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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 90/1

10:00 a.m., January 3, 1990

M. Camdessus, Chairman
R. D. Erb, Deputy Managing Director

Executive Directors	Alternate Executive Directors
	S. Gurumurthi, Temporary
F. Cassell	
C. S. Clark	
Dai Q.	
T. C. Dawson	
J. de Groote	
	L. B. Monyake
E. A. Evans	
	R. J. Lombardo
L. Filardo	
R. Filosa	
	S. K. Fayyad, Temporary
M. Fogelholm	
M. R. Ghasimi	O. Kabbaj
	B. Goos
J. E. Ismael	T. Sirivedhin
A. Kafka	L. M. Piantini
J.-P. Landau	
	B. A. Sarr, Temporary
Y. A. Nimatallah	M. Al-Jasser
G. A. Posthumus	
K. Yamazaki	

L. Van Houtven, Secretary and Counsellor
K. S. Friedman, Assistant

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Also Present

IBRD: F. Lysy, Latin America and the Caribbean Regional Office. African Department: E. A. Calamitsis, Deputy Director; G. E. Gondwe, Deputy Director. Asian Department: M. J. Fetherston. Exchange and Trade Relations Department: L. A. Whittome, Counsellor and Director; T. Leddy, Deputy Director; E. Brau, A. P. De La Torre. Fiscal Affairs Department: A. Ize. Legal Department: A. O. Liuksila, J. K. Oh. Middle Eastern Department: A. S. Shaalan, Director; P. Chabrier, Deputy Director; B. K. Short. Research Department: M. P. Dooley. Secretary's Department: C. Brachet, Deputy Secretary; J. W. Lang, Jr., Deputy Secretary; A. Tahari, T. S. Walter. Western Hemsiphere Department: S. T. Beza, Counsellor and Director; M. Caiola, Deputy Director; J. Ferrán, Deputy Director; R. A. Elson, H. Ghesquiere, G. R. Le Fort, C. M. Loser, P. J. Quirk, L. L. Pérez. Personal Assistant to the Managing Director: H. G. O. Simpson. Advisors to Executive Directors: N. Adachi, F. E. R. Alfiler, M. B. Chatah, A. Gronn, Z. Iqbal, J. M. Jones, J.-L. Menda, P. O. Montórfano, D. Powell. Assistants to Executive Directors: S. Appetiti, Di W., A. Y. El Mahdi, M. E. Hansen, M. Hepp, L. Hubloue, C. J. Jarvis, L. I. Jácome, P. Kapetanovic, C. Y. Legg, R. Marino, G. Montiel, S. Rouai, H.-J. Scheid, J.-P. Schoder.

1. INTERIM COMMITTEE - CHAIRMAN

The Chairman stated that a press release (EBD/90/3, 1/3/90) was to be issued forthwith announcing that The Honorable Michael H. Wilson, Minister of Finance, Canada, had been selected as Chairman of the Interim Committee.

2. REPORT BY MANAGING DIRECTOR

The Managing Director commented that it was important to reassure member countries in sub-Saharan Africa that the Fund would continue to make every effort to maintain its assistance to them despite the significant financial needs of Eastern European countries. To that end, he had recently visited Nigeria, Cameroon, and Côte d'Ivoire, all of which had undertaken Fund-supported programs and were among the group of low middle-income countries with sizable debt problems.

Prior to visiting Africa, he had met in Paris with the Egyptian Vice Prime Minister and Minister of Foreign Affairs, the Managing Director continued. Press reports had suggested that the discussions had been particularly intense; in fact, they had been friendly and frank. The Vice Prime Minister had praised the patience and efforts of the series of staff missions to Egypt and had restated his Government's commitment to make a strong effort at structural adjustment, in line with the thrust of the Fund's recommendations; in that connection, Egypt intended to reduce the budget deficit below 10 percent of GDP, from nearly 20 percent at the end of 1989. While the Vice Prime Minister had indicated that Egypt was also considering some adjustment of the exchange rate, the authorities still intended to delay by four years the unification of the exchange rates, and no decisive action had been agreed in the area of interest rate policy. The Vice Prime Minister had reiterated the reasons why exchange rate unification and an increase in the price of oil in Egypt to bring it closer to world prices were difficult at the present stage; he had mentioned in particular the high transportation costs facing Egypt's low-income groups.

He had stated that, while he was pleased with the policy intentions that the authorities had announced, he felt that an agreement between the Fund and Egypt was unlikely in the absence of action on interest rates and the price of oil, the Managing Director continued. In concluding the discussion, the Vice Prime Minister had mentioned that those areas were open to negotiation and that the authorities wished to see an early resumption of negotiations with the staff. He himself had replied that the Fund could not begin new negotiations before examining the results of Egypt's latest consultation with the World Bank--which should be completed in the coming weeks--on Egypt's liberalization and other structural adjustment policies. Thereafter, if the Government was clearly committed to announced budget policy and to making significant efforts toward exchange rate unification, real interest rate adjustment, price decontrol, and reform of public enterprises, then the Fund could consider starting new negotiations with the authorities.

There was clear movement in sub-Saharan Africa in the direction of the policies recommended by the Fund, the Managing Director stated. The Governments of Nigeria, Cameroon, and Côte d'Ivoire were unequivocally committed to structural adjustment.

In Nigeria, the key problems were the overhang of debt--the payment on the debt was equivalent to 83 percent of the revenues of the federal government--and inflation, which had begun accelerating at the beginning of 1989, the Managing Director remarked. He had discussed those problems with all the key members of the Government and the President, and he was impressed by the resolve of the President, who recognized that reaching both his major goal--to restore civilian democratic rule in the country by January 1992--and maintain social peace would be endangered if inflation was not brought immediately under control through a stronger monetary policy. The Government was committed to do that, and while there had been a reshuffling of ministers since his visit to Nigeria, the positions of the main members of the Government's economic team--the Minister of State and the Governor of the Central Bank--had been confirmed. That development, together with the personal involvement of the President in the adjustment program, led him to hope that the Fund would be able to continue to work with the authorities in 1990. All the performance criteria for 1989 apparently had been met.

In Cameroon and Côte d'Ivoire, the authorities faced a serious internal liquidity problem and intended to take additional steps as necessary, the Managing Director commented. In Cameroon, where the adjustment program was off track because of a shortfall in expected budgetary revenues, the Government was considering the adoption soon of a strong measure--a reduction of public sector wages, probably through the withholding tax on wages. Cameroon's fiscal effort had been very strong on the expenditure side, but the authorities faced difficulties on the revenue side. The President was the driving force behind the needed privatization and deregulation of the economy. Apparently in Côte d'Ivoire and Cameroon the concepts of liberalization and privatization were fully understood and accepted at the administration and public enterprise levels as being absolutely necessary, and good progress seemed possible in the coming months.

In Côte d'Ivoire, he had indicated to President Houphouet-Boigny the Executive Board's recommendation to cut public sector wages significantly and adopt major structural adjustment measures before the next review under the arrangement with the country, the Managing Director went on. The President had indicated that he wished to see all the relevant measures introduced by the end of March 1990.

He was pleased with the strength of the commitment to adjustment in Nigeria, Cameroon, and Côte d'Ivoire, the Managing Director concluded. Of course, debt renegotiation was of crucial importance, particularly in Côte d'Ivoire, where the authorities had been encouraged by the very generous rescheduling granted by the Paris Club and were in the midst of negotiations with the commercial banks, which had made a first offer that was considered to be particularly constructive. The staff had worked very effectively in those three countries, but he was certain that additional work would be required for some time in order to place the economies on the path of sus-tainable growth.

3. VENEZUELA - REVIEW UNDER EXTENDED ARRANGEMENT

The Executive Directors considered a staff paper on the second review under the extended arrangement for Venezuela approved on June 23, 1989 (EBS/89/232, 12/4/89; and Sup. 1, 12/22/89).

Mrs. Filardo made the following statement:

> My authorities would like to express their appreciation to the staff of the Fund for its objective appraisal in the report and supplement prepared for today's discussion and for their assistance and support in this difficult process. In the past few months, several Fund missions have visited Venezuela and from there several missions at technical and at a very high level have visited Washington, especially the Fund, to exchange views on the evolution of the economic program, to report on the progress of the Venezuelan debt negotiations with commercial banks, and to reassure the Fund of the Government's commitment to execute the program as indicated in our two letters of intent of May and December 1989. Various meetings between the Fund staff and the group of economists from foreign creditors were also held in Washington, for discussions about the fundamental assumptions of the economic program and balance of payments projections. As the staff has rightly indicated in its appraisal in EBS/89/232, strong differences of view have prevailed within the Bank Advisory Committee on Venezuela's financing gap and the building up of reserves.
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> In the last Board discussion on Venezuela, a large majority of Directors expressed their concern about the lack of progress in the Venezuelan negotiations with commercial banks and urged the authorities to move expeditiously to obtain the interim financing needed to clear arrears to the banks. As the Board well knows, since last February various attempts were made by the authorities to reach an agreement with the banks for interim financing. The only solution encountered, satisfactory to the banks, was that the Venezuelans would have to contribute approximately $500 million from their international reserves to obtain a short-term loan of $600 million, to be repaid between December 1989 and March 1990 and a retiming of interest of $500 million.

In the meantime, the authorities have made strenuous efforts to secure the external financing of the program by meeting with the banks on a biweekly basis and by making different voluntary market approach proposals, to accommodate the banks' preference, in the context of the program. The result of these negotiations until now has been that a large part of the 1989 financing gap is still underfunded and the counterproposal from commercial banks, if accepted by the Venezuelan authorities, will imply a serious problem of free riders. My authorities made a counterproposal again last December, broadening the menu, and they expect during this January to intensify their efforts in order to reach an agreement in early 1990.

The experience so far with the debt strategy, not only by Venezuela, but also by other countries involved, is completely unsatisfactory and harmful to the countries' economic program and to the credibility of this institution, in that most economic programs have ended by being underfinanced and the process of negotiations has proven long and painful for all the parties concerned, and with the result of poor agreements. These, far from being a solution, could be translated into an even worse situation for the country, which would have to adjust more than could be tolerable; for the Fund, which would have to continue supporting nonviable programs--probably in the short run substituting for commercial bank financing. Meanwhile, the secondary market price of the highly indebted countries' debt will continue to deteriorate as a result of a diminished payment capacity, derived from the mounting debt overhang and from more adjustment.

We in the Board have to reflect seriously on the necessary link between a good growth-oriented economic program and the need for financing, and which avenues have to be undertaken to smooth the process. Especially when structural reforms are involved, a long-term program and long-term financing are required. Nevertheless, after nearly a decade of the debt crisis, it is clear that multilateral institutions do not have and will not have sufficient resources to fully support these programs. It is also clear that commercial banks, under present accountancy and tax regulations, do not want to participate in a strategy that involves new money and a debt reduction scheme. Thus, one has to recognize that if we want the process to continue, it will be a long one, and a balanced burden sharing between the country's adjustment program, the multilateral institutions, and the commercial banks has to be clearly defined from the beginning of the program and the financing package negotiated along these lines.

