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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 92/94

10:00 a.m., July 24, 1992

R. D. Erb, Acting Chairman

Executive Directors	Alternate Executive Directors
	A. A. Al-Tuwaijri
	A. Raza, Temporary
Che P.	Wei B.
	G. C. Noonan
	G. Lindsay-Nanton, Temporary
	Q. M. Krosby
	J. M. Abbott, Temporary
	M. E. Hansen, Temporary
	J. Prader
	V. Kural, Temporary
	R. L. Knight
	E. Quattrociocche, Temporary
	A. F. Mohammed
I. Fridriksson	
H. Fukui	N. Tabata
	M. Nakagawa, Temporary
	S. Shimizu, Temporary
B. Goos	S. von Stenglin, Temporary
	W. Laux, Temporary
J. E. Ismael	T. Sirivedhin
A. Kafka	J. R. N. Almeida, Temporary
	I. Martel
	P. Bonzom, Temporary
A. Mirakhor	O. Kabbaj
L. B. Monyake	
	P. Wright
G. A. Posthumus	
	D. Saha, Temporary
A. Torres	R. Marino
A. Végh	A. G. Zoccali

L. Van Houtven, Secretary and Counsellor
B. R. Burton, Assistant

Also Present

IBRD: C. E. Kimes and D. Morrow, Latin America and the Caribbean Regional Office. European I Department: M. Russo, Director; G. Earp. European II Department: J. Odling-Smee, Director; E. Brau, Deputy Director; A. Cheasty, L. E. DeMilner, D. J. Donovan, L. Hansen, I. Kapur, T. Shikado. External Relations Department: S. J. Anjaria, Director; M. A. Seeger. Fiscal Affairs Department: V. Tanzi, Director. IMF Institute: C. J. R. Morris. Legal Department: H. Elizalde, R. B. Leckow. Monetary and Exchange Affairs Department: M. Guitián. Policy Development and Review Department: J. T. Boorman, Director; T. Leddy, Deputy Director; F. C. Adams, B. Christensen, R. F. Krieger, M. Precious, J. P. Pujol. Research Department: M. Mussa, Economic Counsellor and Director; M. Goldstein, Deputy Director; M. D. Knight. Secretary's Department: J. W. Lang, Deputy Secretary; S. W. Tenney. Southeast Asia and Pacific Department: L. M. Koenig. Statistics Department: J. B. McLenaghan, Director. Treasurer's Department: D. Williams, Treasurer; D. Gupta, C. A. Hatch. Western Hemisphere Department: C. M. Loser, Deputy Director; J.-P. Amselle, M. E. Bonangelino, L. E. Escobar, C. Gonzalez-Rodríguez, O. Gronlie, E. C. Suss, E. S. Williams, R. L. Zandamela. Advisors to Executive Directors: J. O. Aderibigbe, M. A. Ahmed, L. E. Breuer, M. B. Chatah, C. D. Cuong, B. R. Fuleihan, M. Galán, A. Gronn, J. Jamnik, J. M. Jones, E. Martínez-Alas, M. Nakagawa, Y. Patel, A. M. Tanase. Assistants to Executive Directors: M. C. Arraes, D. A. Barr, G. Bindley-Taylor, B. Bossone, J. H. Brits, Chen M., M. Da Costa, Deng H., N. A. Espenilla, Jr., A. Giustiniani, H. Golriz, K. M. Heinonen, T. Kanada, T.-M. Kudiwu, K. Langdon, G. J. Matthews, S. Rouai, P. Salles, D. Sparkes, F. A. Sorokos, T. P. Thomas, Tin Win.

1. STATES OF FORMER U.S.S.R. OTHER THAN RUSSIAN FEDERATION - REPORT BY DEPUTY MANAGING DIRECTOR

The Deputy Managing Director made the following statement on recent developments in the states of the former Soviet Union other than the Russian Federation:

> The Managing Director and I have reported to Executive Directors on Russia on a number of occasions, and you will consider the Russian authorities' request for a first credit tranche arrangement on August 5. On this occasion, I would like to update Executive Directors on developments in the states of the former Soviet Union (FSU) other than Russia. Given the general interest in these countries, and the fact that no papers on these countries will be issued to the Board before the recess, Executive Directors may welcome this opportunity to hear about recent developments.
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> There have been many similarities in the economic developments of the states of the FSU. All were severely disrupted by the collapse of the old central planning system, which has yet to be replaced in most countries by well-functioning markets. Although the old regime has remained stronger in some places, such as Ukraine, Moldova, Azerbaijan, Uzbekistan and Tajikistan, than in others, it has not protected them significantly from the general decline in output. Disruptions in trade between the states of the FSU and a lack of financing for imports from elsewhere have aggravated the general output situation. Monetary disturbances in the form of growing substantial interenterprise arrears (including interrepublican arrears) and a shortage of cash have also contributed to the decline in activity.
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> Incomes in most states of the FSU other than Russia have also been hit by the deterioration in the terms of trade in those cases where they import oil or gas from Russia and other FSU states; and some of the lowest-income countries have been further hit by the loss of transfers from the Union budget.
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> In most of the states of the FSU, output is now expected to be down 20-25 percent in 1992 compared to 1991. There are signs in a number of countries that the fall in output has been diminishing in recent months. A separate note will be circulated to Executive Directors with further details and tables on economic developments and policies in each country.
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> There appears to have been a greater variety of policy responses than of basic economic conditions. Regarding price liberalization, some countries are still controlling the prices of some basic consumer products, such as bread, meat, and dairy products. There has been little change in this since the Pre-Membership Economic Reviews, but the general cost of subsidization

in those countries retaining price controls has been rising as inflation has persisted at a high, though falling, rate throughout the region. There have also been strong pressures, which have been accommodated in some countries, for increases in budgetary producer subsidies and subsidized credits, especially to agriculture.

Since the Tashkent meeting on which the Managing Director has already reported, little progress in improving the arrangements for the coordination of monetary policy in the ruble area has been made. Only two members of the ruble area other than Russia have raised the central bank finance rate to 80 percent, following the Russian move on May 29. Similarly, the exchange rate has been unified only in a very few states. Russia has now started bilateral negotiations with other ruble area members, aimed at agreeing a set of rules for monetary policy. The Fund staff is advising the Russian working group on ruble area issues on these agreements and other matters, making this advice available to other ruble area members at the same time.

There is a growing sentiment among all members of the ruble area other than Russia that their interests might be better served by introducing their own national currencies. They have been influenced in this by a perception that they will continue to have little if any influence over monetary policy decisions, by the shortage of cash supplies, and, in some cases, by increasing doubts about Russia's ability to stabilize the ruble or provide cash. As the degree of commitment to the ruble area has diminished, some of its members have felt less constrained from issuing excessive amounts of central bank credit. This has been most pronounced in the case of Ukraine, but has occurred in a number of countries. However, in others the ruble shortage has sharply constrained credit expansion, and credit policies have ended up being considerably tighter than in Russia.

Despite the shift in favor of the introduction of national currencies, only a few countries have recently added their names to those that have already announced a clear intention to introduce their own currency. After Estonia, which introduced the kroon on June 20, Latvia freed the Latvian ruble from the Russian ruble on July 20, and now in effect has a separate currency although its official new currency, the lats, will not be introduced for another few months. Lithuania, Ukraine, and Moldova are still intending to introduce their own currencies, although the timing is unclear in the case of Moldova. Azerbaijan has recently announced its intention to introduce a currency in mid-August initially as a parallel currency alongside the ruble. Belarus has already introduced a parallel currency to act as a supplement to the ruble because of the cash shortage, but it remains in the ruble area for the time being. There are reports that Georgia is planning to move in the same direction within the next couple of months. Some other states are now actively preparing contingency plans to introduce their own currencies if discussions with Russia on monetary arrangements are not successful in the coming months.

Many states of the FSU are grappling with major budgetary pressures, with the problems being especially acute where subsidies are large, transfers from the Union have been lost, and there are no natural resources available to provide a relatively painless source of revenue. There have been some successes, especially in the Baltic countries: Estonia and Latvia are both planning balanced budgets in the second half of 1992, despite above-average falls in output and deteriorations in the terms of trade, and the absence of natural resources. Good progress is being made in some other countries, notably Kazakhstan and Kyrghyzstan. There are, however, strong pressures in many countries to increase expenditure, especially subsidies and credits to producers, and very large fiscal deficits could occur in those countries if these pressures are not resisted.

The need for structural reform is accepted in the vast majority of countries. Considerable progress has been made in the preparation of privatization programs and in corporatization of state enterprises. Mass privatization, usually through voucher schemes, is more often found now in these programs. Considerable progress has also been made in the privatization of housing. On the other hand, demonopolization is proceeding slowly.

The Fund staff has visited most of the states of the FSU several times in recent months to discuss economic reform and stabilization programs. In nearly all cases the staff has discussed with the authorities memoranda of economic policies which cover similar ground to the Memorandum of Economic Policies in Russia which Executive Directors saw in March. In a few cases, the discussions about policies have evolved into negotiations over a letter of intent. This process is most advanced in the case of the Baltic countries, and I am pleased to inform Executive Directors that the staff reached agreement, ad referendum, with the Latvian authorities on a letter of intent at the beginning of this week. It is our intention to issue a staff report on Latvia next month, so that Executive Directors can consider a request for a stand-by arrangement before the Annual Meetings. Negotiations on a program are currently under way with Estonia, and the indications are that they will soon be successful, so that the Board can consider a request for a stand-by arrangement on a similar timetable. For Lithuania, negotiations will be resumed in the second half of August.

Other countries where we foresee a realistic possibility of reaching agreement on a program within the next few months include

Belarus, Kazakhstan and Kyrghyzstan. The authorities are keen to move ahead fast and progress is being made. However, much work still remains to be done in these countries, and at least another two missions to each will be required. It is not possible at this time to predict how long the process will take, or whether it will in fact be possible to reach agreement.

In all these countries considerable financing requirements are envisaged. The usual financing assurances will be required before the requests for stand-by arrangements will be brought to the Board. In the case of the Baltic countries the process of obtaining financing assurances has already begun within the G-24 chaired by the EC Commission. It is hoped that the meeting in Brussels next week will establish that sufficient financing will be forthcoming for these three countries to enable the programs to go ahead. In the case of the other countries, it is intended to seek financing assurances in the context of consultative groups for each country. The World Bank will chair these groups, and the Fund will take the lead in work relating to balance of payments financing. The Bank is planning to launch this process in a series of meetings in the capitals of potential donors and creditors, beginning next week. The initial series of meetings will focus on Kazakhstan and Kyrghyzstan, and will not discuss specific financing requirements. The Fund staff will participate. When agreement is reached between the Fund staff and a country about a program, the World Bank will arrange a consultative group meeting for that country in order to seek financing assurances. Fund staff will keep Executive Directors informed of developments in advance of such meetings, as has been done in the case of the Baltic countries.

The Fund staff has been discussing the major elements of a suitable economic reform and stabilization program with Armenia, and a staff visit to Yerevan is currently in progress. However, the regional conflict is having adverse economic effects, both direct and indirect, which will make it difficult for a program to achieve its economic objectives. The staff has, therefore, indicated that the prospects for being able to conclude negotiations on a Fund-supported program are likely to depend on, among other things, a diminution of the impact of the conflict on the economy. The same would hold in the case of Azerbaijan where, however, discussions on a program are at a very preliminary stage, partly because of recent governmental changes.

Four European II Department missions to Ukraine in the past seven months have been preparing the ground for negotiations on a program that could attract Fund support. The outline of a possible memorandum of policies was left with the authorities in May, on the understanding that the staff would return in June to discuss the Government's considered response and begin quantifying program objectives. In the event, no such response was forthcoming, and policy discussions were confined to the problems of short-term crisis management. In the meantime, monetary and fiscal policies have become markedly weaker, and a sharp acceleration in inflation is a distinct possibility unless policies are changed. The impact of this situation on the stability of the ruble is causing concern among the Russian authorities and is damaging economic relations between Russia and Ukraine. Ukraine has agreed with Russia to leave the ruble area by October 1, but much clearly remains to be done to ensure the satisfactory introduction of a fully independent monetary policy and currency.

Extensive technical assistance has been rendered to all states of the FSU in the last few months. The emphasis has been on providing advice on changes in the fiscal, monetary and statistics systems which could be implemented quickly and which would improve the prospects for the success of economic reform and stabilization programs in the near future. However, advice about longer-term institutional improvements has also been provided. In addition to providing guidance in the area of tax and expenditure policies, the Fiscal Affairs Department has also provided advice aimed at improving fiscal management through strengthening budgetary procedures, establishing a Treasury, reforming tax administration, and streamlining and targeting social safety nets. The scope of technical assistance from the Monetary and Exchange Affairs Department (MAE) has been comprehensive, covering all major central banking functions in order to support the immediate operational and structural changes needed for effective implementation of monetary and exchange policies. Mission work has been concentrated most on Ukraine and those countries, such as the Baltics, Belarus, Kazakhstan and Kyrghyzstan, that are closest to effecting economic reform and stabilization programs with Fund support. In all cases clear recommendations have been left with the authorities, who have often expressed their great appreciation for the Fund's contribution in these areas. However, the implementation of the recommendations has often been slow or nonexistent. The IMF Institute has not only included participants from the FSU in its courses in Washington, but has also conducted short courses for high-level officials in a number of FSU states, and longer courses in Moscow. Courses at the Joint Vienna Institute will begin next month.

