial community. Therefore, I have no problem with endorsing the proposed decisions.

Having said this, I would like to note that the task of reforming the Czechoslovak economy will not be easy, particularly in the wake of the upheavals in neighboring Eastern European countries and in CMEA arrangements, uncertainties in world oil prices, and the impending slowdown in major industrial countries. In order to be able to make a quick response to any slippages that may emerge owing to unfavorable developments, the authorities should be prepared to make additional adjustments as they become necessary.

Turning now to a few specific aspects of the program, I welcome the steps that have been taken to liberalize prices. These moves will improve economic efficiency in the longer run, though there may be some short-run difficulties. Therefore, I understand the authorities' desire to ease the strains on consumers by using the universal income support scheme. It appears to be preferable to the subsidies that have been eliminated. Nonetheless, because of its welfare effect, as well as the cost to the budget, I would urge the authorities to speed up reform of the personal income tax so that the universal income support can be eliminated as soon as possible. I am encouraged by the authorities' preparedness with regard to the social safety net. I would, however, like to have the views of the staff on the risk of cost overruns.

The trade liberalization measures are also welcome. I note that the authorities plan to review the import tariff system, taking into consideration the currently low level of tariffs. A restructuring that provides for higher tariffs on consumer goods would be preferable to the recently introduced import surcharge, and would be entirely consistent with our views at the recent Board seminar on current account convertibility.

Lastly, I welcome the unification of exchange rates at a slightly overdepreciated rate, and the intention to use the exchange rate as an anchor for prices. The authorities are aware that this must be supported by tight fiscal and monetary policies. The absence of a monetary overhang attests to the authorities' record of prudence and is grounds for cautious optimism that stated policies will indeed be implemented.

Mr. Al-Jasser made the following statement:

I welcome the discussion on the staff report for the first Article IV consultation with Czechoslovakia. I also support the proposed decisions, including the approval of the stand-by arrangement and the use of the CCFF to compensate for the higher cost of oil imports. Czechoslovakia is embarking on a very bold adjustment program, which hopefully will lead to a market-oriented economic system and the integration of Czechoslovakia into the world economy. I could not help noticing that today we are discussing two countries from Mr. de Groote's constituency. One is Turkey, which is graduating from the use of Fund resources; and the other is Czechoslovakia, which is just starting a comprehensive adjustment program with the Fund's support. I hope that this will augur well for the new year.

I am probably as optimistic as the staff concerning the points raised by Mr. Clark. I believe that some assumptions underlying the program are optimistic; such optimism is probably justified. However, I would encourage the authorities to persevere with the policy prescriptions to which they have committed themselves. Such action would lead to the attainment of the expected results.

Perhaps part of the concern relates to the sequencing of trade liberalization and privatization. As highlighted by the new book by Ronald McKinnon, Order of Economic Liberalization, Financial Control, and the Transition to the Market Economy, the question is, should we start with fully liberalizing trade before privatizing an economic system that is largely centralized? This is a very difficult question, which I am sure the authorities and the staff have pondered carefully. The difficulty of appropriately sequencing such major policy decisions cannot be overemphasized. However, there has been little experience so far to guide such a decision. No doubt, the experience of Czechoslovakia will be particularly relevant for other countries; for this the authorities deserve support.

I also support Mr. Finaish on the need for a transparent mechanism for calculating the balance of payments need for the purpose of assessing access to the oil import element of the CCFF. I recognize that this is the first time we are considering such a request. However, in the future, it is imperative that the staff apply a transparent mechanism for calculating need.

I am particularly concerned about the reference in the staff report to the impact on the environment of Czechoslovakia's energy policy. The staff report has concluded that, because of environmental concerns, the use of nuclear energy--as an alternative to coal--will continue to expand over the longer term. This is a very serious recommendation. The staff report seems to suggest that either this is the staff's position or the staff supports it. Since the staff has limited expertise in these matters, I would like to advise the staff to be more cautious in this domain. However, if this reference was intended to reflect solely the official or some other agency's position, then the staff should have phrased the reference accordingly. I would strongly caution the staff against advising on such matters.