On various occasions in this Board, I have emphasized the need for more efficient use of Fund resources. When we endorse economic programs, one of our main goals is to promote a more efficient use of resources in the economy of a member country. The alternative ways to fulfill these goals are for a member country not only to implement a good program, but also to soundly manage its assets and liabilities; therefore, when needed, good use of the secondary market price for its debt should be made. I have also stated the need to promote a concerted-voluntary approach to the debt strategy, under which commercial banks will have to participate in a financing package but would have the option to select an item in the menu most convenient to their interests from the point of view of their balance, accounting, and tax regulations. For this to take place, it is important that both the Board of this institution and the authorities of the country be aware that a deal has to be consistent with the program, for which early participation of the staff from the Research, Exchange and Trade Relations, and Western Hemisphere Departments is of fundamental importance for the definition of minimum parameters for the negotiations that will be consistent with the member's economic program. While negotiations are taking place, arrears, if unavoidable, would have to be tolerated and monitored. We should not impose pressure on the authorities either to clear arrears or to accept a deal contrary to the interests of the program, especially when it is on track; otherwise, we could endanger the program, as has been the case with Venezuela at the end of 1989 and could still be so at the beginning of 1990.

The Venezuelan authorities made a counterproposal to the Bank Advisory Committee on December 19, 1989, as is explained in the staff report. The first reaction from that Committee was not to accept the proposal, in view of the reiteration by the Venezuelans of the program's financing gap and of the need for the banks to fill the gap either through the different items in the menu or through a five-year new money scheme, interest reduction or a capitalization facility equivalent to a yearly average of 5 percent of the principal outstanding of credit subject to negotiations. Nevertheless, from further reactions by the banks, it would appear that they prefer to negotiate by stages, responding favorably to the authorities' new money option in the proposal, which they expect to be negotiated during the first days of January. The authorities are making all efforts possible to speed the conclusion of the financing package in the beginning of 1990, for which they have programmed meetings with the Committee on January 8 and 9, 1990 and, if necessary, on a daily basis. They expect all the parties in the strategy to give them their full support now and in the future. It is my authorities' view that, at this stage of the process, the support of the international community is even more crucial, especially if we really want to protect the program, on which Venezuela has overperformed in spite of a lack of financing.

As the staff supplement indicates, the cash flow of Venezuela is very tight in view of the repayment of the interim financing of $600 million for the first quarter of 1990, a bridge of $500 million from the BIS, and $1 billion in interest payments to the banks on medium and long-term obligations subject to rescheduling. Therefore, if the banks do not agree on a financing package very soon, arrears will be unavoidable, as the gaps for 1989 and 1990, $1.9 billion, remain to be filled.

For almost a year, since February 1989, Venezuela's new Government has implemented one of the strongest adjustment programs in Latin America, aiming at correcting the country's internal and external disequilibria derived from past external shocks and bad policies and at laying the foundation for sustainable economic growth and price stability. The fiscal deficit was reduced from approximately 10 percent in 1988 to nearly 2 percent during 1989, 2 percent more than was programmed. Lending interest rates were raised from 13 percent to 45 percent and deposit rates from the minimum of 8 percent to a minimum of 30 percent. The multiple exchange rate system was eliminated, the exchange rate of the bolívar was floated, and the currency depreciated from Bs 14.50 per U.S. dollar, to Bs 37-38, and more recently to Bs 43-45. The prices of gasoline and of most public goods and services were substantially increased, and the large majority of subsidies was eliminated. The impact of these adjustments has contributed to steadily reducing inflation, from 21 percent in March (911.7 percent on an annual basis) to 1.2 percent in November (16.7 percent on an annual basis). In terms of expected inflation, lending and deposit interest rates at present are substantially positive. Nevertheless, the economic contraction has been dramatic as a result of the adjustment. This is a great concern for my authorities, in view of the fragile social and political stability of the country and given the future adjustment in the prices of gasoline and goods and services that has to be undertaken at the beginning of 1990. Preliminary figures indicate that real GDP for 1989 declined by 8.1 percent, total non-oil GDP by 10.2 percent, and private sector GDP by 12.6 percent. Among these, construction decreased by 30 percent, manufactures by 12.4 percent, and agriculture by 5.7 percent. Unemployment increased from 6.9 percent in the second semester of 1988 to 8.7 percent in the first semester of 1990. My authorities consider that these matters deserve special attention, not only because of the economic and political stability of the country, but also as the Venezuelan labor force is growing at 3.5 percent on an annual basis, and the Government has envisaged a program to reduce the size of the State and to promote the private sector, which seems to have been deeply affected by the shock program.

As is indicated by the staff, most of the performance criteria were observed except for two--for which we are requesting waivers--net international reserves and net domestic assets. These were not observed because of a lack of external financing and the clearance of arrears with the commercial banks using Venezuela's own resources. All economic policies have been implemented as envisaged in the program and structural reforms have been seriously undertaken in all areas. Trade and structural policy loans were agreed with the World Bank. Tax reform and the value-added tax project were introduced in Congress, to be discussed next year. The privatization process started by establishing the proper institutional structure and regulations and by drawing up a list of possible candidates, such as commercial banks and hotels.

Two missions from the World Bank and the Fund and a representative from the Inter-American Development Bank visited Venezuela for an evaluation of the financial sector aimed at the achievement of a comprehensive reform. The final reports of these missions are to be finished soon; at the same time, work in Venezuela has continued, since these reforms will affect various laws that have to be introduced in Congress by the middle of 1990. Meanwhile, the authorities have taken major steps toward the enhancement of monetary policy management in the context of present legal constraints and are implementing those measures that do not require legal reforms.

The current account of the balance of payments experienced a remarkable improvement: from a deficit of $4.7 billion in 1988 it shifted to a surplus of $0.8 billion in 1989, owing to higher than projected oil prices by $2, higher nontraditional exports, and lower imports as a result of the economic contraction. Nevertheless, the capital account deteriorated substantially resulting in a deficit of $2.9 billion, mainly as a consequence of the repayment of letters of credit to foreign creditors for $4.5 billion, which was compensated in part by repatriation of capital. As to external financing, Venezuela implemented the debt equity swap program as envisaged under the extended arrangement; it also received the financial support of the Fund, the World Bank, and the IDB, interim financing from commercial banks, and various bridges from friendly governments and the BIS. At present, the authorities are trying to obtain a new bridge loan from the BIS, given the difficult cash flow situation Venezuela is going to confront in the next few months. As I mentioned, the authorities expect to speed up the negotiations during January, and they look forward to receiving the full support of the Board and the international community for the present review and in the future.

Extending her remarks, Mrs. Filardo said that in its first 10 months the new Government had clearly demonstrated its commitment to the implementation of the economic program, as was reflected in the letters of intent of May and December of 1989. In his speech at the start of the new year, the President had reiterated that commitment and had delineated the economic outline for the 1990s, including major structural reforms under way, such as the fiscal reform, the value-added tax, the trade restructuring policy--not only in the industrial sector but also in the agricultural sector--the revamping of the financial sector, and the privatization of major nonbasic industries. The President had stressed that the Government intended to dampen the effects of the full implementation of those programs on the poorest part of the population.

It was important to note that the President's reiteration of his commitment to the adjustment program had been stated at a time of great political and social distress in Venezuela, Mrs. Filardo continued. The contraction of the economy in 1989 had exceeded 8 percent, and private sector GDP had declined by more than 12 percent. In addition, the Government's party had lost municipal elections held in December 1990, and the President faced stiff resistance from the trade unions, the private sector, and the opposition party to the implementation of many of the measures in the adjustment program. Nevertheless, the President and the rest of the Government firmly believed that the adjustment program was the only way to solve the economic crisis and move the economy in the direction of growth and price stability. The authorities believed that great caution was needed to protect the investment basis for future growth, and, in that connection, they hoped to obtain the Board's full support at the present stage.

Experience during the past 10 months in Venezuela and elsewhere clearly showed that the commercial banks did not wish to play a role in the debt strategy, Mrs. Filardo commented. At the same time, it was not completely clear what role the Fund and the multilateral institutions should play. She had firmly believed that, when a member country reached an agreement with the Fund, the staff should soon thereafter assess the alternative financing packages that should be consistent with the agreed adjustment program. If the staff waited to do so until after agreement had also been reached with commercial banks, there was a risk that programs could be underfunded. The Fund had the expertise to make such assessments, and the Executive Board had discussed the methodology for evaluating menus. Such efforts would certainly be in the interest of the Fund and member countries. When a member country's program was on track, the authorities should be able to count on the Fund's support; arrears should be tolerated, if necessary, and they should be monitored.

The process of adjustment was very painful, Mrs. Filardo said. A government had to be courageous to face the political and social difficulties that emerged in the process. Governments also had to face the complex process of negotiating with commercial banks, and, at the least, the authorities should be able to count on the support of the Fund.

Mr. Lombardo made the following statement:

I broadly agree with the staff appraisal and I support the proposed decision. Venezuela's progress in implementing far-reaching adjustment measures and structural reforms included in its medium-term strategy continues to be highly satisfactory. All the performance criteria have been met, except those related to the absence of adequate and timely financing from commercial banks. It is particularly worrisome that, despite Venezuela's strong determination to stick to its adjustment program and the efforts made to reach an agreement with commercial banks, the required external financing in support of the program has not been achieved.

We also share the authorities' concern about the larger than expected contraction in economic activity in 1989. In our view, this result is a reflection of the costs of the far-reaching domestic adjustment and is not independent of the absence of the required external financial support.

I will concentrate my comments on the two specific issues to be addressed in this second review--the implementation of interest rate policy, and the progress made in securing external financing for the program.

We recognize the substantial progress made by the authorities in achieving a more efficient financial system. In this connection, it is encouraging to note that the Supreme Court rule establishing limits on interest rates seems not to have unduly constrained commercial bank lending rates and thus has not impeded the operation of market forces. The achievement of positive real interest rates in terms of expected inflation is certainly welcome.

The authorities have noted that additional flexibility in pricing loans by commercial banks results from the practice of partial prepayment--that adds about 5 percentage points to the effective cost of borrowing--and the practice of charging fees and commissions. However, these practices can also have a negative effect in terms of the effective cost of borrowing. In this regard, transparency is a crucial feature for the efficient operation of financial markets, and every effort should be made to publish all the information related to additional fees, commissions, and partial prepayments in order to have a clear assessment of the effective cost of borrowing. Furthermore, all these additional factors affecting the effective cost of lending, and the apparent absence of similar mechanisms affecting deposit rates, suggest the existence of a wide range for the bank's effective margin between lending and deposit rates.