The Fund staff has continued to cooperate closely with other international institutions, member governments and central banks. MAE technical assistance has been supported by experts from 22 cooperating central banks and staff from BIS and OECD. Cooperation with the World Bank has been close, with Fund staff relying on Bank staff to provide advice on many areas of structural policies, and Bank staff following Fund staff advice on macroeconomic policies. There has been virtually no overlap between the work of the Fund and the other international and multilateral institutions such as the EBRD, the EC Commission and the OECD, but there has been full exchange of information about each other's activities.

The placement of resident representatives and advisers in the states of the FSU is progressing satisfactorily. There are now two resident representatives in Moscow, and one each in Estonia and Lithuania. Others will take up their posts in Kazakhstan, Kyrghyzstan, Latvia, Moldova and Ukraine in the next few weeks, and in Belarus a little later. We are in the process of confirming or seeking to identify resident representatives for the other countries. In addition, resident advisers in central banks are beginning to take up their positions. Advisers in Lithuania and Ukraine have already begun their assignments and advisers in the Central Bank of Russia will begin soon. These advisers are on secondment from cooperating central banks.

A separate note will be circulated to Executive Directors with further details of missions, resident representatives and advisers, and membership status.

As the Fund's familiarity with the states of the FSU increases, the diversity of economic situations and policy responses becomes more apparent. Management and staff will tailor the activities in each country according to its specific circumstances. But whatever these may be, there can be no doubt that the contribution that the Fund can make to economic reform and stabilization is very great indeed, and will continue to justify a major, and probably growing, allocation of our resources in this direction.

Mr. Goos wondered whether more specific information could be provided on how the consultative group process, which would include staff visits to capitals beginning the following week, would work.

The Director of the European II Department responded that the capitals to be visited were in Western Europe and Japan. A team comprised mainly of World Bank staff, but with Fund representation, would explain the purposes of the consultative groups and how they would operate in future to officials in those capitals. It was his understanding that the World Bank had already contacted officials in those capitals through the Executive Directors' offices in the World Bank to propose how those meetings might be conducted. The process would take about two weeks. Also present at those meetings would be representatives of the Governments of Kazakhstan and Kyrghyzstan, who would give presentations of their view of the situation. The purpose of the meetings was more to explain the consultative groups' functioning and the future consultative group process than to discuss specific developments in those two countries, which were being used as models. Both the Fund and the Bank expected that the consultative group process would be functional in a few months.

Mr. Prader said that he welcomed that information, because it showed that the Fund gave equal attention to all the former Soviet republics, not merely to Russia. In that context, he wondered what the reaction had been in discussions with other former Soviet republics to the Fund program for Russia and whether the Russian model of a first credit tranche approach would be considered in other cases or would the staff recommend stand-by arrangements for the other republics.

The Acting Chairman said that the objective in each case was to try to come to an agreement on policies for the period ahead that could be supported by a full stand-by arrangement. That approach was being taken for each of the states. The first credit tranche was also an instrument that the Fund could use in some of the former Soviet republics, just as it was currently being used in Russia and other member countries. He could not see any near-term prospect for use of the first credit tranche, but he would not preclude it. With respect to the three Baltic states, the staff was negotiating a full stand-by arrangement rather than a first credit tranche arrangement, mainly because programs could be agreed that could serve as the basis for full stand-by arrangements.

The Director of the European II Department remarked that one reason that Russia had not been considered ready for an upper credit tranche arrangement was that ruble area issues had not been settled. In contrast, Latvia and Estonia already had essentially separate currencies. Lithuania was expected to introduce its own currency at about the same time that its program with the Fund was ready.

As to other countries' reactions to the arrangement with Russia, generalizations were difficult, the Director of the European II Department commented. Their reactions had been more in the form of questions, especially what the arrangement meant for them.

Mr. Wright noted that, on the issue of monetary arrangements, it now seemed clear that a number of republics intended to introduce their own currencies, irrespective of the outcome of the working group on the ruble area. Some time ago, Directors had regarded Estonia as the model for introducing a separate currency in an orderly manner with respect to the treatment of remaining ruble balances and other factors. He wondered whether that model was still considered workable and what the prospects were for achieving an orderly transition to independent currencies in those republics that so chose. The information contained in the Acting Chairman's statement did not sound particularly encouraging.

The Director of the European II Department replied that the situation was not at all discouraging. On the contrary, given the possibilities for things to go wrong, he had been pleasantly surprised. Most of the negotiations about exiting the ruble area had been progressing reasonably well.

In the negotiations between Ukraine and Russia on the former's intention to leave the ruble area, agreement had been reached on a number of important points. Among other issues to be discussed, the one that was likely to take time was the exact treatment of rubles after they were withdrawn from circulation in Ukraine. Given that the models of Estonia and Latvia now existed, there was a good chance that amicable and workable arrangements would be reached with Ukraine and with other republics generally. In a sense Estonia did provide the model, but, as the Latvian situation had shown, circumstances could be slightly different in each country. Therefore, the approach had to be adjusted in each case, but the underlying principles were likely to be the same.

The Directors concluded their consideration of the Acting Managing Director's statement.

2. DOMINICAN REPUBLIC - REVIEW UNDER STAND-BY ARRANGEMENT, AND EXCHANGE SYSTEM

The Executive Directors considered a staff paper on the first review under the 19-month stand-by arrangement for the Dominican Republic approved on August 28, 1991 (EBS/92/113, 6/29/92).

Mr. Kafka made the following statement:

> My authorities are in full agreement with the thrust of the staff paper which profiles the dramatic turnaround in the Dominican Republic's situation after the new economic program was adopted by the Dominican authorities in 1990 and particularly since the stand-by arrangement was approved in August 1991.
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> In 1990 my Dominican authorities introduced a bold package of measures that sought to address the imbalances that had accumulated in a period of rapid growth between 1986 and 1989. The package sought to liberalize the price system, introduce a more market-oriented monetary policy, and realign the value of the peso relative to the U.S. dollar to a more realistic level; it also incorporated structural reforms in the tax and trade areas.
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> In 1991, the full-year effect of the 1990 measures contributed significantly to the strengthening of the Dominican Republic's macroeconomic situation, thereby bringing practically to a stop the fall in real GDP growth and dramatically curbing inflation from 100 percent in 1990 to 4 percent in 1991, as well as improving the balance of payments. Underlying these successes was a dramatic improvement in the overall balance of the nonfinancial public sector, which swung from a deficit of 5 percent of GDP in 1990 to a small surplus, owing to both expenditure restraint and increases in revenue.

The improvement in public finances was reflected in the substantial decline in the net domestic assets of the Central Bank and a substantial increase in foreign exchange reserves. Other factors that contributed to the strengthening of the monetary sector and the reserve position were the liberalization of interest rates and the establishment of an essentially unified exchange rate in the interbank market. Toward the end of 1991, the authorities eliminated portfolio requirements of commercial banks and unified reserve requirements in the banking system. The essentially market-determined interest rate structure resulted in high real interest rates, which encouraged domestic saving, promoted substantial capital inflows, and helped to contain demand pressures in the economy.

In the external sector, the current account deficit narrowed marginally as improvements in the services accounts and a fall in imports were partially negated by an almost compensatory fall in exports. The latter reflected the impact of a drought on agricultural production and a shortfall in the export of ferronickel. However, the capital account saw a substantial turnaround from a net outflow of $300 million in 1990 to a net inflow of $250 million in 1991. The latter was due to substantial private sector inflows, reflecting a show of confidence in the policy actions of the authorities and the real interest rate differential that developed between the Dominican Republic and the United States.

During 1991, my authorities observed all quantitative performance criteria--many with substantial margins--and have not drawn upon the resources of the Fund under the current stand-by arrangement, although they drew on the compensatory and contingency financing facility (CCFF). Also in 1991, my authorities took the initiative to begin restructuring their external debt. They reached an agreement with their Paris Club creditors, bought back the outstanding public sector debt to Mexico at a substantial discount, and cleared all arrears to multilateral lenders, with one exception, for which a prompt solution is expected.

In 1992, my authorities intend to pursue vigorously policies aimed at attaining macroeconomic stability and lay the groundwork for sustainable growth. Real GDP is expected to grow by 3 percent, inflation to stabilize at relatively low levels, and the external current account deficit to narrow.

The overall public sector deficit is expected to move from a marginal surplus in 1991 to an equally marginal deficit in 1992. This development represents a rise in capital expenditure in the accounts of both the Central Government and the public enterprises. However, it should be noted that discipline with respect to current expenditures will be maintained, and efforts will continue to be made to improve the overall revenue position of both the public enterprises and the Central Government. The comprehensive tax reform package of April 1992 is expected to enhance government revenue over the medium term, while in the short term my authorities have sought technical assistance and advice from the Fund to improve tax collection and administration.

Monetary policy will remain tight to support the fiscal stance, strengthen the balance of payments, and contain price increases. Interest rates will continue to be market determined and, given the relative stability of the exchange rate and the low level of inflation, interest rates are expected to continue to decline, thereby providing a stimulus to increased private sector activity. My authorities have also embarked on a review process of all the present laws relating to the financial system, with a view to creating a more competitive banking system and providing greater supervisory powers to the Central Bank.

Despite the increase in public sector wages and minimum wage rates in 1991, wage pressures are not expected to be substantial. It should be noted that 1991 increases were below the prevailing rate of inflation and were granted to cushion what would have otherwise been an unsustainable fall in real wages. In addition, my authorities have provided to the more vulnerable sectors of the population a basket of basic necessities at low prices to ease the adjustment burden on this group. However, my authorities simultaneously removed almost all price controls in 1991 and effectively abolished the remainder in May of this year.

In the external sector, the market-determined rate remains relatively stable, and the extensive use of the surrender requirement to the Central Bank will be reduced progressively, as evidenced by the actions taken by my authorities in March 1992. The restructuring of debt obligations which began in 1991 continues in 1992; in March of this year, it resulted in a substantial reduction in outstanding debt held by Venezuela--the largest bilateral creditor of the Dominican Republic outside the Paris Club. Following discussions with commercial bank creditors in 1991, the authorities are now examining commercial bank debt reduction on the basis of proposals presented by the Dominican authorities and a counter proposal submitted by the banks.

There is no question that the policies followed by the Dominican authorities since 1990 have greatly improved the Dominican Republic's capacity to repay the Fund, as indicated by the staff's medium-term balance of payments outlook. Yet, the Dominican Republic remains vulnerable to external shocks. Precisely because of this vulnerability, my authorities are continuing to pursue sound macroeconomic policies and expect to reach agreement with all creditors for a phased reduction in outstanding debt obligations and arrears. The commitment of my authorities is evident in the success achieved in 1991 and the promising results in the first half of this year; it is notable that the success of my authorities has allowed them to eschew drawings on the stand-by arrangement so far. This Board, therefore, ought to have no hesitation in supporting the Dominican Republic in its significant efforts at economic reform and adjustment.

Mr. Torres made the following statement:

We welcome this new opportunity to review the encouraging economic developments in the Dominican Republic, following the successful implementation of sound policy measures after 1990. Since then, the authorities have continued their efforts to reduce the severe internal and external imbalances, and, at the same time, they have made substantial progress in normalizing financial relations with external creditors, which has significantly improved their external debt position and prospects. Today, the Dominican Republic has a better external position and there is a greater possibility of achieving a sustainable growth path if the authorities remain committed to sustaining the adjustment process and the international financial community continues to support those efforts.

We are in broad agreement with the main thrust of the staff appraisal. The core of the adjustment process has been the important turnaround in the fiscal accounts, complemented by a tight monetary policy that, in the context of a prudent exchange rate policy and the liberalization of interest rates, has created favorable conditions to encourage capital inflows and the strong growth of financial savings. We commend the authorities for their efforts to reduce public expenditures and improve revenues. We welcome the measures taken toward the end of 1991 to reduce distortions in the financial system, the approval of the tax package in April 1992, and the elimination of all remaining price controls in May 1992. Those major steps will certainly contribute to maintaining financial discipline and increasing efficiency in the allocation of resources. However, there is still need for a sustained adjustment.

In the fiscal sector, the need to develop high priority projects in 1992 is mentioned as the cause of the increase in capital expenditures by 1 percent of GDP, to which the staff attributes the shift in the overall fiscal balance from a surplus in 1991 to a deficit. We would like to have more information about the nature of those projects and some clarification of the authorities' intentions to increase capital expenditures further if additional long-term external financing is obtained, as expressed in their letter to the Managing Director. The achievements made so far in fiscal consolidation at least should be preserved; higher capital expenditures should not undermine the fiscal position, and, hence, the evolution of the current account should be kept under strict control. The same could be said for public sector enterprises. In this respect, we would like to see further progress in the privatization program.

Developments in the external sector in 1991 were remarkable. The current account deficit, even if higher than envisaged in the program, declined from its 1990 level. The capital account turned to a surplus as a result of strong net private inflows. International reserves increased well above the target. Further improvement is projected for 1992, with a reduction in the current account deficit by 1 percent of GDP and balance in the capital account. It is expected that the overall deficit in the balance of payments and the cancellation of remaining external arrears by the end of the year will be financed by additional debt relief.

Discussions leading to a final agreement with commercial banks, the OPEC Special Fund, and other creditors are taking place, which will improve further the Dominican Republic's creditworthiness. In this respect, we have some concerns about the authorities' expectations of a possible reversal of capital inflows and about the rationale of the provisions in the program to allow the utilization of most of the overperformance in international reserves to finance that reversal. Moreover, the staff paper does not make clear whether that provision is consistent with the possibility of using excess reserves for further buybacks of external debt. We would like some clarification from the staff with respect to this issue. It is our opinion that sound financial policies that lead to positive real interest rates and stability in the exchange rate are the best insurance against capital outflows. Efforts should continue to maintain those conditions, particularly in a country that needs to strengthen its external position substantially.