In conclusion, like the staff, I am very confident about the prospects for Czechoslovakia.

Mr. Marino said that the main elements of a successful transition to a market economy were present: a strong policy consensus, based on a common desire to move toward a market economy; a strong fiscal position; a tight monetary policy; and the rapid implementation of the privatization program. Although the program for adjustment and structural reform was both coherent and comprehensive, there were still some concerns, which were essentially limited to two areas: the way in which the program would respond to inflation rates that exceeded the program's targets; and the conduct of interest rate policy, which depended fundamentally on the assumptions for the path of inflation and on the use of the exchange rate as a nominal anchor. With regard to the vouchers that would be used in the privatization process, it would be interesting to know the magnitudes that were involved and the effect that those vouchers were expected to have on private savings behavior.

The high level of access to Fund resources was completely warranted by the firm resolve of the authorities to transform the Czechoslovak economy into a market-oriented economy, Mr. Marino stated. Accordingly, he supported the proposed decisions. The authorities' resolve was clearly illustrated in the first paragraph of the economic policy memorandum, which stated that "the only practical and realistic way to improve living standards is the total abolition of institutions of central planning, the dismantling of price, wage, and exchange and trade controls, and the radical transformation of property rights." Such a commitment to structural reform certainly deserved high levels of support from the Fund and other international financial institutions.

Mr. Evans said that he shared Mr. Clark's concerns regarding the somewhat optimistic medium-term outlook for the Czechoslovak economy, which was presented in the staff report. The staff's projections for 1991--the program period--were particularly worrisome, as he expected output to decline by significantly more than the 5 percent projected by the staff.

Although such a decline was in itself a cause for concern, as it would inevitably erode support for the courageous reform effort, it would neither generate a significantly different fiscal picture nor affect the Fund's attitude toward the program. The real policy concern, however, was that a sharper output decline would probably not be reflected in a better balance of payments picture, which pointed to the apparent inconsistency in the staff's forecast. The volume of imports was already projected to decline by one third, and exports could be weaker as well, which raised serious questions about the fate of the exchange rate, which was crucial to the success of the program.

He agreed with those Directors who had suggested that the Fund's resources should be earmarked for stabilization and should not be used for intervention, Mr. Evans continued. However, there were genuine doubts about the adequacy, or even the very existence, of the monetary instruments and institutions required to support the exchange rate--even in the absence of concerns about the medium-term outlook. It was important that monetary policy be in a position to defend the exchange rate, if required. He wondered why there was no explicit stabilization fund, as had been established for Poland, as most Directors had agreed that financial assistance from the Fund should be used for stabilization purposes.

The staff representative from the Research Department said that the calculations of the oil import excess and, more generally, export shortfalls, were not subject to large fluctuations historically. The problem was that oil prices were currently extremely volatile. Nevertheless, if Czechoslovakia's request for purchases under the CCFF had been presented to the Board immediately after the completion of the negotiations, the relevant calculations would not have differed greatly from those used in the staff report. As a result of the volatility of oil prices, however, the purchases with respect to the oil import element of the CCFF would be phased.

The staff had used oil price forecasts based on the mid-November 1990 World Economic Outlook projections, the staff representative went on. When a request for CCFF purchases was brought before the Board, judgments had to be made about the extent to which the environment had changed and whether it was realistic to re-open negotiations with the authorities. As a rule of thumb, once negotiations had been completed and certain assumptions had been incorporated, the staff would use those numbers. If, in the meantime, the numbers changed, the staff would provide that information to the Board, but would not re-open negotiations unless absolutely necessary. Of course, to the extent that estimated data were used, a subsequent purchase would take into account any changes in prices. In the present case, if the most recent projections had been used, the calculations for Czechoslovakia's request would have resulted in a smaller excess of oil imports, although it would still have been larger than the initial purchase of 53 percent of quota. If current price projections prevailed over the next few months, the subsequent purchase would in all likelihood be smaller, and overall access would probably fall below the maximum of 82 percent of quota.