We note that some restrictions and inefficiencies still persist in the financial intermediation process, and that the authorities continue to move in the right direction, adopting the necessary actions. In this regard, the measures being considered to enhance the management of monetary and credit policies are very welcome. Especially important are the planned issue of the Central Bank's own securities, the transformation of the Central Bank's money desk into a system of open market operations, as wellas the development of an active secondary market. The prospective reduction of the subsidies included in the preferential interest rates is also a welcome step in the right direction. The program of financial sector reform to be presented to the National Congress in early 1990, which the authorities expect will be supported by the World Bank and the IDB, is certainly a key structural element in the development of an efficient market-oriented financial system.

As to the prospects for external financing, we fully share with the staff and the Venezuelan authorities the very serious concern about the lack of responsiveness of commercial banks to Venezuela's need for external support. The Bank Advisory Committee does not accept either the menu of components proposed by Venezuela or the financial gap envisaged in the program agreed with the Fund. The commercial banks' attitude implies in essence that an alternative program has to be discussed with the banks, since they do not accept the external financing gap already agreed by Venezuela and the Fund. The country is in this way subject to a kind of two-step negotiation process that may negatively affect the credibility, and consequently the success, of the program.

If delays in reaching an agreement with commercial banks persist, they will not only threaten the economic program but also have two additional consequences--a significant shortfall in the target for net international reserves, particularly in the first quarter of 1990, and/or a temporary delay in interest payments to commercial banks. It is clear that both consequences are highly undesirable, will have a negative domestic impact, and could cause additional problems in the implementation of Venezuela's economic program.

However, we strongly believe that the absence of external financing should not imply an additional adjustment effort beyond the one previously agreed between the Fund and Venezuela, and which the country is already successfully implementing. A renewed effort to gain the cooperation of commercial banks is needed, and the Executive Board should proceed vigorously in order to protect Venezuela's program, which has been supported and approved by the Fund. In this connection, we can go along with the suggestion in the staff report to allow an increase in arrears on interest

> payments to the banks up to the amount of financing sought from the banks for the program. Furthermore, we believe that governments of creditor countries should use any other kind of available persuasive mechanisms to convince banks to perform their task of supporting a country that is implementing a successful program.

Mr. Gurumurthi said that the authorities were to be complimented for implementing a strong and comprehensive adjustment program. Significant progress had been made in the implementation of structural reforms in the fiscal, trade, and financial areas, and all the performance criteria had been observed except for the net international reserves and net domestic assets of the central bank owing to the absence of medium-term financing from the foreign commercial banks and the use of central bank reserves to pay interest arrears to the banks.

Despite the progress made by Venezuela in implementing the adjustment program, final agreement on a financing package with the foreign commercial banks had not yet been reached, Mr. Gurumurthi remarked. He welcomed the interim arrangement under which Venezuela had avoided interest arrears to the banks and had postponed to 1992 the remaining interest obligations due in 1989. He fully shared the staff's concern about the fact that, despite Venezuela's efforts, the banks had not been fully responsive to the proposals made by the authorities. In the circumstances, he supported the request for a waiver for the nonobservance of the performance criteria at the end of September 1989 for the net international reserves and net domestic assets of the Central Bank. The proposed decision was acceptable.

Mr. Ismael made the following statement:

> The Venezuelan authorities deserve to be strongly commended for the valiant efforts they have been making over the past long months to put their economy back on a sustainable path. Significant headway has been made in fiscal and financial reforms. However, only some of the economic aggregates have begun to respond favorably.
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> The economy has shown signs of further contraction. Nonetheless, the authorities must continue their determined efforts, which should soon instill confidence in the private sector and induce it to undertake more economic activity. Performance on the price front has shown some improvement, particularly in November. I wonder, however, what effect the recent increase in wages will have on inflation in 1990, and whether such an increase might best have been avoided for the time being in order to contain inflationary expectations.
>
> Strong oil prices helped underpin an improvement in the fiscal position in 1989. A gradual increase in oil prices is assumed

to continue. This does not, however, abrogate the need to pursue the fiscal reforms contemplated under the program. Tax and expenditure reforms, as well as reform of public enterprises, should be continued with vigor.

I noted the positive contribution of monetary policy to the 1989 program, and I greatly welcome the progress being made in the area of interest rate policy. I would like to know whether the authorities are planning to amend the law that makes interest rate controls mandatory; and if not, whether any impediment exists to prevent the authorities setting a wider band between legal minimum deposit and maximum lending rates. This may help to promote greater flexibility without repeated adjustments of the bands, which may have negative effects on market confidence. I encourage the authorities to continue their endeavors to develop money market instruments and to strengthen the financial institutions in order to provide a firm basis for private savings. I welcome the technical assistance provided by the World Bank and the IDB in the area of financial sector reform. In addition, I noted that the increased flexibility of exchange rate policy has not led to undue instability of the bolívar.

It is indeed regrettable that negotiations between the authorities and their commercial bank creditors have not resulted in a mutually acceptable outcome. This has led to Venezuela's failure to observe its performance criteria related to the international reserves and net domestic assets of the Central Bank. I agree with the authorities and the staff that debt reduction and debt-service reduction are crucial elements of the adjustment program. The absence of those elements may necessitate a degree of credit restraint that is unsustainable and would compromise what is already a weak economic recovery.

Efforts are required by all the parties concerned. The Venezuelan authorities appear to be doing what they can to secure the required financing. Besides negotiating intensively with their commercial bank creditors, they have correctly shown their determination to get their economy back on its feet by undertaking a strong adjustment program. The Fund has shown confidence in the program by approving an extended arrangement for Venezuela and providing substantial financial resources. It is therefore fitting that the banks should play their part in ensuring a successful outcome. In principle, I agree that it would be desirable for a "balanced burden sharing" to be clearly defined from the beginning of a country's program and for the financing package to be negotiated along these lines. In practice, however, one must take into consideration the fact that obtaining financial commitments from commercial banks for, say, three years in advance, is a mammoth task and could very well substantially delay the start of a program.

I am relieved to note from Mrs. Filardo's opening statement that, in the case of Venezuela, there is a good chance that a satisfactory arrangement can be worked out in the next few weeks. Regarding the banks' own estimate of Venezuela's financing gap for 1989, I wonder whether the staff has looked at it with a view to determining what additional measures would be implied by the smaller gap, and whether they are feasible. I would not advocate an extension of the interim financing except as a last resort, but the possibility should be explored nonetheless. Finally, I support the proposed decision.

Mr. de Groote made the following statement:

As when we first reviewed Venezuela's Fund-supported program, today's documents once more lead us to the conclusion that this country deserves our full support, and I therefore favor the proposed decision.

The very substantial reduction of the inflation rate from its destructive level of a year ago reflects the program's close attention to this target. Reducing and then stabilizing the inflation rate are crucial for maintaining and strengthening the political and social consensus around the program. Unfortunately, since the first review, it has not been possible to maintain the same pace of progress we noted then; in fact, consumer prices rose by some 75 percent between January and October, exceeding the program's projection of about 60 percent. When we first approved this program, I raised the question whether the assumptions about the slowing of price increases were realistic in light of the program's price, tariff, and fee adjustments; the reply I received was that these expectations were not overoptimistic. It would be interesting to know how the staff assesses this point now, with the benefit of hindsight. Of course, not all of these price increases are inflationary in nature; many of them represent corrective price adjustments. It would therefore be helpful to have the staff's assessment of the share of the overall price increases that is accounted for by corrective price adjustments, and the share that stems from residual inflation, and the staff's view on the extent to which the nonobservance of the targets is due to the latter cause.

Another reason the inflation rate must be reduced still further is to obtain interest rates that are positive in real terms.

Positive real interest rates are necessary to obtain the desirable savings/investment relationship that is expected for the rest of the program and which is fundamentally necessary for its success. On this point, the staff correctly observes that the question whether these interest rates have been positive or negative in the recent past is essentially a question of definition. In my view, higher nominal interest rates would have been justified before now, and will definitely be needed should the future course of the inflation rate fail to match the recent progress indicated by the November data.

Bringing inflationary pressures under control is also essential to accomplish the needed diversification of the economy away from oil, a process that has the further advantage of improving Venezuela's overall competitive position. This brings me to my second point. The competitive edge gained at the beginning of 1989 has already been partially lost: the staff tells us that between April and September 1989, the bolivar experienced a real effective appreciation of about 15 percent. It would be very interesting to learn from the staff its assessment of Venezuela's competitive position during the last quarter of 1989, when the bolívar depreciated in nominal terms and wage increases of about 25 percent were agreed to take effect early this year.

My first reaction to the wage increases is that we must heed two imperative necessities: keeping a competitive edge for Venezuelan exports, and avoiding any further contraction of economic activity. The latter brings me to my third point, growth performance. Even though these aims of maintaining competitiveness and avoiding economic contraction may not be wholly compatible, I would like to know the staff's thoughts about the possibility of combining them. The larger than expected reduction of economic activity, estimated by the staff at 5-6 percent, is estimated by Mrs. Filardo to be more than 8 percent. Reductions of this magnitude should gain our immediate attention. They are not only a potential obstacle to the needed economic diversification and therefore to the adjustment itself, but also their unemployment effects pose a special threat to the consensus supporting the whole economic program. The explanations given for this disappointing contraction are not quite satisfactory. The staff rather cryptically suggests that the private sector's response to the program's incentives has been slower than anticipated. While this is undeniably the case, it does little to explain why the response was slower than anticipated. We need a thorough investigation of this problem. I wonder to what degree the private sector's unresponsiveness to the domestic economic environment can be attributed to the uncertainties surrounding the completion of a financial package with the foreign banking community. Is it not conceivable that uncertainty about the package's refinancing, by making domestic agents adopt a wait-and-see attitude, has undermined the expected effects of adjustment measures already taken? What is the relationship between the banks' continuing unwillingness to aid Venezuela with a debt rescheduling or debt-reduction exercise, and the disappointing growth performance?

My final point has to do with the very difficult issue of the financing assurances surrounding Venezuela's adjustment program. Let me say at once that I very much agree in principle with the basic view that the Fund should continue its strong support of Venezuela's efforts to achieve a mutually acceptable agreement with its creditor banks, and that Venezuela should therefore be allowed to make the scheduled purchase under its arrangement with the Fund. However, I must add that in my view we have reached the limit of the "reasonable period of time" that the guidelines stipulate for concluding a financing package between a member and its creditor banks once the Board has decided to approve an arrangement before the conclusion of such negotiations. Since we are approaching that deadline, a very thorough discussion of the financing assurances must be a prominent feature of our next review under Venezuela's arrangement with the Fund. This will require us to have a clear view of the basic elements of the situation. Does the problem consist of the risk that the Fund will continue to sink resources into an underfinanced program? In that case, should we decide not to do so? Or is the problem one of misunderstanding about the need for and possible magnitude of the debt exercise, as Mrs. Filardo suggests? The view to be taken on these issues will require a judgment about which side must now make further concessions in the negotiations--in other words, which side is "the bad guy" in this game, and to what extent each side is to some degree a "bad guy." Such a judgment must be based not just on a chronology of the proposals and counterproposals, but also on a detailed knowledge of their content and of the possible effects of their implementation on the Fund arrangement. Indeed, we need an assessment by the staff of the relevance and appropriateness of the various proposals that have been made, and I therefore strongly support Mrs. Filardo's suggestion that the staff should become more closely involved in analyzing the pros and cons of the different solutions, and in bringing out more clearly what would constitute an acceptable solution for all the parties involved.