The Dominican Republic authorities have taken important measures to reduce external and internal imbalances, with extraordinary results. The medium-term balance of payments prospects have significantly improved with respect to the 1991 projection, with a reduction of somewhat more that 50 percent in financial gaps projected through 1997. However, the economy still remains vulnerable to external shocks, a vulnerability that makes the need to continue with the adjustment efforts even more urgent.

Ms. Lindsay-Nanton made the following statement:

The turnaround in the performance of the Dominican Republic's economy since the adoption of that country's economic program in 1990 is impressive. Inflation has fallen significantly, the fiscal deficit of about 5 percent of GDP in 1990 has been turned into a small surplus, and the sharp drop in GDP has been halted. Interest rates, which were liberalized, are now positive in real terms; the exchange rate system, which was unified, is now market determined and has stabilized since June 1991. International reserves have accumulated; almost all arrears to multilateral institutions have been cleared, and the authorities are servicing the multilateral debt on time.

This favorable economic performance led to the observance of all quantitative performance criteria under the stand-by arrangement through end-1991 with substantial margins. I can, therefore, support the proposed decisions and commend the authorities on their sound management of the economy to date. While these developments signal an important turn in macroeconomic management, the main challenge facing the authorities now is to sustain these efforts in the long term and to accelerate implementation of the structural reform process to put the economy on a path of sustainable growth.

In the area of fiscal policy, the staff has quite correctly observed that continued strengthening of the public finances remains a central element of the program in 1992. Moreover, they note that a key issue is the need to create a more permanent basis for the fiscal improvement observed thus far.

Admittedly, the customs reform initiated in 1990 and the new tax reform approved by Congress recently are important achievements, but like the staff, I am concerned about the durability of the revenue base. The staff paper notes that, when the tax reforms are fully implemented, tax revenues are expected to increase by 1 percentage point of GDP a year, and this increase is expected to more than offset the loss from the reduced import surcharge scheduled for implementation this month. As the benefits of tax reform will take time to develop, I wonder whether the authorities have any contingency plan in the near term in the event that domestic taxes do not rise fast enough to replace the loss in import duties.

Additionally, the staff notes that further action to incorporate the domestic oil price differential into the permanent tax structure is essential. I would be interested in knowing what provision is being made to secure this source of revenue, given its extreme importance to the improvement of the fiscal finances. The authorities' decision to seek technical assistance with respect to tax administration is appropriate, as the full benefits of the reforms will be captured only if tax administration is substantially improved.

The marked improvement in public enterprises' finances in 1991 is welcomed. The ongoing efforts to strengthen the operation of these entities must remain a priority. The authorities quite correctly are pressing on with their privatization program, and I was curious in respect of the prospects for privatization of the much-troubled Dominican Electricity Corporation. Perhaps the staff could comment on the authorities' plans for solving the power sector's problems.

The tight monetary stance aimed at reducing inflationary pressures and the liberalization of interest rates, which have helped to strengthen financial savings in 1991, have been quite successful. Moreover, the strong fiscal improvement has enabled the reduction of public sector demand on domestic credit, thus allowing for the expansion in bank credit to the private sector. We concur with the staff that continuation of a tight monetary stance will be one important element in building on the authorities' achievements to date.

I have already commented on the rapid progress made in bringing down inflation in just one year within the context of a difficult adjustment program. The staff notes that, owing to the low inflation rate experienced in 1991 and expected in 1992, wage increases are expected to moderate. I would also expect that the cost of this adjustment would have been felt in rising unemployment rates further dampening wage pressures. I would be grateful if the staff could offer some perspective on this situation. Furthermore, I would also like some elaboration on the adequacy and scope of the social safety net, on which so little has been said in the staff paper, particularly in view of the complete removal of price controls.

As to the balance of payments, the staff projects that the tourist industry, the export processing zones, exportable agricultural products, and mineral exports are all expected to show favorable growth in 1992. The implications are that the external current account deficit will improve by some 1 percentage point of GDP in 1992, compared with the previous year. Meanwhile, private capital inflows are expected to moderate. Like Mr. Torres, I would be interested in knowing the reasons behind the volatility that could cause an outflow of private capital in the current year.

While the balance of payments of the Dominican Republic will remain vulnerable to external shocks over the medium term, the staff points to an improvement owing, in part, to debt-restructuring operations. We, therefore, view the recent debt-reduction operations with Mexico and Venezuela as welcome developments. Furthermore, we would urge the authorities to conclude as quickly as possible restructuring agreements with commercial banks and the remaining bilateral creditors, utilizing a phased approach to help strengthen further the external account. The intention of the authorities to eliminate all outstanding arrears through debt restructuring and cash payments during the period of the arrangement should also be pursued.

The medium-term prospects for the Dominican Republic will depend on the continued pursuit of appropriate fiscal, monetary, and structural reforms. Moreover, the attainment of sustainable growth turns in large measure on achieving higher savings and investment levels. The authorities have embarked upon comprehensive reforms of the financial sector aimed at effectively mobilizing private sector savings. On the other hand, improved public sector savings will depend significantly on the capacity of the authorities to implement the recently approved tax reform and on enhanced tax administration.

The authorities seem committed to implementing their difficult adjustment program and to achieving macroeconomic stability. This position can only be reached with the help of the international community.

Mr. Shimizu made the following statement:

Like previous speakers, I am pleased to note that the Dominican Republic made significant progress in 1991 in stabilizing its economy; the decline in economic activity was reversed, the rate of inflation was sharply reduced, and gross international reserves were increased more than sixfold. I am also pleased to note that the authorities observed all the performance criteria under the stand-by arrangement, sometimes by a wide margin.

This being said, the economic situation is still vulnerable, as evidenced by continuing financing gaps in the medium term. It is therefore imperative for the authorities to keep the momentum of the stabilization by pursuing sound macroeconomic policies.

The overall fiscal balance in 1992 is expected to move to a deficit of 0.8 percent of GDP from a slight surplus in 1991. I do not see this shift as problematic, because the turnaround is entirely due to an increase in capital expenditure, which is still at a low level. However, to keep the stabilization program on track, a further increase in the fiscal deficit should be avoided. Therefore, it is important to keep expenditure, including wage bills, under control to maintain the low rate of inflation and to adhere to the prioritization of expenditures strictly. On the revenue side, I welcome the recent tax reform which, among other things, broadened the tax base. In its appraisal, the staff recommends further tax reform of the domestic oil industry and foreign exchange transactions, which I fully endorse. I am interested in hearing from the staff whether the authorities intend to follow these recommendations.

With respect to monetary policy, the main objective should be to keep the rate of inflation low; therefore, a tight monetary policy is called for. In this connection, I welcome the fact that the authorities have maintained a flexible interest rate policy, which has resulted in positive real interest rates. If the high real interest rate continues to attract much foreign capital, the authorities should sterilize excess liquidity through market operations.

On the external front, I welcome the authorities' progress in clearing their external arrears. With respect to the medium-term balance of payments, the staff presents two interesting scenarios, one without debt reduction, but with financing gaps in the medium term and the other with debt reduction, but without financing gaps. These scenarios show the importance of debt reduction in achieving medium-term external viability. I have two questions on the scenarios. First, is the use of Fund resources this year by the authorities under the stand-by arrangement incorporated into the scenarios? Second, do the authorities intend to request a successor arrangement for debt reduction? I support the proposed decisions.

Mr. Laux made the following statement:

I am pleased to note the impressive macroeconomic performance of the Dominican Republic, most notably in the fiscal area and in the fight against inflation. In many respects the outcome is substantially better than expected under the program, and many of the concerns raised by this chair and other speakers when the program was presented to the Board for approval could have been greatly alleviated if, from the outset, the program had aimed at the ambitious results that have now been achieved.

While I, therefore, should like to join others in commending the authorities for their success, the adjustment process is far from being complete, and not all developments are favorable. Export performance, for example, is much worse than expected under the program. In fact, the revised medium-term balance of payments outlook anticipates export levels much below those of the "lower export growth" alternative scenario presented one year ago. This outcome should remind us that even "worst case" scenarios are subject to considerable downside risks that cannot be ignored by economic policymakers.

Another even more worrisome development in 1991 was the increase in consumption as a share of GDP and the accompanying substantial decline in the private sector savings ratio by some 4 percent of GDP. Given the severe problems of the Dominican Republic in servicing its external debt obligations, this development must be quickly reversed if the country is to meet its investment needs and realize its longer-term growth prospects.

Against this background, the authorities would be well advised to consolidate, if not improve, the accomplishments reached so far in domestic and external adjustment. I, therefore, find it quite unfortunate to note that, after the substantial drop in 1991, the inflation rate should be allowed to rise again this year, even though the projected rate of 5-8 percent might be considered low against the country's inflation standard. As a footnote, let me add that in the fact of an inflation rate of 4 percent, it was surprising to read in the staff appraisal that "inflation has been virtually eliminated." I would have thought that the staff should maintain a more ambitious standard of price stability.

The overall budget deficit is expected to widen again in 1992. Although this widening is basically caused by an increase in investment expenditures, I wonder whether a further strengthening of the fiscal position would not be advisable in view of the concerns I just mentioned. At any rate, I agree with the staff that the import surcharge and the tax on foreign exchange transactions should be replaced by more permanent and less distortionary sources of fiscal revenue. In this context, I also wonder whether the increase in the government wage bill of 15 percent in 1992 is justified against the background of a significant decline in inflation and why more effort is not being made to reduce the deficits of the unconsolidated public enterprises. The deficits of those enterprises were much higher than expected in 1991, and no improvement is foreseen for 1992.

Finally, we are discussing today a program review that should have taken place in January 1992. Could the staff elaborate on the reasons for the delay, which, inter alia, has led to the situation that no performance criteria were formulated for the first quarter of 1992. I would also be grateful if Mr. Kafka or the staff could elaborate on the authorities' intentions in respect of a possible successor arrangement with the Fund. As I recall, at the time of the Board's approval of the stand-by arrangement, they expressed interest in an extended Fund facility or an enhanced structural adjustment (ESAF) arrangement. With these remarks, I can endorse the proposed decisions.

The staff representative from the Western Hemisphere Department remarked that the core program of investment now being established--after the drastic cut in investments from 11 percent of GDP in the late 1980s to nearly half that level in recent years--focused on education, health, and infrastructure. The authorities, with World Bank assistance, were drawing up a public sector investment program. The World Bank staff had underlined the need for the Dominican Republic to improve its capacity to implement projects. The possibility of increasing the fiscal deficit in the program, owing to the availability of further external financing on concessional terms, had been included in the stand-by arrangement with the Dominican Republic in both 1991 and 1992 to accommodate further lending for investment purposes by the multilateral financial institutions, particularly the World Bank and the Inter-American Development Bank, which were working closely with the authorities to develop the public sector investment program.

The tax reform had been enacted in April 1992, sooner than anticipated in the program, the staff representative noted. Shortly thereafter, the authorities had been able to put into effect that part of the reform dealing with the value-added tax rate increase, which allowed them to reduce the import surcharge in July 1992. The authorities planned to eliminate that surcharge over time. As some speakers had noted, there were some relatively inefficient revenue sources that should be reduced or eliminated, including the import surcharge and the tax on exchange transactions, as well as the oil price differential, which was not a tax but a profit generated by the public sector oil industry. The staff had recommended that the oil price margin be incorporated into the tax system, and the authorities had prepared legislation to that end. However, the authorities did not expect it would be enacted in 1992.

Some progress had been made in the authorities' program to privatize public enterprises, the staff representative stated. The electricity company, the most important public enterprise in the Dominican Republic, had a troubled history of financial difficulties. Consultants had been hired by the Inter-American Development Bank to propose and evaluate options for its partial or full privatization. Negotiations were currently under way to sell the domestic airline to a foreign carrier. Other attempts at privatization had included a company, government ownership of which was being challenged in the legal system.

Surveys of unemployment were infrequent in the Dominican Republic, the staff representative said. The most recent government survey had been taken in 1988, when the unemployment rate had been estimated at 19 percent. The Inter-American Development Bank had conducted a survey in 1991 that had showed an unemployment rate exceeding 20 percent.

With respect to the adequacy of the social safety net in the Dominican Republic, the authorities had said in their letter of intent one year ago that the best safety net was a growing economy, and they continued to hold that view, the staff representative remarked. The authorities had developed feeding programs, including school feeding programs. There was a system of public health clinics. A World Bank evaluation had considered those efforts somewhat inadequate, and the authorities were working with the multilateral institutions to improve social and educational programs. In 1991, the World Bank had approved an important education loan for the Dominican Republic. In addition, the Government provided baskets of basic foodstuffs at reasonable prices to fairly well-targeted groups in the population.

The use of the net international reserves accumulated in excess of the program target in 1991 had a bearing on the delay in holding the Board's review, the staff representative explained. In 1991 the authorities of the Dominican Republic had generated $187 million of net international reserves in excess of the program target. When designing the 1992 program, the authorities had originally wanted a much freer hand in the use of that excess than could be accommodated under a Fund program. In the ensuing discussions, it had taken some time for the authorities and the staff to reach an agreement on the model presented in the staff paper for the use of that $187 million, in which the authorities stipulated that it would not be used for current operations. Instead, it would be used only to reduce the external debt and/or support the exchange rate if the recent private capital inflows were to be reversed.