The budgetary burden of agricultural subsidies was equivalent to about 1 percent of GDP, the staff representative said, and additional costs were associated with subsidies for rents and transport, which had been fully incorporated into the budget estimates. There was adequate flexibility within the current budget for undertaking additional adjustment, if necessary. However, if the decline in output was substantially worse than expected--say, 10 percent--then that would have to be taken into account, as it would completely change the environment. In general, every additional one percentage point increase in the unemployment rate corresponded to an additional budgetary cost of Kcs 2 billion. Therefore, a 4 percent increase in the unemployment rate would, ceteris paribus, eliminate the projected surplus.

A number of Directors had referred to the sense of optimism that was associated with some of the program's projections, the staff representative noted. In that context, it was important to consider the soundness of the underlying assumptions of the program. Although the price assumptions could be characterized as somewhat optimistic, the relevant issue was the formulation of financial policies on the basis of an agreed set of price assumptions. Recognizing that policies might need to be adjusted in the future, the program's price assumptions were deliberately set on the conservative side. Although the target for the decline in output was 5 percent, it was recognized that it could be closer to 10 percent. Formulating the initial financial program on a conservative basis implied that balance of payments targets were attainable. Nevertheless, it was important to emphasize that the standard of error was large on either side of the estimates, as it was very difficult to predict the effects of dismantling a 40 year old structure through such a comprehensive and fundamental program of reform.

The 32 percent decline in the volume of imports from CMEA countries was a reflection of changing trade relations within the CMEA, rather than changing demand in Czechoslovakia, the staff representative remarked. Import volumes from non-CMEA countries were expected to increase by about 17 percent. A large part of that increase was the result of the considerable deterioration in the terms of trade, which was associated with both the breakdown of trade in the CMEA zone, including the introduction of new price arrangements for CMEA trade, and the increase in the prices of oil and other raw material imports. He agreed with Mr. Evans that a distinction had to be made between the projections for 1991 and those for the subsequent period. Notwithstanding the inevitable uncertainties, the staff had used the most realistic assumptions possible for the broader formulation of policies, fully recognizing that those policies were likely to be changed substantially as the program proceeded.

The purchase of firms and enterprises, even small-scale enterprises, in the earlier part of the period would allow for the substitution of savings, which were presently held mainly in the form of monetary balances--the only assets available to the private sector, the staff representative said. Those savings could be expected to be held in the form of assets in small enterprises, which would affect the demand for, and velocity of, money. Therefore, there would clearly be some effect on savings from the privatization program, and that had been incorporated into the velocity assumptions of the financial program.

The staff did not have a strong comparative advantage in the area of energy policy, including nuclear energy, the staff representative from the Research Department said. References in the staff report to Czechoslovakia's energy policy were intended to report on the policies of the authorities and did not reflect recommendations by the staff.

Mr. Al-Jasser observed that it would be helpful if the views of others, when cited in a staff report, could be more clearly attributed. The staff report seemed to imply that the Fund was making a recommendation to switch from coal to nuclear energy, and that nuclear energy was environmentally safer or better for Czechoslovakia.

Mr. Kafka said that he wondered about the institutional arrangements that had enabled Czechoslovakia to avoid the development of a sizable monetary overhang. Was there, for example, an unusual degree of independence of the central bank in Czechoslovakia compared with other Eastern European countries? In addition, he wondered how Czechoslovakia's socialized agriculture sector had been able to maintain a level of production sufficient to feed its population--a feature that was certainly uncommon to most centrally planned economies.

The staff representative from the Research Department responded that fiscal policy in Czechoslovakia had generally been quite prudent, partly because there had been little subsidization of enterprises. That had important implications for the budget and, ultimately, liquidity expansion. The reasons for Czechoslovakia's relative success in the field of agriculture, however, were less clear.

Mr. Posthumus said that he, like Mr. Clark, had been concerned that, in the near future, the effects of the reform effort on the economy would be worse than had been assumed. It would be useful if the staff could look closely at the experiences of Poland and Eastern Germany, because other countries in Eastern Europe would inevitably undertake reform programs, and the same issues could be expected to arise. Estimates that were too optimistic might undermine the political support for a program if the outcome failed to meet those expectations, which was perhaps the biggest danger of the current reform effort.