If I may try, very cautiously, to anticipate some of the elements of such an assessment, I would say that it would probably require very thorough analysis of the basic requirements in terms of debt and debt-service reductions. Let me again use extreme terms here, just to galvanize attention. We could start by considering that the situation is entirely different from that of, say, Bolivia. For a country with prospects for good export growth, it is unlikely that the banks would accept a significant reduction in principal unless it were accompanied by recapture elements of the contingency clause variety. The need for reserve reconstitution would be greatly lessened if the banks would accept the introduction of recapture elements into a debt-reduction exercise. Indeed, the whole discussion about whether or not to reconstitute reserves and about the appropriate level of reserves would appear in a very different light if a contingency clause or some other form of a recapture element could be introduced into the contracts that the banks might be ready to negotiate with the Venezuelan authorities. I am therefore greatly interested in learning from Mrs. Filardo or the staff whether up to now any opposition to the introduction of such recapture elements has come from the banking community or from the authorities themselves. Who has an advantage in opposing what we could all regard as very essential progress?

Mr. Yamazaki made the following statement:

The economic performance of Venezuela in the past 11 months attests to the authorities' strong commitment to the resumption of external viability. Since embarking upon a courageous and radical transformation of the economy last February, the authorities have basically persevered with the program. They are to be credited with the favorable turnaround of the current account balance in 1989, although they have been helped by such favorable exogenous factors as the surge in petroleum prices. The higher than projected oil receipts also have helped the performance of fiscal policy exceed the program target. In our view, in light of the basically satisfactory performance under the program, as well as the commitment that the authorities have demonstrated, the authorities deserve our support for the completion of the second review under the extended arrangement as well as a waiver for the nonobservance of the performance criteria at end-September 1989.

Needless to say, the situation in some important areas remains precarious. The persistent intense inflationary pressure has been a cause for concern, although the fall in consumer prices recorded in November is encouraging. In order to bring the price movement under complete control, the authorities should intensify their efforts to increase the effectiveness of monetary policy. The current situation of the negotiations with commercial banks on the financing package, in particular, underscores the urgent need for the authorities to improve the open-market policy. Improved open-market operations would also be conducive to stabilizing the exchange market.

In this connection, it is essential for the authorities to maintain positive real interest rates. While we recognize the constitutional issue involved in the control of interest rates, we encourage the authorities to explore ways to eliminate interest ceilings. In this context, we would welcome the staff's comments on the authorities' plan to eliminate interest control. We are particularly interested in whether the authorities have any time frame in mind for the legal reform required for the elimination of the interest ceilings.

We attach importance to financial sector reform and welcome the staff's elaboration on the current situation of the financial sector reform program, which is expected to be submitted to the Congress early this year. Furthermore, we concur with the staff view that the authorities should make an effort to contain the public sector's demand for domestic bank financing until the external financing is secured.

We welcome the elimination of arrears on interest payments to the commercial banks in October. Although the staff paper does not appear to attach importance to the interim financing provided by the commercial banks, which enabled the Government of Venezuela to eliminate arrears to commercial banks, I would venture to say from my personal involvement in helping to arrange the interim financing that the agreement on that financing validates the willingness of all the parties concerned to work toward the conclusion of the negotiations on the financing package. It is our view that the significant momentum that began last year toward agreeing on a financing package has not yet been lost.

Since the strengthened debt strategy took effect, financing packages have been agreed in three cases. We believe that Venezuela will be the next country with which an agreement will be reached on a financing package. Having said this, we certainly share the concern expressed by the staff on the delay in the financing negotiations. However, it seems to us premature to make generalizations about the Venezuelan case. Only time will tell how effective the strengthened debt strategy has been, coming as it did after all the adjustment fatigue in indebted countries as well as the reduced cohesion among the commercial banks. Because the Board will have an opportunity to review the debt strategy in March, for the time being we would like to proceed along the path endorsed by the Interim Committee in both the spring and the fall meetings last year. Thus, while we sympathize with the authorities, who feel frustrated by the financing negotiations with commercial banks, and we encourage the authorities to redouble their efforts to conclude the negotiations as well as to persevere with the program.

Mr. Cassell made the following statement:

The staff papers before us send a mixed message: Venezuela's strong program continues to be on track, and the authorities have abundantly demonstrated their commitment to it; but there has been virtually no progress in the negotiations between Venezuela and its commercial bank creditors.

The contraction of the economy has been greater than originally expected--and, it seems from Mrs. Filardo's statement, even greater than indicated in the staff's latest forecasts. It is disappointing that this severe output loss has not been associated with a faster fall in the rate of inflation.

The cornerstone of the adjustment effort is fiscal policy, and here the authorities' performance has been particularly impressive. They have, of course, been aided by higher oil revenues, but they have also brought expenditure under control. I have one question here. The supplement to the paper says that the Government has agreed an increase in wages averaging 25 percent from January 1. Although this is well below the increase in prices in 1989, I would appreciate receiving some assurance from the staff that it is consistent with the program.

As to monetary policy, the decision of the Supreme Court last year that the abolition of interest rate controls was unconstitutional was certainly unhelpful. The authorities, however, responded with commendable flexibility, and were able to achieve positive real interest rates for at least part of the year, although, of course, as Mr. de Groote noted, the achievement does depend on the definition that one chooses to employ. Domestic saving must be encouraged, and I strongly urge the authorities to do all they can to maintain positive real interest rates. I agree with the staff that structural reform in the area of monetary policy is very important. The news that the authorities are negotiating a financial sector adjustment loan with the World Bank is very welcome.

While Venezuela's performance on the parts of the program that are under the direct control of the authorities has been excellent, progress on securing financing for the program has been very disappointing. There are still substantial differences between the views of the staff and the authorities on the one hand and the commercial banks on the other as to how the financing gap should be filled, and, indeed, what the financing gap is. This puts us today in some difficulty. On the one hand, we have Venezuela's firm commitment to the program--a commitment that surely deserves our support. On the other hand, the program is not fully financed, and our guidelines say that the Fund should be prepared to lend into a financing gap only when "it can be expected that a financing package consistent with external viability will be agreed within a reasonable period of time."

This case is but one example of what is becoming a major problem for the Fund: protracted negotiations with the banks are leading to a series of underfinanced programs. This situation is no help to the Fund, to the country concerned, or ultimately to the banks themselves.

It is not clear to me how the Fund should respond to this situation. In principle, I certainly sympathize with Mrs. Filardo and others who have suggested that we need a much closer watch over, and much more timely information on, the progress of the negotiations between a debtor and the banks, but this must be achieved while avoiding what I thought many of us accepted as a major danger in the circumstances, namely, of the Fund itself becoming involved in the negotiations. We do want the staff to be present as an observer, but once the staff is in the negotiating room, it might be difficult for the staff to stick to that role of observer. We might usefully discuss that difficulty among ourselves.

How should Venezuela's financing gap be filled while negotiations continue? There would seem to be three possible courses: increased adjustment to close the balance of payments gap; a rundown of reserves; or a withholding of interest payments to the commercial banks up to the amount of the financing being sought from them for the 1989-90 program. None of these is attractive to me. On the first, the authorities seem to be doing their utmost on adjustment, and it would not only be difficult for them to do more, it would also be difficult for us to ask them to do more in light of the state of the economy.

A rundown of reserves would increase the risks to Venezuela's other creditors and seriously undercut the aims of the program. Nevertheless, Venezuela's reserves appear to be fairly substantial, especially when gold holdings are taken into account. There might therefore be some scope for an exceptional use of reserves as part of a deal that promised medium-term viability. The important thing is that the reserves should not be used to finance current spending.

The option that the staff appears to favor is to make only partial interest payments to the commercial banks. This option, of course, puts the Fund in the position of endorsing arrears to commercial creditors, but, in the circumstances of this case, that outcome may be preferable to running down reserves.

But in reaching a judgment on this matter one needs to assess carefully the likely impact of such a move on the negotiations with the commercial banks. The Venezuelan authorities will need to form a clear view of whether withholding interest payments is likely to induce the banks to negotiate seriously or whether it would actually make them more intransigent. They also need to consider whether such an approach is sustainable in the longer term, should negotiations drag on. Interest arrears are a bad way in which to fill the financing gap while negotiations are continuing, but if the banks are not prepared to come to an agreement that provides for medium-term viability, it is difficult to see how arrears can be avoided, with or without the Fund's endorsement.

Given Venezuela's continued adherence to the program, I can support the completion of this review and a further disbursement under the arrangement. But I would stress that my authorities would wish to see substantial progress toward a satisfactory agreement with the banks by the time of the third review. It is not easy to judge who are the "good guys" and the "bad guys," to use Mr. de Groote's terminology. Although I have not been able to follow the negotiations closely, my impression is that both sides set out with proposals that revealed a high degree of unreality. Given that wide gap at the start, it is not surprising that the negotiations have taken a long time. We need, among other things, to find some way in which negotiations can begin with a higher degree of reality than apparently occurred in this case; that might help expedite their progress. The evidence in the paper seems to indicate that the commercial banks must bear much of the responsibility for the failure to reach agreement so far. I do not contest that conclusion. But the Venezuelan authorities must make sure that they too are negotiating realistically if they are to retain the support of the international community.

Mr. Al-Jasser made the following statement:

I commend the Venezuelan authorities on their perseverance with the adjustment program. The staff papers and Mrs. Filardo's statement detail the achievements that merit our continued support. Therefore, and since I have little to add to the staff paper and appraisal, I will restrict myself to a few general comments, particularly on the role of the Fund in the strengthened debt strategy.

Regardless of the outcome of the negotiations between any indebted country and its creditor commercial banks, perseverance with adjustment should be the bulwark of government policy. Adjustment should be pursued because it is good for the country, and not because it is necessary for the repayment of the commercial banks. A stop-and-go approach to adjustment is detrimental to the credibility of a government's economic policy and, therefore, its success; hence, that approach should be avoided. That being said, I would like to hear from the staff about the possibility of Venezuela intensifying its adjustment efforts, especially if the negotiations with the commercial banks drag on further.

The strengthened debt strategy provides for the possibility of debt and debt-service reduction, or the provision of new money, or a combination of these. However, given the protracted nature of some negotiations, is it feasible to envisage an outcome combining debt and debt-service reduction with new money that is satisfactory to all the parties concerned? Or will it be necessary for both parties to agree at the outset on either debt reduction or new money in order to facilitate the timely arrangement of financing assurances? I would appreciate staff comment on this prospect.