The authorities had explained that in 1991 the Dominican Republic had experienced large inflows of private capital, the staff representative continued. They had been concerned that the inflows might be reversed, despite the program's strong policies. They had argued that in 1991 the Central Bank had absorbed much of the inflow to prevent an appreciation of the exchange rate, and they had wanted to be in a position to halt an exchange rate depreciation, if necessary, in 1992. Therefore, the staff and the authorities had agreed that two thirds of the excess reserves would be available to support the exchange rate, in which case the net domestic assets target of the program would not be adjusted. In other words, the active credit components of the program would remain unchanged, so that a reduction in net international reserves would only be permitted in response to a reduction in the Central Bank's monetary base.

The medium-term projection of monetary growth in the staff report included the use of Fund resources under the current stand-by arrangement, the staff representative affirmed.

The wage bill would increase by 14 percent in 1992, the staff representative from the Western Hemisphere Department remarked. However, 9 or 10 percent of that increase was a carryover from the 20 percent wage increase that had been approved in mid-1991.

Mr. Kafka said that his authorities proposed to continue the same careful financial, fiscal, and monetary policies and to concentrate in the coming months on the continuing re-integration of the Dominican Republic into the international financial system.

As to capital outflows, he would merely stress that the excess reserves were there, inter alia, in order to be used to good effect, Mr. Kafka remarked. If the large capital inflows that the Dominican Republic had experienced in 1991 were, for some reason, reversed temporarily, applying those excess reserves to avoid a depreciation that might affect the financial stability of the program in such an open economy would be a reasonable course of action. However, the careful financial policies pursued by the authorities would likely render it unnecessary to use much, if any, of those reserves.

In view of the fact that the Dominican Republic had not made a purchase under the stand-by arrangement, the authorities had not yet actively pursued an arrangement under the extended Fund facility, Mr. Kafka reported. The authorities were likely to do so in connection with their debt renegotiations.

Mr. Torres said that he wondered what the limits were on financing for additional investment under the loans provided by the World Bank and the Inter-American Development Bank. He also wondered whether there was any limit to the potential increase in the public sector deficit.

The staff representative from the Western Hemisphere Department replied that the World Bank and the Inter-American Development Bank were discussing a sectoral loan with the authorities. It was uncertain whether that loan would be approved and a disbursement made while the current stand-by arrangement was in effect. It was difficult to estimate how much additional financing would be required or how much the deficit would increase if the loan was approved, because the disbursement profiles of such loans could extend over a long period. Cofinanced by the Inter-American Development Bank and the World Bank, the loan was approximately $100 million.

Mr. Torres said that he would appreciate further clarification on the program's provision for the use of the excess reserves. It was his understanding that in the beginning the authorities had the view that the program should allow them a free hand in deciding the use to which the excess reserves should be put. That approach was reasonable and consistent with Mr. Kafka's comment that excess reserves were there to be used. He wondered what the rationale was for the staff's position allocating a certain percentage of the excess reserves to exchange market intervention and a certain percentage to the reduction of external debt and whether that rationale was commonly used in other programs.

The staff representative from the Western Hemisphere Department explained that in 1991 the authorities had implemented a program that had been stronger than envisaged. As a result, they had generated reserves that had exceeded the target. They had continued to implement that strong program in 1992. The authorities had wondered whether the $187 million in excess reserves could be retained in reserves to be used for unspecified purposes as the need arose. The staff could not see any possibility requiring the use of excess reserves other than the buy-back of external debt and intervention in the exchange market.

Unless the program specified the uses to which the excess reserve funds could be put, the authorities would be able to use them for domestic purposes, the staff representative from the Western Hemisphere Department continued. There was no need to do that, because their fiscal program was sufficiently strong. The authorities' main concern had been the possibility that capital inflows might be reversed. It had, therefore, been agreed that a part of the excess reserves could be used to provide a cushion for that eventuality, because the authorities had absorbed the inflows in 1991. In other words, one would treat the capital flows symmetrically. The 1991 capital inflows had not led to an appreciation of the rate; the Central Bank had absorbed them. If the reverse was to occur in 1992, the program provided for central bank intervention, but that eventuality was remote. The preliminary data suggested that the program was continuing on track and that targets would be exceeded again in 1992. The authorities expected an overperformance in 1992, because they hoped to eliminate a large part of their external debt. Even if central bank intervention in the exchange market was needed, the two-year reserve target for 1991 and 1992 that had been drawn up in 1991 would be kept intact.

Mr. Knight made the following statement:

In the two years since the authorities embarked upon the current economic program, there has been a substantial turnaround in the economic performance of the Dominican Republic. We commend the authorities for their commitment to the initial stages of this program, evidenced by the fact that all of the performance criteria under the stand-by arrangement through end-1991 were met by wide margins.

Nevertheless, as other speakers have stressed, there is still much to be done, and the authorities should not be lulled into complacency by their success to date. The operations of the public sector will continue to be central to the outcome of this program. The projected return to an overall fiscal deficit in 1992 reflects an expected increase in capital expenditures, after a period of subdued expenditure in this area. This gives rise to obvious concerns that the success on the fiscal front in 1991 may have been partly the result of a postponement of capital projects that will surface again in 1992 and beyond.

The steps taken by the authorities to improve and extend the system of taxation are laudable, as far as they go. But we, like other speakers, agree with staff on the need for more permanent sources of revenue to permit the removal of the tax on the sale of foreign exchange and the special surcharge on imports.

The remarkable success of the authorities in reducing inflation and stabilizing the now market-influenced exchange rate has been based on strong monetary policies. These policies will need to be continued, while the authorities must also ensure that wages in the public sector are held at a level that complements the other elements of the economic program.

The improvement in the current account of the balance of payments in 1991 was a significant achievement, given the effects of the Gulf war, lower ferronickel prices, and the extended drought. However, the staff forecasts suggest that, without further reductions in external debt, the Dominican Republic will continue to be faced with a financing gap of between $50 million to $100 million a year for the foreseeable future. Despite the fact that a buy-back of commercially held debt will initially reduce international reserves, that action may be needed to secure a sustained improvement in the balance of payments.

The authorities of the Dominican Republic have achieved a great deal over the past two years. The way ahead will require continued commitment to the economic program and, in particular, further measures to improve the public sector accounts. We can support the draft decisions.

Mr. Bonzom made the following statement:

The results obtained by the Dominican Republic under the current stand-by arrangement have been quite impressive. The performance criteria at end-1991 have been observed with wide margins. Inflation has been reduced from 100 percent in 1990 to less than 5 percent in 1991; it has probably been reduced even further in 1992. Fiscal and external deficits have significantly diminished. The exchange rate has been stabilized. Progress has been made in the resumption of normal relations with foreign creditors. Structural measures have been taken--sometimes ahead of schedule--that have led to the abolition of price controls, the reform of the tax system, the unification of the exchange rate, and the reduction of distortions in the financial sector. For economic agents, those remarkable achievements have already been translated into a reduction in the interest rate and a recovery in the level of activity.

However, I fully concur with the staff that "important challenges lie ahead." Because I agree with the thrust of the staff paper, I would like to stress the importance of only two of those major challenges, namely, the necessary control of price developments through appropriate fiscal, wage, and monetary policies and a full normalization in the external debt area. With respect to inflation, the information that actual performance in 1992 could be better than the 5-8 percent range mentioned in the letter of intent is particularly welcome. In order to ensure the achievement of this improved outcome, all policy instruments will be helpful, and special attention will have to be paid to the three following points.

First, with respect to the need for a further consolidation of the fiscal performance, the remarkable adjustment that has been carried out so far has hinged heavily upon the reduction of capital expenditure and, more recently, on the building up of revenues. It is important to avoid cutting productive capital expenditures excessively--especially in the areas of health, education, and infrastructure, for instance. The 1992 program provides for an increase of 1 percent of GDP in those expenditures and for a higher prioritization of capital outlays. Those are very welcome developments that will help the economy in the medium term. Greater emphasis will thus have to be put, as stressed by previous speakers, on current expenditures and especially on the need to further reduce transfers to public enterprises and to control wage trends.

Second, and as far as these wage trends are concerned, we fully concur with the staff on the need to pursue a "cautious incomes policy," which, together with the continued stability of the exchange rate, will help anchor economic agents' expectations on prices. Third, even though the authorities must be praised for their conduct of monetary policy to date, it will be useful to continue a close monitoring of real interest rates. As stressed by the staff, special attention will have to be paid to the monetary impact of capital inflows and reserve trends.

This leads me to the question of the external accounts. The staff rightly points out that recent developments have not completely eliminated the vulnerability of the country's balance of payments. Furthermore, the authorities, themselves, insist on the volatile character of the recent capital inflows. In such a context, the completion of the first welcome steps taken toward the full normalization of relations with foreign creditors would help consolidate the international community's confidence. The authorities' intention to eliminate arrears completely before the end of the stand-by arrangement is, therefore, most welcome. We fully support the proposed decisions.

Mr. Wright said that he generally agreed with the comments contained in the staff paper. The authorities should be commended for the Dominican Republic's impressive progress since 1990 in redressing a number of serious economic imbalances. The decision not to make purchases under the stand-by arrangement was, in his view, correct, given the increase in the reserves in 1991. He hoped that the authorities would continue to regard the arrangement as precautionary. He agreed with the staff and earlier speakers on the need to consolidate the fiscal position to ensure that the improvement in the public finances proved durable.

The capital inflows in 1991 had a fairly direct impact on the monetary aggregates, given the authorities' unwillingness to see an appreciation in the exchange rate, Mr. Wright noted. There appeared to have been only intermittent use of open market operations to sterilize the inflows. As a result, liabilities to the private sector had increased by almost 5 percent of GDP--more than had been projected. Inflation, on the other hand, had been considerably lower than expected, and, according to the staff paper, was still subdued. The projected increase in velocity for 1991 had not materialized; indeed, with the fall in real GDP had come a fall in velocity.

He wondered why inflation was so low, given the monetary overshoot that had just preceded the price liberalization, and whether current inflationary trends were sustainable or whether there were underlying inflationary pressures as a result of monetary developments, Mr. Wright stated. Also, following the discussion in the first round of staff replies, he would be interested to hear more about the evolution of private sector capital flows thus far in 1992.

Mrs. Hansen made the following statement:

> We, too, would like to commend the Dominican Republic's authorities for implementing a program that was substantially stronger than agreed. We concur with many of the comments that have been made to this point, so I will just add a few more points of emphasis. With respect to fiscal policy, we share Mr. Torres's uneasiness about the increase in capital expenditure, not only because of the background of an expenditure program that, in earlier years, was out of hand, but also because of the fact that there appears to be no World Bank-approved investment program at this point. I understand that World Bank approval of the investment program is bound up in ongoing negotiations on policy-based lending, which have not yet been resolved. But if there is some further information about the prospects for coming to an agreement on the investment program, I would be interested in hearing it.
>
> With respect to the public enterprise sector, I note that performance improved markedly in 1991, but this sector is still a weak point in the overall financial performance of the Dominican Republic. I gather that the deficit of the public sector enterprises in 1991 was on the order of 0.8 percent of GDP and will rise to about 1.5 percent of GDP in 1992 with the increase in investment. In future documents, however, it would be helpful if there was a clear exposition of exactly how the public sector enterprise sector as a whole is doing, so that we can monitor developments there more closely.

I also share the regret of some previous speakers that there has not been more progress on privatization. I was interested in the staff's comments on the three or four enterprises mentioned. There may be legitimate problems that impede faster progress; however, these enterprises appear to be just the tip of the iceberg of a rather large public sector enterprise sector. We would like to see further progress in that area.

As to monetary policy, I wonder whether the staff could elaborate on how it arrived at the monetary target of 11 percent. Given the priority attached to consolidating the decline in operations, the objective should be at least a neutral monetary policy stance. However, with the 3 percent real growth projected for 1992 and the estimated GDP deflator of 4-5.8 percent of GDP, one would arrive at a monetary growth target on the order of 7-8.8 percent instead of 11 percent. Only by taking the upper end of the consumer price index forecast of 8 percent, can one arrive at a monetary growth target of 11 percent. I wonder whether the consumer price index is inherently a better indicator on which to base the monetary target. If so, is it wise to use the upper end of this estimate? Would that not be accommodating an up-tick in the 4 percent inflation rate apparently achieved at the end of 1991?

Penultimately, with respect to the external sector, we were pleased to see the overperformance on the net international reserve target in 1991. The authorities would be well advised to conserve this windfall for a possible debt-reduction operation. We feel all the more strongly about this usage, given the vulnerability of the external position owing to the high external debt and the continued financial gaps in the medium term. We welcome the discussions between the authorities and the commercial banks on the reduction of the Dominican Republic's external debt and hope that they will lead to a speedy agreement. Like other speakers, we encourage the authorities to eliminate remaining external arrears.

Finally, more on principle than on substance, I join Mr. Laux in regretting the delay in completing the review and the fact that no performance criteria were set for the first quarter of 1992. On the other hand, the staff evidently had a valid reason for not being able to conclude these discussions more quickly, and the outcome was quite satisfactory, given the agreements that were reached and the overall strong performance under the program.

Mr. Posthumus commented that he had no hesitation in supporting the Dominican Republic's significant efforts at economic reform and adjustment, to paraphrase Mr. Kafka in the last sentence of his opening statement. The ongoing macroeconomic adjustment and structural reform measures being implemented by the Dominican Republic were remarkably successful. Double-digit problems had become single-digit problems.