Mr. Peretz said that he had also suggested that the staff should prepare a paper in a timely fashion, which would draw on the experience of other countries, because the Fund would obviously be faced with further requests for programs from Eastern European countries and there were lessons to be learned from past experience.

The Chairman noted that reviews of the stand-by arrangements for Poland and Hungary would be scheduled for Board discussion shortly. There were certainly lessons to be drawn from those early examples of reform in Eastern Europe. Similarly, the current experience in Germany promised to provide additional insights into the reform process, which he would discuss with the German authorities. Furthermore, the Board's schedule would be organized so that, before discussing staff papers on Bulgaria and Romania, for example, the relevant lessons could be drawn in one way or another from the experience of other countries.

The Director of the Exchange and Trade Relations Department said that, with respect to the level of optimism reflected in some of the program's projections, the staff had not tried to lean in one direction or the other. The lesson from the experience with Poland was that one had to be modest in making estimates, particularly at the beginning of a program. The purpose of clearly setting out the explicit assumptions was to enable the staff to come to an agreement with the authorities on a steady path for policy under a specific set of assumptions. In that way, policy expectations had been made clear, although modesty had also been injected from the experience of Poland and others. The performance of Poland's current account, for example, had not been anticipated by anyone, and the decline in real output was somewhat larger than had been expected. With respect to Czechoslovakia, the figure that Mr. Clark had cited might be related to the decline in output in the socialized sector rather than the decline in GDP, which was projected at 5 percent.

The modesty of the staff's estimates was reflected in the robustness of the program itself, and particularly the medium-term scenarios, the Director of the Exchange and Trade Relations Department remarked. The robustness of the program was obviously a function of the stability of the relationships that underlay the program; however, in countries such as Czechoslovakia, those relationships were not meaningfully measured in terms of elasticities. Mr. Clark had implied that it appeared inevitable that the stand-by arrangement would be subject to numerous waivers and modifications. While that was not necessarily inevitable, it was important to be realistic and acknowledge that the stability of some of those relationships was uncertain. In many cases, there were very wide margins of error in estimating elasticities, which clearly affected the medium-term scenarios. Under those conditions, the only way to proceed was to review the progress of the program, learn from experience, and redefine the relationships for subsequent periods. That approach might require some waivers and modifications simply because the Fund traditionally operated by establishing targets and expectations in a relatively hard and fast way at the beginning of a program.

Mr. Clark said that he agreed with the staff concerning the uncertainties and difficulties inherent in establishing elasticities and other economic relationships, and that the process was governed by a learning curve. Presumably, the staff was in the process of preparing a paper that would draw together the lessons of Poland and Hungary.

Public support was clearly an absolute necessity for the program to be successful, Mr. Clark stated, which suggested that the accuracy of the economic assumptions was critical, because those assumptions would set the context for debate and discussion within the country. Therefore, it was important to determine whether the assumptions created expectations that were not going to be realized. The staff's selection of elasticities had probably been on the overly optimistic side, and he would have been less optimistic.

The Director of the European Department said that the estimates for output, in the cases of Poland and Czechoslovakia, were arrived at through a process of negotiation with the authorities and, consequently, were not genuine projections. There was a significant difference in Czechoslovakia, however, in that the program would begin with a much less imbalanced economy. As inflation was much lower in Czechoslovakia, making a judgment on the future path of inflation had been somewhat easier. Nevertheless, the central theme underlying all the projections was that a loss in output had to be accepted.

Several speakers had noted that the Fund made extensive use of review clauses in the arrangements for Eastern European countries, the Director of the European Department observed. In general, there were at least three reviews during the period of each program, as a result of uncertainties; that approach was preferred to one in which performance criteria were set for the year as a whole, and which might then be modified on a number of occasions. The staff would try to adopt the review clause concept in all programs of the kind under discussion.