This point is particularly relevant to our revised policy on financing assurances. The Fund's toleration of arrears to commercial banks is of a temporary nature so as to allow or promote the expeditious conclusion of negotiations. But if the negotiations become protracted, as they seem to be in the case of Venezuela, the Fund, as an institution, may need to re-evaluate that policy. I realize that this is a most sensitive question, but the continuity of the adjustment process, and the integrity and revolving nature of the Fund's resources must be safeguarded.

My final point concerns the role of the Fund in the negotiating process. Clearly, while the Fund is not a party to the negotiations, it is an interested party with respect to the outcome of the negotiations. Therefore, the question comes to mind how the Fund could help the negotiating parties should an impasse develop. The case at hand may be an illuminating one. I would appreciate staff comment on these points.

With these comments, and in the light of the staff appraisal, I support the proposed decision in the hope that the negotiations will be concluded soon, so as to conserve the energies of the Venezuelan authorities for the more critical task of adjustment.

Mr. Landau made the following statement:

We are satisfied that the program remains on track and that all the targets at the end of September were reached, except those for the net international reserves and net domestic assets of the

Central Bank. The failure to observe those criteria is closely related to the question of the financing by commercial banks and, therefore, has to be considered in a more general context.

There is no doubt that the adjustment efforts that the authorities have made are beginning to bear fruit. In the area of fiscal policy, the preliminary information points to a large reduction of the overall public deficit for 1989. As to the rate of inflation, the latest figures are also very encouraging, and the results achieved in November--at a rate of 1.3 percent--are highly commendable. For the future, the Central Bank's ability to manage monetary policy is of the utmost importance in keeping inflation under control, and, in this context, the establishment of real positive interest rates seems necessary to enhance economic adjustment. Finally, in the external sector, the performance has been impressive: the sharp cut in imports has allowed a significant reduction in the current account deficit and a narrowing of the financing gap.

These results, however, have been costly, as adjustment puts a heavy burden on the real economy. Therefore, it is clear that, if the program must be maintained in order to eliminate the present imbalances, it is also critical that Venezuela be able to find rapidly the way to sustainable growth. Achieving this objective depends first on adjustment measures, such as rationalizing the public sector and modernizing the financial sector. But growth is also heavily dependent on the ability of Venezuela to meet its external financing needs. In this context, the impasse to date in the negotiations between the authorities and their commercial bank creditors is a cause for great concern.

As far as this institution is concerned, we recognize that the program is well implemented, but the financing assurances cannot yet be confirmed today, given the slow pace of the discussions. Thus, a difficult balance has to be found among different objectives. On the one hand, previous experience--for example in the cases of Mexico, the Philippines, and Costa Rica--shows that negotiations with commercial banks are lengthy. Therefore, it is not unusual to see that, in the case of Venezuela, such negotiations are difficult. Furthermore, were we not to authorize the third tranche today, we would run the risk of nullifying the progress that has already been made. But, on the other hand, we must avoid pursuing the transfer of risks to public creditors, as occurred in 1989, and we must encourage the conclusion of an agreement with the banks.

In this connection, critical issues have been raised by Mrs. Filardo in her opening statement. We think that these questions--including more involvement by the Fund staff in the negotiations with the banks--will have to be addressed. At this stage, it would certainly be difficult to come to a final judgment on these issues. But, in the case of Venezuela, two clear conclusions can be drawn. First, the continuing support of the Fund is highly warranted, notwithstanding the fact that financing assurances have not yet been provided. Second, as long as the program is on track, central bank reserves should be protected from the consequences of protracted negotiations with commercial banks. For this reason, partial payments to the banks could be tolerated as the negotiations proceed, to the extent that this would substitute for the financing expected from the commercial banks under the present program. However, this is an exceptional position owing to exceptional circumstances; I strongly hope that Venezuela and commercial banks will soon come to a mutually satisfactory agreement.

I fully agree with the staff appraisal and support the proposed decision.

Mr. Kafka made the following statement:

We commend the Venezuelan authorities for persevering with a strong economic adjustment program implemented through 1989. The results of the program are highly positive from the point of view of adjustment in spite of the shortfall in the medium-term external financing. In fact, according to the latest figures, the public sector deficit is a fraction of that originally programmed and the expected current account deficit has been converted into a surplus. In return, there has been a major deterioration in real wages during 1989, notwithstanding the lower monthly inflation rate during the second part of the year, and the contraction in real GDP will be even greater than expected.

During the past three months, structural reforms have continued in the financial, fiscal, and trade areas, while monetary and fiscal policies have remained on track. The authorities have increased the flexibility of interest rate policy. The Central Bank's rediscount rate and the yield offered in open market operations have been increased and are now positive in real terms compared to the last three months' annualized inflation rate. This development has undoubtedly contributed to the stability observed in the foreign exchange market during the same period.

However, the success of the program is threatened because of the shortage of external financing. In this regard, the crucial element is the financing agreement between Venezuela and its commercial bank creditors, the conclusion of which is taking much longer than expected. This delay is occurring despite the efforts of the Venezuelan authorities to implement the country's economic program and to avoid the accumulation of external arrears. In this latter context, Venezuela has even dangerously reduced the level of its readily available international reserves. As a result, Venezuela has been unable to observe the performance criteria on the net international reserves and the net domestic assets of the Central Bank for the end of September 1989. All the other performance criteria were fully met.

Venezuela's position in the debt negotiations has been flexible and cooperative. In this sense, the authorities have moved from their starting point of not considering a new money option among the alternatives of debt rescheduling offered to the commercial banks, and recently a menu of options--including new money--was presented to the Bank Advisory Committee. However, this new proposal also seems to be unacceptable to the banks, which apparently do not recognize the existence of either an external financing gap on the scale projected by the authorities, or a debt overhang that adversely affects economic activity.

We share the staff's concern about the impasse in these negotiations, because it can foster negative expectations about the future of the Venezuelan economy. Such a situation could create additional difficulties for the economic program, increase the level of the adjustment that is required, and, hence, raise the already high social cost to Venezuelan society. In this connection, we think that if the commercial banks remain noncooperative, external arrears on interest payments should be allowed to accumulate during the period of the negotiations, up to an amount equivalent to the resources required from the banks for the program for 1989 and, as far as necessary, 1990. This is a troublesome matter, but I see no other choice. I agree with Mr. Cassell that, on some future occasion, we should discuss the general questions this matter raises.

In conclusion, the Board should give full support to the Venezuelan macroeconomic program and approve the authorities' request for a waiver for the nonobservance of the performance criteria.

Mr. Sarr made the following statement:

We are encouraged by the updated information provided in the staff's supplement on the most recent economic and financial developments in Venezuela under the extended arrangement. As indicated in the paper and Mrs. Filardo's statement, the preliminary outcome for both the nonfinancial public sector and the external current account positions was better than expected, and, thanks to the positive contribution of monetary policy, the foreign exchange market is now operating smoothly despite some remaining uncertainty about the availability of external financing. Moreover, all the performance criteria set for end-September 1989 have been met, except for the targets on the net international reserves and net domestic assets of the Central Bank. The breach of these two performance criteria is due to the lack of external financing as well as to the heavy payment of arrears to commercial banks in late September 1989.

These are indeed encouraging developments, and the Venezuelan authorities deserve to be commended. However, there are some unsettling developments that could endanger the authorities' adjustment program. In particular, despite their strenuous efforts, the medium-term financing package expected under the program is yet to be secured, the magnitude of the contraction in non-oil GDP is now much larger than anticipated, and the consumer price index for the year as a whole is likely to be higher than initially envisaged. Under these circumstances, I concur with the staff that there is a crucial and urgent need for the authorities to conclude a satisfactory agreement with commercial banks while sustaining their adjustment efforts. I am in broad agreement with the thrust of the staff appraisal and I will therefore make only a few observations on monetary policy, fiscal policy, and external financing.

I welcome the progress recently made by the authorities in mobilizing financial savings and improving the efficiency of the financial sector. However, with all the difficulties they are encountering in mobilizing external financing, there is a case to be made for envisaging further tightening of monetary policy if the major gains made in the program are to be preserved. In this context, the short-term adjustment measures implemented to alleviate the most obvious distortions in the interest rate structure are appropriate. Nevertheless, the authorities will need to take a longer-term view on the conduct of their monetary policy in order to increase the efficiency of their financial system. The introduction of market-based instruments of monetary policy at the earliest possible time should be given a high priority. In this regard, the review of the financial system initiated recently and the authorities' intention to submit to Congress a proposal for financial reform are encouraging.

The results achieved so far in the fiscal policy area have been better than anticipated. The fiscal structural measures submitted to Congress in the framework of the 1990 budget, particularly in the area of the petroleum tax, income tax, value-added tax, and expenditure restructuring, are commendable and will undoubtedly play an important role in achieving the program's objective of a fiscal balance by 1990. Perhaps the staff could provide us with the latest information on the status of these fiscal measures.

Despite the improvement in the external sector in 1989, the program's medium-term outlook remains clouded by uncertainties as to the timing and magnitude of the external financing to be mobilized from commercial banks. As is indicated by the staff, it was expected that the elimination of interest arrears to commercial banks in late September 1989 and the most recent proposal made by the authorities would have facilitated progress in the negotiations for the financing of the program. But from Mrs. Filardo's statement we note that commercial banks' response so far has been disappointing. Moreover, the views expressed by the Bank Advisory Committee on the adequacy of the net international reserve target under the program do not augur well for a rapid and satisfactory agreement with commercial banks on the basis of the program approved and supported by the Board. While we encourage the authorities to pursue all efforts to conclude an agreement with commercial banks, we fully support Mrs. Filardo's view that, in present circumstances and pending further progress, a temporary buildup of arrears to commercial banks up to the amount sought from the banks to support the 1990 program is unavoidable. We welcome the authorities' intention to service all other debt obligations despite the disappointing medium-term external financing outlook.

I support the proposed decision.

Mr. Clark made the following statement:

Venezuela has made a commendable effort to implement needed structural reforms and to follow appropriate macroeconomic policies. As the failure to meet end-September 1989 performance criteria for the net international reserves and net domestic assets of the central bank was related to the absence of an agreement on a medium-term financing package with banks and the use of central bank reserves to pay interest arrears, we agree that a waiver is warranted.

We welcome the recent move by the Venezuelan authorities to allow more upward flexibility in interest rates through an upward adjustment of the legal minimum savings rate and the legal maximum lending rate. In addition, it is reassuring to see that there was a deceleration in the rate of inflation in the latest month for which data are available. However, we urge the authorities to set interest rate limits so as to allow market forces to operate and to reduce interest rate subsidies. We agree with the staff on the critical importance of the authorities moving ahead rapidly with financial sector reform and on the need to enhance the effectiveness of monetary policy. It is vitally important that Venezuela implement policies that contribute to greater price stability, improve the efficiency of financial intermediation, and encourage the growth of private savings that will be needed over the medium term to support the investment and growth targets of the program.