The improvement in public sector finances had been an important factor in the turnaround in the Dominican Republic's financial condition and, together with measures to restructure external debt and the support of creditors, including Mexico, seemed to have led to a virtuous circle situation, Mr. Posthumus observed. That turn of events was essentially what the Fund would like to be attained in most Fund program countries. The Fund must now hope that the authorities would not be satisfied and relax, but, in a virtuous circle, there should be no reason to.

He could support the staff appraisal, Mr. Posthumus remarked. He nevertheless had a few questions. The first question was on what was meant by a realistic exchange rate regime. After having had flexible, active, aggressive, and floating exchange rate policies, a realistic regime was a new one. The staff had mentioned, with apparent approval, the large devaluations in 1990 and 1991, but it had not indicated whether a realistic exchange rate regime meant more of the same, or whether it aimed at a stabilization of the peso, which was what was now taking place.

He wondered whether it was true that the debt problem was more or less under control, Mr. Posthumus stated. After rescheduling, the external public debt service was on the order of 18 percent of goods and services exported, which was usually a sustainable level.

Mr. Fridriksson remarked that he wanted to commend the Dominican authorities for the strong economic performance in 1991, which had continued in 1992 and had reversed the previous downward trend in economic activity. That development had been largely generated by major improvements in the public finances and the measures introduced to reduce distortions in the financial system, including liberalization of interest rates. The authorities needed to pursue vigorously the policy course they had embarked upon. In view of the fragility of the external situation, they ought to stand ready to react promptly, should it deteriorate.

As others had noted, the Dominican Republic had not drawn under the program so far, Mr. Fridriksson recalled. Table 1 in the staff paper indicated that the full amount would be drawn in the next period, and he would like to hear a comment from the staff on the intention of the authorities in that respect. He supported the proposed decisions.

The staff representative from the Western Hemisphere Department said that, as to private capital flows, people had been willing to hold pesos thus far in 1992. Therefore, the growth in the monetary aggregates had been determined from the demand side. As a result, earlier in 1992, when the staff was designing the program and wanted to project the monetary aggregates for the year as a whole, the indicators of monetary growth had suggested that the capital inflows were continuing, at least to some extent, and that the growth figure for nominal GDP was not consistent with events through the first quarter of the year. Therefore, projecting a certain decline in the income velocity of money under the program had been justified.

Discussions between the World Bank and the Dominican Republic on the public sector investment program had been intensive and had included frequent missions by the World Bank, the staff representative reported. Progress was being made. There were a number of obstacles, including the capacity of the Dominican Republic to execute a major public investment program. According to the World Bank, that capacity needed to be strengthened.

He had taken note of Mrs. Hansen's comment that the presentation of public enterprise performance in the staff paper had been somewhat convoluted, the staff representative from the Western Hemisphere Department said. The staff report for the second review and the annual consultation would include a separate table to make public enterprise performance clearer.

The staff representative from the Policy Development and Review Department remarked that the staff had not intended to create a new vocabulary for exchange rate regimes. In terming the exchange rate "realistic," the staff had intended to indicate that the adoption of the current exchange rate and the steps that had been taken more recently had contributed significantly to the success of the program--almost as much as the efforts on the fiscal side. The exchange rate levels and the exchange rate regime as it now operated were considered adequate and appropriate to the current circumstances of the Dominican Republic. The previous exchange rate regime had been subject to various distortions, partly as a consequence of the disequilibria that had developed, first in the external sector and then internally as a result of inflation and other factors. In the recent past, the authorities had introduced a number of restrictions and multiple currency practices that had distorted the actual exchange rate significantly, and their elimination was a welcome improvement that brought back realism to the management of the exchange regime.

Mr. Wright wondered whether thus far in 1992 capital inflows had continued to be fairly strong or had been rather flat, as expected in the projection for 1992.

The staff representative from the Western Hemisphere Department replied that, although the staff did not have data on 1992 capital inflows, monetary growth had remained fairly robust. The only cause of that growth could have been the continuation of capital inflows, which the staff had identified in the 1991 balance of payments.

Mr. Wright responded that that information merely reinforced the concern that he had raised in his statement. Mrs. Hansen had correctly pointed out that the projected growth in nominal money in 1992 was 11 percent--a growth predicated on the assumption that capital inflows would more or less cease. If other factors remained unchanged, monetary growth--unless there was some offsetting component in net domestic assets--was likely to grow faster than 11 percent if the capital inflows continued. The result was a rather odd pattern of monetary and price relationships.

Table 8 in the staff paper showed that the money supply had grown in real terms in 1991 by 28 percent more than had been projected, Mr. Wright noted. That growth could be attributed partly to the capital inflows and partly to the unexpectedly large slowdown in inflation--a rather odd and paradoxical result. That rather counter-intuitive combination of monetary and price developments seemed to add up to a considerable slowdown in velocity. He understood why there might be some slowdown in velocity in behavioral terms. Nevertheless, it made him rather nervous, but he agreed with Mrs. Hansen on the 1992 projection of capital flows and monetary growth. If the inflows were increasing the money supply beyond the projection, the authorities would need to pay careful attention.

The staff representative from the Western Hemisphere Department said that in calculating the projected monetary growth of 11 percent, the staff had incorporated the capital inflow.

Mr. Kafka said that he understood Mr. Wright's concern about the 1992 projection of monetary growth. Expectations had not been at all good at the beginning of 1991, but they had turned around dramatically and had led to the lower than expected inflation rate in 1992. The turnaround in expectations had been even more dramatic than the turnaround in performance, which had been dramatic enough. The result had been a remonetization; only a remonetization could explain how a substantial expansion of the money supply in real terms could be compatible with a low inflation rate.

As to the rate of inflation, the staff had not been convinced by the 8 percent rate projected by the authorities, Mr. Kafka recalled. The Dominican authorities had been cautious in setting an inflation rate target of 12 percent; they had not wanted to announce an objective that they were not absolutely sure they could fulfill. The economy had performed well in 1991 and continued to perform well in the first half of 1992.

The Executive Board approved the following decisions:

Review Under Stand-By Arrangement

1. The Dominican Republic has consulted with the Fund in accordance with paragraph 4 of the stand-by arrangement for the Dominican Republic (EBS/91/127, Sup. 3) and paragraph 35 of the letter dated July 5, 1991 from the Governor of the Central Bank and the Secretary of Finance of the Dominican Republic in order to review progress in the implementation of the Dominican Republic's economic program and to review the external financing associated with the program.

2. The letter dated June 16, 1992 from the Governor of the Central Bank and the Secretary of Finance of the Dominican Republic and the Technical Memorandum of Understanding attached thereto shall be annexed to the stand-by arrangement for the Dominican Republic, and the letter of July 5, 1991 and the Technical Memorandum of Understanding attached thereto shall be read as supplemented and modified by the letter dated June 16, 1992 and its Technical Memorandum of Understanding.

3. Accordingly, paragraph 4(a) of the stand-by arrangement is amended to read:

"4(a) during any period in which data at the end of the preceding period indicate that

(i) the target for the net international reserves of the Central Bank of the Dominican Republic; or

(ii) the limit on the cumulative changes in the net domestic assets of the Central Bank; or

(iii) the limit on the combined credit of the Central Bank and the Banco de Reservas to the nonfinancial public sector; or

(iv) the limit on the overall deficit of the nonfinancial public sector; or

(v) the limit on the public sector's net use of foreign credit with maturities of up to 12 years and with limits on maturities of less than one year; or

(vi) the target on the cash payment on nonrestructurable external payments arrears,

respectively described in paragraphs 3, 4, 5, 6, 7, and 9 of the Technical Memorandum of Understanding attached to the annexed letter dated June 16, 1992; or".

4. The Fund decides that the first general review, and the second review on the financing of the program, both contemplated in paragraph 4(b) of the stand-by arrangement for the Dominican Republic, have been completed.

Decision No. 10087-(92/94), adopted
July 24, 1992

Exchange System

As described in EBS/92/113, the Dominican Republic maintains exchange restrictions on payments and transfers for current international transactions evidenced by (a) external payments arrears and (b) limitations on profit remittances, which are subject to Fund approval under Article VIII. The Fund notes the intention of the authorities to eliminate the external payments arrears during the remaining period of the Dominican Republic's economic program described in EBS/92/113. In the meantime, the Fund grants approval for the retention of the exchange restriction mentioned in (a) above until December 31, 1992, or the date of completion of the last review contemplated in paragraph 4(b) of the stand-by arrangement for the Dominican Republic (EBS/91/127, Sup. 3), whichever is earlier.

Decision No. 10088-(92/94), adopted
July 24, 1992

3. HONDURAS - REQUEST FOR ENHANCED STRUCTURAL ADJUSTMENT ARRANGEMENT

The Executive Directors considered the staff paper on Honduras's request for arrangements under the ESAF (EBS/92/110, 6/18/92; and Sup. 1, 7/22/92). They also had before them a policy framework paper for the period 1992-95 (EBD/92/120, 6/17/92).

Mr. Torres made the following statement:

Honduras's adjustment efforts, initiated in March 1990, are being further enhanced with a medium-term economic program, in support of which a three-year ESAF arrangement is requested. The arrangement represents an additional and complementary support to my authorities' efforts to achieve sustained growth and external viability.

In the short span of 28 months, the Honduran Government has taken bold and far-reaching measures aimed at stabilizing the economy and addressing the deeply rooted structural imbalances. The tax system has been reformed, and revenue collection is steadily improving. Public expenditure growth has been kept under strict control, and credit expansion under a strong grip, while interest rates have been liberalized. The exchange rate regime has been fully liberalized--ahead of schedule--and further steps to remove the remaining trade restrictions are under way.

The strengthening of economic policies has brought about significant improvements. The public sector deficit was more than halved from end-1990 to end-1991, from 8.5 to 3.5 percent of GDP, 1 percentage point below the program target. In addition, a further reduction of 1 percent of GDP is expected for the 1992/93 period. The reduction in inflation--after an initial surge in 1990 owing to price and exchange rate liberalization--the fall in real wages, and the increased flexibility of the exchange rate contributed to a strong performance of nontraditional exports in 1991/92. The international reserves position has been strengthened, and it is expected that external viability may be achieved by 1996. Important advances have been made in clearing external payments arrears, and it is the intention of my authorities to remain current in servicing their external obligations.

The 1992-95 economic program, supported by a three-year ESAF arrangement, will consolidate the significant progress made so far in the stabilization of the Honduran economy and will deepen the structural reform process, while ensuring that the poor are provided with broader access to social services. The program objectives are ambitious, and they are backed by the full commitment of the Honduran authorities to strengthen the adjustment process as needed. Real GDP is expected to grow 4.5 percent by the end of 1995, and inflation is expected to be reduced to international levels. The external deficit is expected to be more than halved, compared with its 1991 level, while the overall deficit of the nonfinancial public sector is expected to be reduced to 1.5 percent of GDP.

To achieve these objectives, tight financial policies and structural reforms will be implemented. On the fiscal front, ongoing programs to improve tax administration will be continued, and additional steps to reduce and rationalize public expenditures will be taken in the context of a public sector reform program. Monetary policy will remain tight, and the projected reduction in public sector net indebtedness will provide room for credit expansion to the private sector.

The Government intends to modernize financial sector legislation to enhance that sector's competitiveness and implement prudential regulations to maintain sound credit institutions. To accomplish these objectives, legislation in these areas will be submitted to the National Congress by September 1992. Once implemented, the new legislation will strengthen the regulatory capacity of the monetary authority and the superintendency of banks in their respective areas of responsibility.

With the full liberalization of the foreign exchange market, a new and important step to improve the climate for private sector activity has been taken. Laws related to agricultural real property rights and to private investment regulations were approved in early 1992. A new law to simplify the privatization process of state-owned enterprises is being drafted.

Social stability is a crucial element for sustaining the adjustment process over time, and the Honduran authorities are expanding the scope of social programs, mainly the Social Investment Fund (FHIS) and the Program of Family Allocation (PRAF), and encouraging private sector participation in solving housing shortage problems by creating a housing construction program, the Social Fund for Housing (FOSOVI), which will provide the low-income segment of the population with affordable housing. The medium-term social strategy is directed at increasing the coverage of education, health, and sanitation services.

Notwithstanding the successful implementation of Honduras's economic adjustment program, it is clear from the staff report that the country's external position will remain weak and vulnerable to domestic and external shocks. Further concessional assistance and debt relief will be required to supplement Honduras's adjustment efforts.

To date, my authorities have demonstrated their strong commitment to economic adjustment, and this commitment will be maintained during the medium-term program implementation. The Honduran Government expects that the international community's support of its efforts, which continues to be crucial for the achievement of the program's objectives, will be maintained, and thus complement the Government's actions to improve the living standard of the Honduran people.

Mr. Almeida made the following statement:

After the strong fiscal adjustment in 1991, when the overall public sector deficit declined from its 1990 level of 8.2 percent of GDP to 3.5 percent, the 1992/93 program emphasizes a more moderate speed of adjustment. The fiscal targets are reasonable, and they are divided between a moderate increase in taxes and a smaller reduction in overall expenditure, which rightly allows some room for public investment growth.

The financing of the medium-term program seems to be on the optimistic side, with both public and private savings expected to double in the next four years. We are not sure about the validity of these assumptions, particularly for the private sector. Fiscal policies remain strong and this strength will, no doubt, help to increase public savings, but the private sector seems to be reticent about its long-term plans. Perhaps the staff could elaborate on the reasons for the forecast derived for the private sector savings rate.