The Director of the Exchange and Trade Relations Department said that price liberalization was not part of a new set of standard prior actions that would be required of all centrally planned economies, although it had been required in the present case. Some earlier programs for planned economies had incorporated a different schedule for the liberalization of prices, such as the programs for Yugoslavia during the 1980s. Prior actions would be determined on a case-by-case basis, with due consideration given to confidence in the authorities' policy implementation and the need to put in place certain critically important policies.

With respect to the possible establishment of a stabilization fund, the situations facing Poland and Czechoslovakia at the outset of their respective programs had been quite different, the Director considered. Poland had had a very high level of reserves, while Czechoslovakia had a much lower level of reserves relative to imports. Similarly, the political situation in each country was different. When the Polish authorities had asked for a stabilization fund, it had been possible to mobilize $1 billion from various sources. Those resources had served as a second line of reserves for the stabilization of the exchange rate and the exchange system. In Czechoslovakia, there was a need for reserves to be accumulated very quickly at the outset of the program. A judgment had been made that the Fund was the institution to provide the required external resources when a member decided to undertake a fundamental reform of its exchange and trade system. That judgment had influenced the staff's assessment of the level of Fund resources that should be provided to Czechoslovakia.

It was noteworthy, however, that some of the clauses that had been incorporated into the agreement for Poland's stabilization fund by bilateral creditors had become part of the conditionality of the program for Czechoslovakia, the Director of the Exchange and Trade Relations Department continued. Although the staff had set a target for net international reserves for end-March 1991, it had also defined a pace for the loss of reserves that would trigger consultations with the Fund. Therefore, the Czechoslovak authorities might have to enter into consultations with Fund management after a relatively short period in the event of an unexpected loss of reserves--an arrangement that was not unlike the consultation process that had been built into the Polish stabilization fund arrangement. Consequently, there were similarities between the Polish and Czechoslovak situations, but in Czechoslovakia the reliance was on the use of Fund resources in the first instance.

The Executive Directors agreed to resume their discussion in the afternoon.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/90/179 (12/21/90) and EBM/91/1 (1/7/91).

3. VALUATION OF SDR - AMENDMENT TO RULE 0-1

In accordance with Executive Board Decision No. 6631-(80/145) G/S, adopted September 17, 1980, Executive Board Decision No. 9549-(90/146) G/S, adopted October 5, 1990, and the guidelines set out in Decision No. 8160-(85/186) G/S, adopted December 23, 1985, Rule 0-1 shall read as follows, effective January 1, 1991:

Rule 0-1. The value of the SDR shall be the sum of the values of the following amounts of the following currencies:

U.S. dollar	0.572
Deutsche mark	0.453
Japanese yen	31.800
French franc	0.800
Pound sterling	0.0812

Decision No. 9619-(91/1) G/S, adopted
December 31, 1990

4. ZAMBIA - OVERDUE FINANCIAL OBLIGATIONS - REVIEW FOLLOWING DECLARATION OF INELIGIBILITY - POSTPONEMENT

Paragraph 4 of Decision No. 9496-(90/109), adopted July 10, 1990, shall be amended by substituting "by February 8, 1991" for "within six months of this decision." (EBD/90/430, 12/27/90)

Decision No. 9620-(91/1), adopted
January 2, 1991

5. ARAB REPUBLIC OF EGYPT - TECHNICAL ASSISTANCE

In response to a request from the Egyptian authorities for technical assistance in the area of the exchange system, the Executive Board approves the proposal set forth in EBD/90/431 (12/27/90).

Adopted January 2, 1991

6. MYANMAR - TECHNICAL ASSISTANCE

In response to a request from the Myanmar authorities for technical assistance in the fiscal field, the Executive Board approves the proposal set forth in EBD/90/422 (12/20/90).

Adopted December 27, 1990

7. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 90/30 through 90/37 are approved.

8. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/90/330 (12/21/90) and EBAP/90/333 (12/28/90) and by Assistants to Executive Directors as set forth in EBAP/90/329 (12/20/90) and EBAP/90/331 (12/26/90) is approved.

APPROVED: September 24, 1991

LEO VAN HOUTVEN
Secretary