The purpose of the current review is to assess Venezuela's progress in securing external financing for the program as well as the implementation of interest rate policy. Unfortunately, despite the series of meetings between Venezuela and commercial banks since early last year, it apparently has not been possible to reach an agreement on a financing package. Moreover, it does not appear that such agreement is in the offing, although further meetings are scheduled.

This chair has been among those which have expressed considerable concern about Fund financing of a program that is not fully funded beyond a relatively short period. In Venezuela's case, we had reservations at the time of the review in September about a second drawing without greater assurance that the financing gap would be shortly closed. Approval of the current review would allow the third drawing under the program with little sign still of agreement on a financing package sufficient to close the program's financing gap. In these circumstances, we can only reluctantly agree to the proposed decision.

We are very concerned about the implications of such decisions and future similar decisions for the Fund's policy on financing assurances. We seem to be sliding into a situation in which virtually every case is an exception. We note that the staff has asked for guidance from the Board on appropriate ways in which to gain cooperation from banks in situations in which a country has adhered to the policies agreed upon with the Fund but has not been able to convince banks that it is in their own interest to provide the financing that is thought to be needed.

We do not have any suggestions to make on how to resolve this impasse. However, this problem and the Fund's whole policy on financing assurances constitute an important issue. The Fund is becoming increasingly exposed in countries that are engaged in programs that are underfunded. We agree with the staff on the crucial importance of not allowing this trend to lead to a faltering in a country's adjustment effort. We are also concerned about the potential implications for the Fund's credibility and longer-term financial viability. We agree with other speakers that a reassessment of the policy on financing assurances and of the best way to try and close financing gaps is needed. It may be that there is little alternative to continued Fund financing in such cases, but we should be aware of the implications of such a policy for the Fund and other creditors and for a country's prospects of a return to external viability.

Mr. Filosa made the following statement:

This case offers reasons for mixed feelings. While, in fact, we have reason to be satisfied with Venezuela's adjustment efforts, the status of the negotiations between Venezuela and the commercial banks has particularly disquieting features.

On the one hand, notable progress has been made by Venezuela in its adjustment efforts. Venezuela continues to overperform as far as the borrowing targets of both the central administration and the public sector are concerned. As a result of the stabilization measures, GNP has fallen more than expected and inflation has decelerated markedly, although the most recent developments show that the disinflation process has been less satisfactory than previously envisaged. Some progress has also been made in the conduct of monetary policy and interest rate policy. Arrears on interest payments of the public sector to the banks have been eliminated. All in all, Venezuela's efforts should be judged positively, particularly given the difficult political and social environment in which the adjustment process is taking place.

On the other hand, the negotiations with the banks have unacceptably protracted. Several months have elapsed since the program's approval, and little, if any, progress has been achieved.

I am not in a position to fully evaluate the exact status of the negotiations. However, on the basis of what is known, it is clear that, in the case of Venezuela, banks are showing greater than expected resistance to effectively participating in the implementation of the debt strategy by unduly prolonging negotiations, by requesting new money enhancement, and by questioning the main assumptions and figures in the arrangement with Venezuela, including the crucial assumption that there is a genuine need to substantially reduce Venezuela's burden of debt.

As a result of the lack of an agreement, an excessive burden has been placed on official creditors, as the staff has correctly pointed out. More important, the lack of an agreement greatly increases the risk that the program might be derailed because of the lack of the required financing. In the case of Venezuela, this risk has already partially materialized, as Venezuela has notbeen able to comply with performance criteria for the net international reserves and net domestic assets of the Central Bank, even though a greater than expected oil price increase and lower interest rates, together with lower imports, have significantly relaxed Venezuela's balance of payments constraint.

In these circumstances, we face the dilemma of whether to reject the Venezuelan's request to waive the nonobservance of the performance criteria at the end of September 1989 for the net international reserves and net domestic assets of the Central Bank, or approve the proposed decision, thereby further stretching our financial assurances policy.

Denying Venezuela authorization to resume purchases under the extended arrangement would send a highly counterproductive signal to the international financial community. Therefore, I approve the proposed decision to clearly signal to the international community our support of Venezuela's adjustment effort as a part and parcel of the implementation of the debt strategy.

However, we should make it clear that we consider contributions by banks crucial for the successful implementation of the debt strategy. We should therefore find ways and means to voice loud and clear the message that we will not accept agreements that imply financial support that falls short of the requirement of the Venezuelan program, both in terms of the total amount of resources needed to fill the gap--including a satisfactory buildup of international reserves--and the composition of the financing package itself. In this regard, we expect that the terms and conditions of the financing package to be agreed upon between Venezuela and the commercial banks will be comparable with the terms and conditions agreed upon between Venezuela and official creditors. In particular, I consider new money enhancement to be unacceptable.

We should seriously consider the possibility of fixing a deadline for the conclusion of the agreement between Venezuela and the banks. On the occasion of the previous review, a number of Directors--including myself--raised this question. In the future, this issue should be discussed further. Today, we might envisage a situation in which a temporary and limited accumulation of arrears might be tolerated if, within a certain period--perhaps by the time of the next review--the agreement between Venezuela and the banks is not reached.

I note from the staff papers that progress has been made toward a more market-oriented management of monetary policy. I also note that, despite the number of steps that have been taken in the right direction, much remains to be done. I encourage the Venezuelan authorities to eliminate, in the context of the financial sector reform, the legal requirement for the Central Bank to set interest rate limits. In fact, if these limits prove to be binding, then they would be clearly inconsistent with the need to increase the flexibility of monetary policy. If, on the contrary, they are not binding, there would be no need for them. In addition, as experience in other countries shows, these limits on interest rates will, sooner or later, become ineffective, because it is extremely difficult to properly monitor their observance. In addition, I agree with Mr. Lombardo's point on the lack of transparency regarding interest policy owing to the practices of adding significant fees to the basic rates. Changes in those fees might reduce or amplify in an unpredictable way the impulses coming from the Central Bank.

Another consideration is that the present spread between the minimum deposit rate and the maximum lending rate is clearly excessive. The authorities maintain that this spread, and its recent widening, reflect the attempt to strengthen the banks' capital position. I fully appreciate the Venezuelan authorities' concern for the need to increase the strength of the financial system. However, it is not difficult to see that this policy has two main drawbacks. The first one, on which I would appreciate some staff comments, is that such a wide intermediation margin greatly diminishes the incentive to reduce operating costs of the banks. Second, the large spread between deposit and lending rates might imply a substantial financial burden for the productive sector. If real growth and capital accumulation are the final objectives of Venezuela, the authorities should realize that the cost of the financial stability should be shared in appropriate proportions among the different sectors of the economy.

I support the Venezuelan authorities' intention to make rediscount operations less automatic. The staff report is, however, silent on the ways in which the authorities would proceed in this area. It seems to me that an effective way to proceed in the direction of a more market-oriented system should be to preestablish rediscount rates, which would escalate according to the amount and the frequency of recourse to the Central Bank. I would appreciate staff comments on this aspect. Such a policy, together with the establishment of a competitive auction mechanism for issuing short-term securities, would clearly help control monetary aggregates and provide the relevant indication from the market concerning the interest rate structure and its changes over time.

I do not share the view that interest rates were generally positive with regard to expected inflation. Expected inflation is a rather elusive concept, and I am not aware of any firm conclusion on how inflationary expectations are evaluated in Venezuela. I note instead that ex post real interest rates were consistently and substantially negative in most of 1989. This trend clearly shows that expected inflation has been greatly and constantly underestimated. Therefore, a significant increase in interest rates is required if monetary policy is expected, as it should be, to become an effective instrument in the adjustment process.

Mr. Ghasimi made the following statement:

We support the proposed decision permitting Venezuela to proceed to make the purchases that became available after November 15, 1989. We can also support the waiver requested by the authorities for the nonobservance of the end-September performance criteria on the net international reserves and the net domestic assets of the Central Bank, which were clearly related to the absence of an appropriate medium-term financing arrangement with commercial banks.

We are in broad agreement with the staff appraisal and Mrs. Filardo's comprehensive statement. It is clear from these documents that Venezuela has decisively implemented the rather ambitious medium-term program supported by the extended Fund facility. It is indeed heartening to note from the statement by the staff that adjustment policies and structural reforms contemplated in the Government's economic program remain basically on course.

Apart from the observance so far of all the performance criteria not directly related to the financing arrangement with commercial banks, the authorities submitted to the Congress in October 1989 an appropriate central government budget for 1990. The 1990 budget is indeed consistent with the program objective of achieving overall fiscal balance in 1990. In addition, implementation of far-reaching structural reforms is also being pursued vigorously. In this context, it is worth mentioning that the completion of technical work on the reform of the income tax and introduction of a new value-added tax aimed at reducing the dependence of the public sector on foreign trade revenues, which have been prepared with technical assistance from the Fund, will play a crucial role in attainment of the envisaged fiscal balance for 1990.

A second important aspect of the structural reform is the divestiture program, which, through an Interministerial Commission under the chairmanship of the Minister in charge of the Venezuelan Investment Fund (FIV), will aim at a comprehensive privatization program over the medium term. We are pleased to note that the FIV has already started divesting government property with the sale of certain financial institutions and hotels.

A third component is the initiation, with technical assistance from the World Bank and the Inter-American Development Bank, of a comprehensive review of the financial sector to be supported by sectoral adjustment loans from these institutions.

The authorities' determination to implement appropriate adjustment reforms is also reflected in the recent corrective measures adopted in the monetary field with the further widening of the interest rate band. In this regard, we agree with the staff that it is of the utmost importance to aim for a competitive financial environment if the program is to succeed.

The absence of an arrangement with the banks is rightly a matter of concern for the authorities, and we urge the banks to be more cooperative with the authorities in order to maintain financial viability. We generally find that the authorities have shown considerable flexibility and goodwill in discharging their obligations to all creditors. The program is now at a critical stage and it would be unfortunate if the authorities were faced with the difficult task of augmenting their already heavy adjustment efforts in order to compensate for lack of a proper financing. Given the considerable adjustment efforts under way, a lack of sufficient financing could discourage the authorities and derail the program. We welcome the Managing Director's personal intervention in this matter and approve of the way in which he and the staff have handled this case.

Mr. Dai made the following statement:

Notwithstanding the commendable achievements in carrying out its strong program, the present difficult situation facing the Venezuelan authorities, as described in the staff paper and Mrs. Filardo's statement, is evident and straightforward. The continuous failure to reach agreement between Venezuela and its commercial bank creditors on financing arrangements from the banks has posed a serious threat to the authorities' economic adjustment program. I fully share the staff's concern that, in order to avoid a serious cash flow squeeze and to protect the authorities' program, there is now an urgent need to reach agree ment on an adequate financing package in a timely fashion. I am in broad agreement with the staff appraisal, and I shall comment on the topic of external financing, which is of great concern to all.