We also see problems in the financing of the external account. Even with an optimistic assumption of high export growth--12 percent--there is still a substantial financing gap in 1992/93. Moreover, the staff has called attention to the vulnerability of export revenues, which are highly concentrated on a few primary products. The projection emphasizes the need to continue structural policies aimed at diversifying exports. In addition, if the EC persists in its purported objective of introducing both a quota system and a 20 percent tariff on banana imports from Latin America, we could also expect a further widening of the financing gap.

All this suggests that multilateral institutions and bilateral official donors should be aware that they might need to step up their financing efforts over current estimates. We particularly urge bilateral creditors to show flexibility during the next discussions with Honduras in the Paris Club.

We are pleased to see that the authorities are contemplating a new banking law, which will give the Central Bank power to impose legal reserve requirements on nonbank financial institutions. The present level of reserve requirements is so high that we wonder if some financial disintermediation has not already started in the economy. The opportune time to reduce reserve requirements is coming soon, when reserve requirements are extended to nonbank institutions and when tax revenues are slowly increasing.

The program has structural elements that are very positive, as mentioned in Mr. Torres's opening statement, particularly in the area of poverty alleviation and social expenditure. Its fiscal and monetary policies are designed to encourage moderate, but sustained, growth. We support the proposed decisions.

Mrs. Krosby made the following statement:

The fruits of Honduras's careful stabilization and structural policy cultivation in 1991 are ripening in 1992, with faster growth, lower inflation, and an improving external account. The program described for 1992/93 should be a good start for a three-year ESAF program. It is ambitious, but with Honduras's recent record of good policy implementation and economic performance, we are confident it is within reach. We agree with the staff analysis and fully support the proposed decision approving the request for an ESAF arrangement. We have only a few thoughts on specific policy measures and timetables.

Considering first the centerpiece of the program--fiscal policy--the pruning of the budget deficit achieved so far has been important in reducing the inflation rate. The inflation target for later years is tough, but accessible. It is critical for the success of the ESAF program, as well as for the health of the Honduran economy, that the proposed fiscal agenda be implemented fully and consistently over the future. We have some regrets that the downward trend in declining central government budget deficits will be broken by a renewed, but hopefully temporary, swelling of the deficit in 1992. The staff attributes this reversal to higher investment outlays, which seem to be justified this year, owing to the bunching of international financial institution-related projects.

Although current spending is expected to be held roughly level in terms of GDP, some acceleration of projected expenditure pruning--of subsidies, for example--might have been possible. Further, the projections on current expenditure levels for 1992 are based on public sector employment reductions that have yet to take place and have already been delayed from the previous fiscal year.

On the revenue side, we note with considerable satisfaction the higher than projected receipts, owing to a concerted approach to tax administration and enforcement of effective fines and penalties. At the time of the next Board review, we will look with interest for details of the 1993 fiscal plan, including measures to further shrink the role of government in the economy.

The Honduran authorities will diminish the possibility of reverting to inflationary domestic bank financing of the fiscal deficits with the implementation of their plans to improve monetary policy control by greater reliance on indirect policy tools. Given the importance of this move, we are pleased that the adoption of biweekly open market operations in October 1992 has been set as a structural benchmark. As the increased use of open market operations goes hand in hand with the reduction in the high reserve requirements for banks, we would have been interested in more detail on the timing and end-level of the "gradual" reduction in the reserve requirement. While understanding that the monetary authorities probably desire some leeway in adapting the new policies, it should not become a way to delay the move to lower reserve requirements. To maximize the potential for a successful move to open market operations, the authorities are encouraged to promote a well-functioning secondary market for government bonds, including through the simplification of bond issuance rules as well as transparent reliance on allowing the market to function freely, without recourse to moral suasion between the monetary authorities and the financial institutions.

These proposed monetary policy changes would seem to remove one of the major sources of the wide wedge between lending and deposit rates, helping to unglue the current upward stickiness of deposit rates and thereby easing one disincentive to saving. We would be interested in plans to address other sources of the existing 12 percentage point interest rate spread, such as the existing high level of nonperforming loans. This problem would seem to be related to a broader issue facing the Honduran financial market--that is, lack of adequate competition. Fewer but more competitive banks that are less tied to key economic interests could better serve Honduras's financial market needs.

The decision to accelerate considerably the schedule for unifying the exchange market and floating the lempira is impressive, and we hope that remaining restrictions in the exchange market will be removed quickly. The move to a unified exchange rate gives full credence to the Honduran authorities' commitment to the economic adjustment program, as well as to their ability and confidence in flexibly managing the stabilization program.

Similar bold moves in other areas where structural change is needed or expected, such as the financial market, the public enterprise sector, and the investment regime, will do much to advance the potential for increased private sector investment, and hence, increased economic activity overall.

The authorities' exchange rate policy spurred growth in nontraditional exports, which, in turn, was important in checking deterioration in the trade account in 1991 when traditional exports flagged. Total exports will be important in the near term for boosting growth expectations for the economy and improving the current account outlook. We note that the potential for external viability looks considerably brighter than when we previously discussed Honduras in the Board in February 1992 (EBM/92/17, 2/14/92), with the current account deficit now expected to fall to under 3 percent by 1996. The improvement seems traceable to lower interest payments owing to falling interest rates and debt forgiveness, but it is not completely clear why the pattern should change so dramatically so quickly.

The emergence of arrears in the second quarter of this year is a bit unsettling, given Honduras's history. We urge the authorities to prevent a reoccurrence to ensure that Honduras's newly won credibility is not eroded once more.

In conclusion, over the recent past, the Honduran authorities have embarked on a program comprising the macroeconomic and structural policies necessary for growth and development. They have taken critical steps from which neighboring economies have shied away. In doing so, Honduras has chosen to build on the improving economic situation rather than sit back in the midst of a half-finished economic adjustment process. We believe that Honduras has the resources and potential for solid economic performance. With the removal of rigidities that discourage innovation and competition, which is now under way, combined with the stabilization policies being followed, we hope that the spark necessary for solid economic growth has been lit. The most important effort now is to sustain these policies into the future.

Mr. Ismael made the following statement:

I am pleased with the successful implementation of the various adjustment and structural measures under the previous stand-by arrangement, which resulted in significant progress toward higher economic growth, a reduction in inflation, an improved fiscal condition, and a strengthened external position. I am also encouraged by the authorities' determination to continue their adjustment efforts to a successful end by adopting a medium-term comprehensive economic program, including politically difficult prior actions of approving the Agricultural Modernization Law and a full unification of the exchange rate six months ahead of schedule. I can, therefore, support the proposed decisions with the following comments.

First, despite recent positive developments, inflation still remains relatively high, and the external position continues to be vulnerable to adverse external developments. Moreover, the need to reduce the relatively high population growth rate should be emphasized, as should the need to raise the rate of economic growth to ensure an increase in real per capita income. The program objectives of accelerating economic growth and further reducing inflation and the external current deficit seem appropriate, considering the circumstances.

Second, to achieve these objectives simultaneously, a stronger focus should be placed on stabilization policies and structural measures that would enhance the supply response of the economy. In this respect, liberalization policies that have been taken in the domestic pricing and trade and exchange systems are encouraging, and I welcome the authorities' intention to eliminate export permits and the import tax surcharge. Reforms in key sectors, especially in agriculture, and implementation of the recently introduced private investment law should be vigorously continued. In this connection, I wonder what kind of additional measures have been taken to restore declining manufacturing production.

Third, a substantial increase in domestic savings and the availability of sufficient foreign financing are crucial in achieving the required level of investment. A higher domestic savings ratio will also help to reduce the external current account deficit in line with the program objective. The program outlines several measures to increase public sector savings through fiscal consolidation and private sector savings through the establishment of positive real interest rates.

With respect to fiscal consolidation, more emphasis should be placed on a reduction in current expenditures, especially on wages, subsidies, and transfers, in view of the fact that current expenditure reduction may have a smaller effect on private savings, compared with a tax increase. While I welcome the intention to pursue a policy of wage restraint, I am concerned about its attainability in light of the existence of strong labor unions.

On the revenue side, tax reform and the strengthening of tax administration should be continued. The rapid implementation of the divestment program should provide the opportunity to develop the private sector. The restructuring and privatization of public enterprises should be pursued with vigor. I welcome the assistance provided by the World Bank in preparing and implementing public enterprise reform, as well as growth-oriented and financially feasible public investment programs. Given the past experience of slippages in policy implementation, fiscal developments will need to be closely monitored, so that timely corrective action can be taken to keep the fiscal program on track.

Fourth, the reduction of the overall budget deficit would facilitate monetary restraint to help achieve the inflation and balance of payments objectives and, at the same time, permit sufficient bank credit expansion to the private sector to support the growth of economic activity. Financial reforms, including reforms in the banking sector, should be speeded up to improve the effectiveness of monetary policy by increasing reliance on indirect instruments of monetary control, particularly open market operations, and enhancing competition and efficiency. It is also important to reduce the quasi-fiscal losses of the Central Bank through measures such as raising the interest rates of its preferential lines of credit to levels closer to market rates. The authorities could have gone much further in liberalizing interest rates and credit operations. In this respect, I welcome the authorities' intention to lower the legal reserve requirements with a view to reducing interest rate spreads and keeping deposit rates positive in real terms.

Fifth, private savings and its efficient use could be raised by providing a macroeconomic framework in which inflation is low and incentives are predictable. To meet the required foreign financing needs, cautious debt management and adherence to the adjustment program are crucial to enhance the confidence both of creditors and investors. A successful negotiation and normalization of relations with bilateral creditors is also essential. While strong capital inflows are encouraging, foreign direct investment should be actively encouraged, particularly in cases which bring with them foreign technology and export markets.

Sixth, I strongly welcome the early unification of the exchange rate regime and the recent legalization of exchange houses. Curbing inflation, together with wage restraint, would prevent a deterioration in external competitiveness and simultaneously facilitate the maintenance of a stable exchange rate. The flexible exchange rate supported by tight financial policies and structural reforms would improve both private sector confidence and incentives for export diversification.

Finally, regular consultations with all parties concerned, especially with the labor unions and the national assembly, and strengthening social safety net measures, will help maintain the social consensus necessary to carry out the adjustment measures to their successful conclusion. It is also advisable that the authorities remain vigilant on the adverse effects of external developments.

Mr. Knight made the following statement:

Honduras is to be commended for its sustained progress in implementing economic reforms. Building on a successful stand-by arrangement, the pace of reforms is now being appropriately accelerated and intensified in the context of an ESAF arrangement. Honduras will be the first among the newly ESAF-eligible countries to follow this path. The general design and intention of the medium-term program seems sound, and we have no difficulty in supporting it. Nevertheless, some key areas deserve further comment, if only to ensure a general consistency in approach.

In the fiscal area, we would strongly encourage the authorities to pursue their planned civil service reforms aimed at reducing staff numbers while undertaking an upgrading of salaries where appropriate. This course of action seems the only fiscally consistent approach that can assure a reasonable degree of competence and expertise in the civil service. Given the impressive scale of reforms to be undertaken, there is a clear need for administrative capacity to be enhanced.

The planned improvements in public sector enterprises are also welcome and should go a long way toward strengthening public sector finances as well as facilitating eventual privatization objectives.

On monetary policy, I am pleased to see the authorities' intention to move toward greater use of open market operations and less reliance on reserve requirements and other direct controls.

The continuing inadequacy of banking competition, as evidenced by the very large spread between deposit and lending rates, is a problem that needs to be addressed more seriously. The proposed easing of entry requirements for new banks will assist, as will the lowering and eventual removal of reserve requirements. But the intention to impose reserve requirements on nonbanks must be regarded as a backward step. It is normal for the activities of nonbank financial intermediaries to develop and flourish only where there are significant constraints on the activities of banks. The preferred solution is surely to remove those constraints, as far as possible, rather than use scarce resources to further complicate official oversight of the financial system.

I should, perhaps, interpose the comment that those remarks do not represent instructions from my Australian authorities, who are themselves embarking on a similar endeavor, but rather from my own personal experience in New Zealand of the futility of such action in terms of either financial sector efficiency or the successful implementation of monetary policy. And I can speak, knowing that New Zealand has almost the lowest inflation rate in the world currently.

In this respect, the stated objective of a level playing field for financial institutions is, in my view, being pursued from the wrong direction. Prudential controls should be regarded as a necessary evil, their scope being limited by the authorities' need to ensure that banks are properly capitalized and well managed. It is all too easy for banking supervisors to begin to assume the role of bank managers. This process is unlikely to assure the survival of banks, but is almost certain to pose moral hazard problems for the real bank managers and their customers.

I also wonder whether the creation of exchange houses merely reflects constraints on the ability of banks to conduct foreign exchange business. One would expect efficiently functioning fully competitive banks to be able to service the foreign exchange needs of the community well. I would be grateful for staff comments on both of these points.

The medium-term outlook makes clear the risks inherent in this program stemming from the possibility of unfavorable external developments. Those risks will be most acute in the first two years when financing gaps are widest. The program itself incorporates fairly optimistic assumptions on export revenues and private capital inflows. While these projections are not necessarily unrealistic, their realization will obviously require firm adherence to the economic reform agenda. In this respect, the authorities should attach particular importance to the removal of constraints on inward private investment.

Finally, the authorities deserve to be commended for their successful operation of social safety nets. As other cases constantly remind us, such measures have an important role to play in ensuring the political viability of economic reform. We support the proposed decisions.