It has been emphasized time and again during our previous discussions on the Venezuelan program that adequate external financing is of the utmost importance for the success of the program. And the successful implementation of the current medium-term growth-oriented adjustment program by the authorities is also essential for the country to be able to escape its debt plight and restore external viability. I concur with the staff that it is the task of all the parties concerned to protect the program of Venezuela and minimize the damage arising from the current impasse in the financing negotiations between Venezuela and its commercial bank creditors. In this regard, I believe that the authorities, despite some undesirable cost, have firmly done their part by adhering to the policy targets outlined in the program and by observing performance criteria for the past three review periods, with the exceptions of the net international reserves and net domestic assets of the Central Bank owing to the absence of an adequate medium-term financing arrangement with the banks. In order to facilitate such financing from the commercial banks, the Fund has also done its part by playing a catalytic role in approving an extended arrangement for Venezuela last June, on the one hand, and by offering assistance to both parties during the financing negotiation on the other.

As is indicated by the staff, the authorities' most recent proposal to the commercial bank creditors is consistent with the requirement under the program to secure external financing, and they took steps to have their interest arrears to the banks eliminated last October. The next move should be up to those banks that have failed to date to contribute adequately to the financing of the program. I hope that the commercial bank creditors of Venezuela can be advised of just how important their contributions are to the country's adjustment program. After all, the success of the program is in the best interests of not only the debtor country concerned, but also eventually the international banking community.

As to appropriate ways in which to gain the cooperation of the commercial banks, perhaps the staff can propose practical alternatives to suit present circumstances, particularly possible further efforts the Fund could make to help facilitate negotiations. In any event, it will be helpful if creditor governments can institute the necessary incentives to encourage more active bank participation in debt reduction operations by removing legal, tax, and regulatory impediments, and by exerting political influence and playing a more active catalytic role as in previous cases.

I fully support the proposed decision.

Mr. Posthumus said that he agreed with the staff appraisal and supported the proposed decision. Venezuela's adjustment program was basically on track, and there was every reason to continue supporting Venezuela to sustain the present adjustment efforts. It was satisfactory that, in its negotiations with the banks, Venezuela had not accepted the banks' estimates of Venezuela's financing need and therefore had not changed the assumptions of the Fund-supported program. If the Fund continued to support those assumptions, it should find a way to indicate to the commercial banks that their hopes of negotiating lower new money and/or debt-reduction requirements would not be fulfilled. The staff's indication in EBS/89/232 that Venezuela's debt burden was comparable to that of other countries that had recently negotiated agreements with commercial banks that included debt and debt-service reduction was much too vague. Serious consideration should be given to Mrs. Filardo's suggestion that minimum parameters for the negotiations should be established by the authorities and the staff. The Fund should clearly indicate the size of debt reduction, debt-service reduction, and new financing needed to enable Venezuela to attain sustainable growth.

He questioned the need for further bridge loans from the BIS referred to in Mrs. Filardo's statement, Mr. Posthumus commented. He wondered whether the cash flow situation in the near future was as serious as had been suggested. Bridge loans in the middle of a program weakened the objective of tranching drawings on the Fund, because they limited in a de facto sense the Board's freedom of maneuver when a program went off track. He doubted whether the Fund should support further bridge loans in such situations.

Mr. Dawson made the following statement:

I agree with a number of previous speakers that we are faced here with both good news and bad news. The performance of the Venezuelan authorities has generally been very good under somewhat difficult circumstances, but we share the concern of other chairs about contemplating a second review and approval of a third drawing without a financing agreement.

With regard to the economic program, clearly the performance has been commendable, although that is not to say that the outcome has been desirable. Clearly the evidence of contraction in the Venezuelan economy is greater than had been anticipated. In that connection, the staff should try to reconcile the more recent information Mrs. Filardo provided with the information in the original staff paper.

The turnaround in fiscal policy is impressive, as other speakers have noted. The improvement in oil prices and volume clearly helped. The oil contingency mechanism seems to be working as desired.

The recent relative stability of the exchange rate in the last several months of 1989 shows that there is confidence in the market about the Venezuelan performance. I think that should make us feel better. The recent decline in the November inflation figure is welcome, but I, like Mr. Ismael and Mr. de Groote, wonder whether that performance is consistent with what seems on the face of it to be a rather large increase announced in the minimum wage. I would appreciate an indication by the staff of how that increase is to be phased according to income levels and what impact it is expected to have in 1990.

The staff report and Mrs. Filardo's statement refer to the larger than expected capital reflows this year, which have, in a sense, prevented the financing gap from worsening. The staff could usefully give some indication of how much better than originally anticipated the capital reflows are expected to be, and whether capital reflows were built into the program.

The Venezuelan Investment Fund has not performed as well as anticipated, and I would appreciate some indication of the cause. Does it reflect a slowdown in the pace of privatization or divestiture, or a downturn in the performance of the companies themselves owing to the contraction of the Venezuelan economy?

There is a program to increase debt equity swap operations in 1990. I was under the impression from some reports I have received from Caracas that there was a less than enthusiastic response to the last auctions in 1989. I wonder whether this is the case, and whether the staff has any views on the likelihood that the level of swaps planned for 1990 will be achieved.

With regard to the external financing situation, this chair expressed some concern at the previous review about the continued existence of interest arrears to the commercial banks. At that time, we saw that bank negotiations were continuing, and clearly our financing assurances guidelines anticipated the possibility of continuing to support a program when negotiations had not yet been completed. Almost three and a half months have now passed since the last review, and while I think that the negotiations should be characterized as having made some progress, they have also encountered difficulties. My authorities have been following the conduct of the negotiations and have considerable sympathy for Mrs. Filardo and the staff's view that perhaps the banks have been somewhat unrealistic regarding the assumptions about Venezuela's financing need and its ability to provide funds out of its own resources for such a refinancing effort, as well as the implications of the banks' position for growth of the Venezuelan economy. At the same time, we are very much of the view that this is a negotiating process that we should, to the extent we can, encourage to proceed.

Three possible options have been mentioned by Mr. Cassell. The first is a strengthened adjustment effort by the Venezuelans, and while most generally favor strengthened adjustment, it is clear that the adjustment effort in Venezuela is already quite strong. He mentioned as a second option a further drawdown of reserves. I would not rule that out, but as Mr. Al-Jasser mentioned, that action would occur in the context of an overall agreement. The course on which we seem to be embarked is to tolerate the emergence of arrears up to the level implied to sustain the program. I certainly can see the case for that arithmetically, but it is not one that would make us as happy, particularly since we are not certain how that affects the negotiations and the pressure on both parties. I am not in a position to say we are dealing with "good guys" and "bad guys," but clearly we consider it important to keep pressure on both parties, to the extent that the Fund can do so. If the tolerance of arrears increases pressure on the banks, that could be useful, but I am not entirely convinced of that.

There is a fourth option, which Mr. Cassell did not mention: the banks and the Venezuelan authorities could reach an agreement soon. We clearly view that as a high priority. Mrs. Filardo made a reference in her statement to the willingness of the authorities to negotiate, perhaps even on a daily basis. I am not quite sure we would go so far to recommend that people be locked in a room to reach an agreement. I can see some frustration with and attractiveness of such an option. Clearly, the problem of free riders mentioned both by the staff and Mrs. Filardo is a cause for concern. While I do not think that we could support the Venezuelan authorities' counterproposal, I do think that it is one that has been made in good faith. In that sense, the ball is back in the banks' court. We hope that the talks scheduled in the next few days will produce some progress.

In both the staff paper and Mrs. Filardo's comments there is some sense of frustration. The staff paper talks about a renewed effort needed to gain the cooperation of commercial banks, and the staff seeks the guidance of the Executive Board on appropriate ways to proceed. As some other speakers have said, this is not the precise time to provide that guidance. That is one of the subjects we need to look at as we review both our financing assurances policy and the enhanced debt strategy. We will also need to look at the problem of underfinanced programs that seems to be developing as bank negotiations drag on. At this point, I would not support the Board giving the staff guidance in this regard. I support the comments and suggestions made by some of the other speakers that the Fund should actively monitor the state of the negotiations, and that perhaps the Board should be kept up to date in some fashion on the state of the negotiations. My authorities have been following the negotiations quite closely, but it might be useful to other members of the Board to receive reports on the situation, as well as some assessment by the staff of the nature of the proposals. However, I would not go as far as Mrs. Filardo suggests in her statement and have the staff grade the efforts of the banks and try to give pass, fail, or signs of approval in that regard. However, I agree with Mrs. Filardo's comments on the unrealistic assumptions that the banks are perhaps making with respect to Venezuela's financing needs. However, the Fund should not be actively involved in the design and evaluation of instruments in an operational sense.

I take some exception to the comments in Mrs. Filardo's statement that the experience so far with the debt strategy is completely unsatisfactory. We need to recognize that this is a drawn-out process. We embarked on a strategy that is a voluntary one, and its voluntary nature makes it hard to have firm deadlines that are met and that can lead to satisfactory conclusions by certain dates. I definitely believe that, as Mr. Yamazaki indicated, we have made progress in the three cases that he alluded to, and I hope that, in the near future, progress will be made in the case of Venezuela as well. If the negotiations with the banks were to draw on seemingly endlessly, I might understand the pessimism that Mrs. Filardo displayed in her opening statement, but I do not think that we are at that point now. With concerted efforts by the two parties involved--the banks and the Venezuelan authorities--a satisfactory agreement should be reached in the foreseeable future--I would hope by the time of the next review.

I support the waiver and the conclusion of the second review.

Mr. Evans said that he, too, considered that the Venezuelan authorities were to be commended for their exceptional policy efforts through 1989. He agreed with the staff appraisal and proposed decision and wished to comment only on the question of external financing and financing assurances.

He would support greater Fund involvement in early stages of negotiations and would like to see the Board have a general discussion in the near future on other related issues raised by the present case of Venezuela, Mr. Evans continued. In his view, there were limits on what could be done to influence debt negotiations through artificial means. The problems encountered by Venezuela were due partly, as mentioned by Mr. Cassell, to unrealistic expectations on both sides in the early stages of the negotiations and, perhaps equally important, to considerable and perhaps justified doubts on the part of the banking community about the authorities' commitment to policy reform. Both of those factors could at present be viewed in a more favorable light, given the experience of the past nine months, and he was inclined to agree with Mr. Yamazaki that agreement might be near in the negotiations. For that reason, he was more relaxed on the question of financing assurances.