Mr. Nakagawa made the following statement:

Like other speakers, I welcome the Honduran authorities' adoption of a medium-term economic program to continue the stabilization effort and to consolidate and deepen the significant progress made so far under the stand-by program. As the staff report and Mr. Torres's opening statement note, the improvements in Honduras's economy in 1991 were remarkable. I welcome this achievement and commend the authorities' efforts. In particular, the significant reduction in the central government deficit and in the overall public sector deficit is highly welcome.

With respect to the medium-term program, I certainly agree that it is comprehensive and ambitious and deserves support by an arrangement under the ESAF. I would like to encourage the authorities to be strict in maintaining their commitments under the program, so that they can further improve their creditworthiness. Because I broadly agree with the staff appraisal, I would like to comment mainly on the program's fiscal and monetary policies.

This chair still has some doubts about the Central Government's fiscal stance this year, which permits an increase in the deficit of 1 percentage point of GDP. I would also like to register my concern that the projection for the improvement in the overall public sector deficit this year might be on the optimistic side. Given the need to strengthen capital expenditure in the coming period, while improving the external current account balance, there is a strong case for the authorities to further strengthen the central government balance. Therefore, a further strengthening of revenue and a reduction in expenditure would be called for. I certainly welcome the tax reforms that the authorities have implemented so far and their intention to pursue further tax reform in the near term.

In this connection, I am slightly uneasy about the Central Government's small revenue loss this year owing to the elimination of the export tax on traditional exports and the reduction in the coffee tax. I would like to caution the authorities to pursue revenue-neutral or revenue-strengthening tax reform assiduously for the next fiscal year. The planned reform of the sales tax to increase its rate and coverage should produce more than enough revenue to offset the revenue loss resulting from the elimination of the remaining export tax. I would welcome a more detailed explanation by the staff on this point. Also, I would appreciate the staff's comments on the possibility of introducing a more comprehensive value-added tax in the future.

On the expenditure side, I welcome the authorities' determination to contain the wage bill through a 10 percent reduction in the Central Government's labor force. On the other hand, the 1991/92 fiscal year budget provides some compensation for the loss in real wages experienced during the past several years by permitting a wage increase this year that is almost identical to the projected inflation. I am wondering whether the size of the wage increase could be adjusted based on developments in inflation this year. Could the staff explain how the wage increase in the public sector is determined? I would like to have a confirmation that there is no indexing system.

Turning to monetary policy, I welcome the measures taken by the authorities to allow more flexibility in interest rates. I hope that the upper bound of lending rate spreads will also be abolished soon, as the lower bound was eliminated this spring.

I also welcome the reduction in the subsidies on rediscount rates on directed credit lines by the Central Bank--a step in the right direction, because preferred interest rates could have shortcomings, such as allowing credit extension to inefficient and unviable firms. However, if used properly, they could have merits too. For example, they could play a role in promoting and fostering the export sectors of the economy. In this respect, I wonder whether the authorities' decision to eliminate the remaining subsidy on central bank rediscounts by September 1992 is based on an assessment of the pros and cons of the preferred interest rate mentioned above. I would appreciate it if the staff could elaborate on this point.

The staff report notes that there are sizable nonperforming loan portfolios in the banking system. These bad assets need to be cleared in order for the financial system to be more efficient. I wonder how the authorities will tackle this issue, and what the impact will be on the Government's budget. I welcome the staff's comments on these points.

On external sector policy, I welcome the acceleration of measures to unify the exchange rate. I would also encourage the authorities to take the necessary measures to implement a new foreign investment code as soon as possible, as this code is expected to play an important role in revitalizing Honduras's economy.

The staff's analysis on the sensitivity of Honduras's balance of payments to the international prices of coffee and bananas indicates the vulnerability of Honduras's external balance. It also shows the necessity of strictly pursuing tight fiscal and monetary policy in the coming years. Premature relaxation of policies could easily wash away the achievements so far. This risk should be kept in mind especially in the immediate future, because an election is expected next year. With these comments, I support the proposed decisions.

Mrs. Martel made the following statement:

Like previous speakers, this chair commends the Honduran authorities for the results attained so far. Indeed, the measures adopted in 1991 have largely contributed to a significant improvement in the economic and financial situation and to a progressive return to normalization of relations with the international financial community. In 1991, real GDP growth rose to 2.2 percent; the rate of inflation declined to 21.3 percent; and the overall deficit of the public sector was reduced from 8.2 percent to 3.5 percent of GDP. These trends were confirmed by developments in early 1992.

I welcome the social measures designed to accompany the adjustment process. I refer to the creation and expansion of the two safety net programs and the medium-term policies aiming at strengthening primary services such as health and education. These positive moves need to be consolidated by putting in place tight economic and financial policies. The program, which has well-targeted objectives, relies on a large increase in domestic savings to be achieved through an improvement in the public finances and the reinforcement of structural measures.

The expected fiscal consolidation leads me to make three points. First, I noted the increase in the central government deficit by 1 percentage point of GDP in 1992. Steady progress has been made since 1989 in reducing this deficit. I do not underestimate the difficulties of the fiscal adjustment for the Government, and I am aware that, even with the average wage increase of 12 percent in 1992, the real wages in the public sector declined by around 40 percent between 1990 and 1992. A continued effort to limit public sector wage growth and, more important, current expenditure growth, will be central to the accomplishment of fiscal adjustment objectives.

Second, in this context, I welcome the Government's intention to reduce public sector employment. I look forward to the midterm review of the program to put in place the public sector reform which, with the assistance of the World Bank, should improve the overall organization and management of government functions and reduce further the size of the civil service.

Third, I understand that a review of the accounting system is under way at the Central Bank and that, with the help of technical assistance from the Fund, a more reliable estimate of central bank losses would be provided. I would appreciate it if the staff would comment, as was mentioned in the Board discussion in February 1992, on the possibility of identifying even roughly the impact of these losses on the fiscal deficit.

With respect to monetary policy, the progress registered on interest rate deregulation, the authorities' plan to eliminate the remaining subsidy on central bank rediscounts by September 1992, and the authorities' intention to pursue a tight credit policy are welcome developments. I note that the authorities intend to depend more on open market operations as a mechanism of monetary control and to reduce progressively the level of reserve requirements. I agree with the staff that it is important to control this shift, so that it does not give rise to new central bank losses. During the last Board discussion, this chair expressed concerns about the movement of disintermediation. In this respect, as well as for the creation of a more competitive business activities environment, it is crucial that the financial sector reform law that strengthens prudential controls and imposes legal reserve requirements in nonbank financial intermediaries be presented to Congress rapidly. I also agree with the staff that the maintenance of real positive deposit interest rates is required if the imbalance between savings and investment is to be redressed.

As to the external sector, and especially to exchange rate policy, past successive adjustments of the exchange rate have borne witness to the difficulty of ensuring a sufficient degree of adjustment and, therefore, of credibility. Considerable progress has been achieved in this sector: the maintenance of exchange rate stability and the recent complete unification of the exchange rate are, indeed, indispensable factors in ensuring that the process of regaining credibility is continued.

On the external position, the program envisages a reduction in the current account deficit from 6.8 percent of GDP in 1991 to 4.7 percent of GDP in 1993, reflecting an improvement in the merchandise trade account. In spite of projected positive developments in this area, following measures to diversify the economy and to stimulate the growth of nontraditional exports, Honduras's external situation remains weak, and Honduras will continue to need external concessional assistance and debt relief. In this context, my authorities are ready, for their part, to consider rescheduling Honduras's external debt on Trinidad terms. In this respect, the authorities' record on the payment of unconsolidated debt is an important factor.

As to structural reforms, the Government should be commended for the bold liberalization action already undertaken. In order to meet the medium-term program targets on gross investment--projected to increase from 12.9 percent of GDP in 1991 to 17.5 percent in 1995--it is crucial that the planned reforms aiming at increasing competition and easing regulations governing business activities be adopted as soon as possible.

With these remarks, considering the progress registered so far, the ongoing consolidation process, and the commitment of the authorities to pursue tight economic and financial policies, I support the proposed decisions.

The staff representative from the Western Hemisphere Department noted that the inflation rate was declining. At end-June 1992, the inflation rate had been 7 percent on a 12-month basis, compared with the 12 percent projected in the program.

The projected rise in the central government deficit in 1992 was largely due to the increase in capital expenditures, which had been suppressed over the past few years, the staff representative observed. A curb on capital expenditures had been a negative element of the adjustment in 1991. In 1992, the program provided for an increase in capital spending of 1 percent of GDP. As indicated in the staff's opening statement, the authorities appeared to be exceeding that target, because the pace of the implementation of a major investment project in the first six months of 1992 had been faster than anticipated in the program.

The reduction in export taxes in 1992 was partly expediency, the staff representative commented. Because of the sharp decline in international coffee prices, the authorities had been forced to reduce the 7.5 percent tax on coffee exports, in order to improve the viability of the coffee sector. Moreover, they intended to move away from taxation on international trade toward taxation on domestic transactions.

The program provided for an increase in the national savings rate of 8 percent of GDP, one half of which was expected to come from the public sector, the staff representative said. Therefore, the public sector reform would be of crucial importance. The staff was of the view that an increase in the private sector savings performance of 4 percentage points over four years was attainable, given the recent measures taken to liberalize the exchange system, bring the nonbank financial intermediaries into the mainstream, and establish more confidence in those institutions. With the decline in inflation, interest rates were now positive in real terms over the whole range of deposits, including savings deposits.

As to the measures envisaged in addition to the reduction in the reserve requirements to help narrow the large spread between deposit and lending rates, one important element was an increase in competition in the banking system, the staff representative explained. Following the easing of requirements for the entry of new banks, one new bank had been established. As part of their efforts to make customers more aware of the need for competition in the banking system, the authorities now required commercial banks to advertise their rates publicly.

The partial data for the first six months of the year suggested that real GDP was increasing at a rate of 3 percent of GDP, in 1992, in part because of some recovery in the manufacturing sector, the staff representative remarked. That recovery was the result of the liberalization of price controls, the opening up of the Central American market, and the decline in interest rates.

The legalization of the exchange houses was a device used to initiate the liberalization of the exchange system, the staff representative commented. Existing laws had imposed restrictions on commercial banks to deal freely in foreign exchange. One such law, the law of repatriation, required commercial banks to deal in foreign exchange only at an interbank rate, and thus the idea was to legalize exchange houses, to provide a free foreign exchange market. Subsequently, the authorities had been able to change the arrangements imposing those constraints on the commercial banks. Now the commercial banks are allowed to negotiate freely for foreign exchange. Apparently, the strength of the commercial banks in the exchange system was such that--notwithstanding the legalization of eight exchange houses--only one exchange house had opened.

The 12 percent wage increase in 1992 should be evaluated in the context of the reduction in real wages of 35-40 percent that had occurred since 1990, the staff representative remarked. The wage policy pursued by the authorities was not based on automatic adjustment or indexation.

The nonperforming loans in the commercial banking system were in the private banking system, the staff representative explained. There were no state banks in Honduras, and the Central Bank had no plans to provide subsidies or any other assistance to those banks.

The data provided by the Central Bank had indicated that the Central Bank had, in fact, made a small profit, the staff representative from the Western Hemisphere Department remarked. The staff had some questions about that information, notwithstanding efforts by the authorities to remove some sources of central bank losses by eliminating interest rate subsidies and doing away with foreign exchange guarantees. The Central Bank of Honduras did not currently issue its own stabilization bonds but the staff still held the view that the Central Bank's own debt-service costs ought to result in some losses. The staff was continuing to examine the issue. A project on central bank statistics and accounting was being conducted throughout the region, and the staff expected that the project would yield a better estimate of those losses.

Mr. Knight remarked that the description of Honduras's experience with respect to exchange houses parallelled New Zealand's. Once his authorities had, in principle, opened up the foreign exchange market by authorizing foreign exchange dealers, giving commercial banks full powers had led to the rapid demise of the exchange houses.

The extension of reserve requirements from banks to all financial institutions was, in his experience, fraught with difficulty, Mr. Knight recalled. It did not level the playing field. It did provide, however, considerable work for bank officers, which could be a disadvantage in an economy that was short of administrative resources. It did provide a delightful playing field for lawyers, who always found ways to get around those necessarily complicated requirements. New Zealand had now removed reserve requirements entirely, and most of the nonbank financial intermediaries had gone out of business. As a result, the financial sector was much more efficient, and so was monetary policy. He was concerned that the path being taken by the Honduran authorities was influenced only by the constraints on the banking system that prevented the banks from being the most efficient possible institutions and, therefore, the dominant players in the market.

The staff representative from the Western Hemisphere Department said that the rationale behind the proposal to extend the reserve requirements to the nonbank sector was to establish a level playing field. The extension of reserve requirements to the nonbank sector was expected to reduce the need for high reserve requirements in the commercial banks; indeed, the entire structure of reserve requirements could be considerably lower. Most of Central America had experimented with a system of reserve requirements in both commercial banks and nonbank financial intermediaries, which had worked reasonably well.

Mr. Nakagawa said that he wondered whether or not next year's fiscal reforms would be revenue neutral or revenue strengthening.

The staff representative from the Western Hemisphere Department replied that the next fiscal reform would need to strengthen revenues. The authorities' current plans were to eliminate the remaining taxes on international trade, including those on exports and the import surcharge. To compensate, the authorities were considering increasing the scope of the sales tax and raising its rates.

Mr. von Stenglin made the following statement:

> I am in broad agreement with the staff appraisal. Performance in the first year of the previous program was, indeed, disappointing, but in 1991 and in the first half of 1992, Honduras's economic performance improved significantly. I should like to join previous speakers in welcoming the authorities' success in bringing the economy back on a path toward greater macroeconomic stability.

It is encouraging to note that the staff expects Honduras to achieve external viability in 1996. However, this viability can materialize only if the authorities adhere to the agreed policy course. In view of the extremely vulnerable external position of the Honduran economy, the authorities should even consider strengthening their adjustment efforts in 1992 beyond the program's targets.

This need to strengthen efforts applies particularly to the planned increase in the Central Government's budget deficit in 1992, which is difficult to reconcile with the need to reduce inflation, strengthen the private sector, and consolidate the balance of payments. I am particularly struck by the erosion in the revenue position projected for 1992 and 1993. Moreover, the authorities would be well advised to reconsider the significant increase in the wage bill envisaged for 1992. They should accelerate the preparation of the public sector reform program to prevent the wage issue from falling hostage to political pressure in the 1993 election year. Furthermore, I wonder whether a stronger effort is not required to improve tax administration.

I have nothing to add to the monetary policy stance, which is quite appropriate, and, in this context, I should also welcome the efforts made in the area of financial sector reform. Those efforts, including measures to improve the flexibility of domestic interest rates, will be of particular importance to the stability of the recently unified exchange regime, as will the maintenance of tight financial policies. Needless to say, I warmly welcome the authorities' decision to unify the exchange markets prior to the agreed deadline.

Given Honduras's fragile balance of payments position, it is a matter of concern that it remains uncertain whether the residual financing gaps in 1992 and 1993 will be fully covered. In Table 8 on page 23 in footnote 5 of its report, the staff mentions that the gaps are only largely expected to be covered by external debt rescheduling. I would be grateful if the staff could give us a more precise assessment of the financing assurances for the first-year arrangement under the ESAF. Furthermore, I urge the authorities to continue their efforts to improve Honduras's payments record vis-à-vis official creditors; delays in discharging agreed payment obligations could jeopardize the needed balance of payments support. Timely support is all the more important, because Honduras remains dependent on exceptional external financing in order to restore a viable balance of payments position. I support the proposed decisions.

Mr. Végh made the following statement:

I am happy to support Honduras' request for an ESAF arrangement, following a satisfactory performance under the recently expired stand-by arrangement. Prudent policies and the recent reforms have led to a remarkable improvement in the internal and external position of the country, and the Honduran authorities should be commended for this performance. I am in general agreement with the thrust of the staff's report and will, therefore, limit my intervention to two points.

First, with respect to the policy mix, the fiscal adjustment undertaken during 1991 has been quite impressive, but there is room for additional consolidation, considering both the level of the existing deficit and the role of the public sector in the economy as measured by expenditures in relation to GDP. While I applaud the moderate reduction in the deficit programmed for the current and next years, as well as the pricing of electricity to better reflect long-run marginal costs, the current slowdown in the fiscal adjustment limits both the recovery of international reserves to more prudent levels and the expansion of credit to the private sector at a time when a recovery in the production of the traditional export crops is expected.

In this connection, I would like to call the attention of the Board to Table 5 on page 20 of the staff report in connection with the general question of sensitivity of the fiscal position to interest rate movements. We can see in that table, in the column corresponding to the preliminary figures for 1991, that interest outlays represented almost one third of central government expenditure and fully 40 percent of tax revenue. Of total interest outlays, about three quarters correspond to external debt and one quarter to domestic debt.

Given these proportions, fiscal accounts are highly sensitive to interest rate developments. In the case of external debt, given that Honduras operates within the dollar area and that at present short-term dollar interest rates are unusually low, any significant increase in interest rates in the future will affect fiscal outcome. In the context of domestic debt, the problem becomes one of potential conflict between monetary and fiscal policy. A restrictive monetary policy that may be necessary to fight inflationary expectations in the short term may become inconvenient or impossible because of its fiscal impact, namely, interest payments on domestic debt.

My second point refers to the absence of any initiatives on privatization in the program. Considering the magnitude of the public sector and the new orientation of economic policy, that omission seems a bit puzzling. Could the staff comment on the reasons for this?

Mr. Kural made the following statement:

The Honduran Government will use the support of the ESAF arrangement requested today to continue its stabilization process, streamline the structural reforms begun under the stand-by arrangement, maintain its market-based exchange rate policy to support the competitiveness of Honduran exports, and accelerate the financial and structural reforms adopted as part of the medium-term economic program.

The authorities made vigorous adjustment efforts during late 1990 and 1991 aimed at restoring growth and further reducing the fiscal deficit. The success of these efforts, together with credit restraint to combat inflation, have encouraged large private capital inflows and increased Honduras's net international reserves.

We fully agree with the staff view that the authorities' past efforts and present plans deserve Fund support through the requested three-year arrangement under the ESAF. This support will enable the authorities to supplement their present track record by continuing and reinforcing the medium-term adjustment program aimed at correcting Honduras's financial and external imbalances and the structural weaknesses of the economy.

My comments will focus on financial policies and the exchange rate regime. Given the risk that the 1993 election will cause slippages in the fiscal policy area, keeping the program on track will require firm implementation of the agreed expenditure policies, especially the sharp cut in public sector employment and the reduction of subsidies and transfers. The program should strengthen the permanent tax reform by replacing the remaining export taxes with sales tax increases. Experience warns us of the potentially destabilizing effects of commencing financial deregulation and capital account liberalization before inflation is fully under control, fiscal discipline ensured, and exchange rate restrictions completely eliminated. Could the staff comment on this issue of readiness for liberalization and provide fuller information on the present volume of nonperforming assets in the financial system and the operating costs of the banks?

It is widely believed that financial compression gives rise to economic inefficiencies and distorts resource allocation, with adverse effects on growth. It is not advisable to increase the interest rate on preferential lines of credit without first establishing some link between deposit rates and lending rates, because doing so would widen the spread between the negative real deposit rates and loan rates and strengthen the cost-push component of inflation through mark-up pricing. Excessive spreads can be avoided, either by removing the current ceilings on deposit rates or by eliminating the taxation of financial intermediation and relaxing legal reserve requirements. For this reason we applaud the authorities' plan to reduce the legal reserve requirements.

Even though late 1990 and 1991 saw Honduras achieve some improvement in its short-term prospects for foreign exchange flows through a combined rescheduling of arrears and debt service, the country's medium-term balance of payments outlook will continue to depend on firm implementation of appropriate fiscal and credit policies and structural reforms. This dependence underscores the importance of Honduras's current structural adjustment efforts, which involve removing existing restrictions on the ownership and leasing of agricultural land and modifying the exchange regime. It behooves the authorities to maintain an appropriate balance between progress with structural adjustment and the maintenance of macroeconomic policies. Now that its payment record has been improved, Honduras' next concern must be to correct its external position in order to preserve the growth momentum and stability of the economy.

The Executive Directors agreed to continue 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/92/93 (7/22/92) and EBM/92/94 (7/24/92).

4. STRUCTURAL ADJUSTMENT FACILITY, ENHANCED STRUCTURAL ADJUSTMENT FACILITY, AND ESAF TRUST - REVIEW OF OPERATION

Pursuant to Decision No. 9808-(91/114) SAF/ESAF, adopted September 4, 1991, the Fund has reviewed the operation of the Structural Adjustment Facility, of the Enhanced Structural Adjustment Facility, and of the Enhanced Structural Adjustment Facility Trust. The operation of these facilities and of the Enhanced Structural Adjustment Facility Trust shall be further reviewed not later than July 10, 1993. (EBS/92/106, Sup. 2, 7/16/92)

Decision No. 10089-(92/94) SAF/ESAF, adopted
July 23, 1992

5. STRUCTURAL ADJUSTMENT FACILITY - REVIEW OF POTENTIAL ACCESS

Pursuant to paragraph 4(1) of the Regulations for the Administration of the Structural Adjustment Facility within the Special Disbursement Account (Annex to Decision No. 8238-(86/56) SAF, as amended), the Fund determines that the potential access of each eligible member to the resources of the facility established by Decision No. 8240-(86/56) SAF, adopted March 26, 1986, as amended, continues to be adequate. The potential access under the facility shall be further reviewed before the increase in quotas under the Ninth General Review becomes effective in accordance with paragraph 3 of Board of Governors Resolution No. 45-2, adopted effective June 28, 1990, and in any event not later than July 10, 1993. (EBS/92/106, Sup. 2, 7/16/92)

Decision No. 10090-(92/94) SAF, adopted
July 23, 1992

6. ESAF TRUST - REVIEW OF ACCESS LIMITS

Pursuant to Decision No. 9810-(91/114) ESAF, adopted September 4, 1991, the Fund as Trustee has reviewed the maximum limit and the exceptional maximum limit on access to the resources of the Enhanced Structural Adjustment Facility Trust established by Decision No. 8845-(88/61) ESAF, adopted April 20, 1988. These limits shall be further reviewed before the increase in quotas under the Ninth General Review becomes effective in accordance with paragraph 3 of Board of Governors Resolution No. 45-2, adopted effective June 28, 1990, and in any event not later than July 10, 1993. (EBS/92/106, Sup. 2, 7/16/92)

Decision No. 10091-(92/94) ESAF, adopted
July 23, 1992

7. ESAF TRUST INSTRUMENT - AMENDMENT

The Instrument to Establish the Enhanced Structural Adjustment Facility Trust annexed to Decision No. 8759-(87/176) ESAF, adopted December 18, 1987, as amended, shall be further amended as follows:

(i) In Section II, paragraph 1(d), "1993" shall be substituted for "1992," to read as follows:

"(d) Commitments under three-year arrangements may be made during the period from January 1, 1988 to November 30, 1993."

(ii) A new subparagraph shall be added to Section II, paragraph 1, as follows:

"(f) The provisions of (c) and (d) above on three-year arrangements shall also apply to new commitments under paragraph 14(5) of the Regulations for the Administration of the Structural Adjustment Facility." (EBS/92/106, Sup. 2, 7/16/92)

Decision No. 10092-(92/94) ESAF, adopted July 23, 1992

8. STRUCTURAL ADJUSTMENT FACILITY - AMENDMENT TO REGULATIONS

Paragraph 14 of the Regulations for the Administration of the Structural Adjustment Facility annexed to Decision No. 8238-(86/56) SAF, adopted March 26, 1986, as amended, shall be further amended as follows:

(i) The second sentence of subparagraph (1) shall be substituted by the following:

"They shall remain available for disbursements until the expiration of any commitment under the Enhanced Structural Adjustment Facility."

(ii) Subparagraph (5) shall become subparagraph (6) and the following new subparagraph (5) shall be added:

"(5) If a three-year commitment to an eligible member has expired with undrawn amounts, the Fund may approve a new commitment for that member, subject to these Regulations, provided that the member submits a three-year macroeconomic and structural adjustment program and that the amount of resources that could be made available under the new commitment shall not exceed the undrawn amounts under the expired commitment. The new commitment may be made under a one-year or a two-year arrangement, as the case may be, with annual access to be determined on the basis of the strength of the member's program and its balance of payments need." (EBS/92/106, Sup. 2, 7/16/92)

Decision No. 10093-(92/94) SAF, adopted July 23, 1992

9. GREECE - ACCEPTANCE OF OBLIGATIONS OF ARTICLE VIII, SECTIONS 2, 3, AND 4

The Fund notes with satisfaction that, with effect from July 7, 1992, Greece has accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement. (EBD/92/147, 7/16/92)

Decision No. 10094-(92/94), adopted
July 22, 1992

10. LATVIA - REPRESENTATIVE RATE FOR LATVIAN RUBLE

The Fund finds, after consultation with the authorities of Latvia, that the representative exchange rate for the Latvian ruble, under Rule 0-2(b)(i), is the midpoint between spot buying and selling rates for the U.S. dollar in the exchange market as ascertained by the Bank of Latvia. (EBD/92/155, 7/20/92)

Decision No. 10095-(92/94) GS, adopted
July 23, 1992

11. JOINT COMMITTEE ON REMUNERATION OF EXECUTIVE DIRECTORS - GOVERNORS' VOTE

The Executive Board approves the report of the Secretary (EBAM/92/17, Sup. 2, 7/22/92) on the canvass of votes of the Governors on Resolution No. 47-18, with respect to remuneration of Executive Directors and their Alternates, approved by the Executive Board (EBM/92/73, 6/10/92) for submission to the Board of Governors. The Governors' vote on the Resolution is recorded as follows:

Total affirmative votes		672,955
Total negative votes		209,093
Total votes cast		882,048
Abstentions recorded	14,022	
Total replies		896,070
Votes of members that did not reply		109,730
Total votes of members		1,005,800

Decision No. 10096-(92/94), adopted
July 22, 1992

12. STAFF MEMBER - LEAVE WITHOUT PAY

The Executive Board approves the proposal set forth in EBAP/92/127 (7/20/92) concerning the extension of leave without pay for a staff member.

Adopted July 23, 1992

13. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 92/1 and 92/2 are approved.

14. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAM/92/42, Supplement 1 (7/21/92) and EBAM/92/51 (7/22/92) and by Advisors to Executive Directors as set in forth in EBAM/92/51 (7/22/92) is approved.

15. TRAVEL BY MANAGING DIRECTOR

Travel by the Managing Director as set forth in EBAP/92/122, Supplement 2 (7/23/92) is approved.

APPROVED: March 19, 1993

LEO VAN HOUTVEN
Secretary