However, the negotiations process had been much longer than one would have desired, Mr. Evans remarked. In that connection, he wondered whether there was any constraint on the Venezuelan authorities resorting to greater domestic financing--in effect, overfinancing their budget deficit--and using the proceeds to purchase foreign exchange in the market to meet external liabilities. With an unchanged monetary stance, such an approach would imply a shift toward greater private sector financing of the external deficit--a shift that the international banking community might be expected to view favorably. In particular, that approach might be expected to influence secondary market prices favorably and facilitate agreement on debt negotiations. That approach might well no longer be appropriate in the case of Venezuela, but it might prove to be a useful addition to the policy armory in other cases at an early stage of negotiations. In effect, it would require a change--albeit at the margin--in the design of Fund-supported programs.

The Fund should be unequivocal in its support of Venezuela during the final stages of its negotiations, Mr. Evans considered. Perhaps the Managing Director could find ways in which to convey that message including, in a press release, if one was usually issued at the conclusion of such a discussion.

Mr. Fogelholm made the following statement:

> I wish to join other Directors in complimenting the authorities for having, to date, successfully implemented the extended arrangement, both with regard to macroeconomic and, particularly, structural measures. As a result, the economy is at present, with only minor exceptions, on the planned course, which is of course most encouraging.
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> In the circumstances, it is most regrettable that the commercial bank financing necessary for continued successful implementation of the program has not yet materialized. In particular, in view of the borrowing prospects for Venezuela, it is important for the parties to the negotiations to find a voluntary solution. Therefore, we urge both sides actively to seek a reasonable compromise to this financing problem.
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> The staff seeks the Board's guidance on the manner in which the negotiating impasse can be resolved, and how cooperation with the banks can be reinvigorated. However, providing such guidance would perhaps be premature--as has been suggested by some Directors. In any event, giving guidance in these matters is not easy, as it is extremely difficult for outside observers to understand the true nature of the problems involved. In addition, as Mr. de Groote suggested, insufficient information has been provided about the difference between the staff's assessment and the commercial banks' assessment regarding the financing

requirements. For instance, in what manner and to what extent can the proposals by the banks be expected to affect growth, the current account, and foreign exchange rate developments? How sensitive is the ensuing financing gap to different oil price assumptions, and to what extent will the risk for official creditors, including the Fund, be affected by the smaller international reserve buildup that the banks consider is sufficient?

In light of these open questions, we would have preferred to have had the decision on the third disbursement postponed for a short time, with the Board reconvening to discuss these issues based on an assessment by the staff. By that time, we might also have had more information on the outcome of the negotiations between the banks and the authorities.

We have consistently attached great importance to confirmation of appropriate financing before the Fund makes its own disbursements. Because of exceptional circumstances, and by applying liberally the case-by-case approach, Venezuela has already received approval of two purchases despite the lack of actual financing assurances. At the September Board meeting on financing, several chairs--including this one--underlined the necessity of knowing the entire financing picture before continuing disbursements by the Fund.

Now we again face a situation in which we have to consider the release of a purchase--the third tranche--in the absence of an agreement on the financing. As a number of speakers have noted, this is clearly a further deviation from the guidelines for the debt strategy and our present policy on financing assurances. Against this background, I strongly agree with Mr. de Groote and Mr. Clark that it is necessary--for the reasons given by them--to have soon a Board discussion on our policy on financing assurances in general, and in connection with the application of the debt strategy in particular. In that connection, we will need to carefully assess the consequences for the Fund and its monetary character of the approach that we now seem to be accepting as standard, namely, permitting disbursements for under financed programs. I also agree with Mr. Cassel that it is very much in the interest of the country concerned to evaluate the wisdom of covering the financing gap through the accumulation of arrears to commercial banks. However, since the program is basically on track, and in view of the strong commitment by the Government to stay on course, we are willing once more to show flexibility in response to the changing circumstances with respect to the debt strategy and to approve the proposed decision.

Mr. Goos made the following statement:

I commend the authorities for their continued close adherence to their far-reaching and bold adjustment program. The information that--except for the net international reserve target and the net domestic assets of the Central Bank--all the performance criteria are likely to have been observed by the end of the year is most encouraging, especially as the adjustment is taking place in a much more depressed climate of economic activity than originally envisaged under the program. In this connection, it would be interesting to hear the staff's assessment of the reasons that might explain the slow response of the private sector to the incentives of the program. Moreover, I would appreciate some clarification of the discrepancies in the information provided by the staff and Mrs. Filardo on last year's growth performance.

While there can be little doubt that the deep economic recession poses an enormous challenge to the authorities' ability to follow through, the staff rightly stresses the need for continued strong policy implementation. This applies particularly to fiscal policy, where one has to recognize that the welcome strong performance of last year resulted in large measure from exceptional factors, such as the stronger than expected price of oil and the delay in essential expenditures. At the same time, one has to note that the performance of the nonfinancial public enterprises apart from the National Petroleum Corporation fell considerably short of program assumptions. I wonder whether the staff could indicate the magnitude of the fiscal deficit if it were corrected for the impact of the exceptional factors, and I would welcome some information on the public sector saving performance of last year.

I should also like to stress the importance of strict monetary control for the success of the stabilization effort. In this context, it is worth noting that the stronger than programmed expansion in September 1989 of the net domestic assets of the Central Bank and of base money resulted in substantial downward pressure on the exchange rate; and it is probably no coincidence that price performance showed a substantial deterioration beginning in exactly the same month. While the more recent deceleration in the rate of inflation is most welcome, the substantial slippage in the overall inflation target for 1989 is no doubt a cause for serious concern, particularly as it occurred in an environment of very weak economic activity. Therefore, I endorse the staff's recommendations concerning the need to enhance the effectiveness of monetary and interest rate policy in order to further reduce inflation and increase the stability in the exchange market.

As to the negotiations between Venezuela and its creditor banks, I share the concern that the external financing required to fill the balance of payments gap is not yet in place. This fact puts us in a very awkward position: as you will recall, at the last review of the program, we already indicated that, consistent with the existing guidelines on financing assurances, we would have great difficulty in supporting a further disbursement of Fund resources if the necessary external financing was not secured by the time of this review; at the same time, one certainly has to acknowledge that the authorities have faithfully implemented their bold program and also appear to have made a strenuous effort to come to an agreement with the banks, although I share some others' doubts about identifying the "good" and "bad" guys. The situation appears to be complicated further by the risk, as I understand it, that withholding further Fund disbursements might undermine the authorities' ability to maintain their adjustment effort. In sum, we face the dilemma of adhering to our existing guidelines on financing assurances and recognizing that such adherence could harm the commendable adjustment effort of a member country.

Still another complication is the fact that the approach proposed by the banks appears quite attractive in that it would be fully consistent with the principle stressed under the Brady initiative of voluntary and market-determined approach to debt restructuring. However, the likelihood that this exercise would lead to an underfunding of the program and, by the same token, would jeopardize both the success of the adjustment effort and the security of the Fund's resources seems to indicate a serious inconsistency between fundamental principles of our debt strategy--voluntarism and market determination on the one hand--and the "gapology," on the other, still being pursued by the Fund, involving the pre-specification of external financing gaps that are expected to be closed by the commercials banks without giving the banks a say in the design of the program. On previous occasions, I therefore proposed that all the parties involved--the country, the Fund, and the banks--should come together at an early stage of program formulation in order to reach understandings on the reasonable and financeable size of the financing gap. I continue to feel that this idea would be worth closer examination, since it could help to reactivate the cooperation of the banks. Pending the result of such an examination, which would have to be pursued in the context of the necessary review of our financing assurances policy, I have great sympathy for the approach outlined in the appraisal of the supplementary paper. However, this approach would again require us to disregard fundamental policy guidelines aimed at safeguarding the Fund's resources and it would be inconsistent with the existing Fund policy concerning external payments arrears. Some of my authorities therefore find the proposed approach inopportune at this time, and they fear in particular that it could prejudge in an inappropriate way the outcome of the review of the relevant Fund policies.

In an effort to find a way out, I noted from Mrs. Filardo's statement that the negotiations with the banks will be resumed in the very near future; and it struck me that Mrs. Filardo, as well as other speakers, appear to be quite optimistic that those negotiations could soon lead to tangible progress. Against this background, I wonder whether it would not be feasible and appropriate to delay the now pending drawing for a few days, until we will have a clearer picture of the banks' intentions.

As mentioned by our chair at the last meeting, such a delay on Fund disbursements could signal to the banks the seriousness of the situation, and notably the fact that they cannot expect the Fund to enhance the quality of their claims by maintaining the disbursement of its resources without commensurate contributions from the banks.

I share Mr. de Groote's interest in a closer assessment by the staff of the various proposals tabled so far by the authorities and the banks. Mr. de Groote's suggestion on the possible integration of recapture clauses in bank packages warrants further consideration.

Mr. Fayyad said that he welcomed the progress that had already been made toward restoring financial stability in Venezuela under the program. He agreed with previous speakers that the record of policy implementation under the program thus far was impressive, as all the policy undertakings set out in the program had been implemented, and the authorities had responded flexibly in making additional adjustments when needed.

The recent decline in the rate of inflation reported by the staff in the supplementary paper was an encouraging sign, Mr. Fayyad continued. It was of course of utmost importance that, in the months ahead, the authorities should continue to monitor price developments with vigilance and be prepared to respond to any adverse developments in that area. The remarkable improvement in the current account, although partly a result of a much larger than anticipated contraction in economic activity in 1989, was also highly encouraging. On the other hand, however, that larger than anticipated contraction was a cause for concern, and he agreed with the authorities that an early resumption of economic growth would be critically important for the ultimate success of the program.

Attainment of the program objectives, including the important one of achieving a pace of growth commensurate with Venezuela's economic potential, was crucially dependent on the extent to which policy implementation was supported by the type of financing that was compatible with the country's debt burden, Mr. Fayyad commented. He agreed with the staff and previous speakers the fact that the external financing required for the program was not yet in place was most regrettable. He hoped that the authorities' current efforts to reach an agreement with creditor banks early in 1990 would soon bear fruit. Meanwhile, he could go along with the staff's recommendation that the Board conclude the second review under the extended arrangement so that Venezuela could make the purchase that had become available after November 15. Accordingly, he supported the proposed decision.

The staff representative from the Western Hemisphere Department said that there really was no difference in view between the staff and the authorities on the rate of economic contraction in 1989. The Board had been presented with different estimates from different exercises conducted at different times. The figure on economic contraction mentioned in the original staff report and in the letter of the authorities of December 1, 1989 was the product of a joint assessment, basically made in October, looking at the indicators available, which suggested that economic activity was clearly going to be more depressed than had been expected earlier. In the light of the selected evidence then available, including some partial evidence, the staff and the authorities had agreed to use 5-6 percent as the tentative figure for the decline in economic activity. The more recent estimate that Mrs. Filardo had presented in her opening statement was the result of an exercise conducted by the Central Bank in December 1989 and which the staff was evaluating with the authorities in the context of the third review; the staff would be presenting a more elaborate discussion of the issue in the context of the report for that review. There were no major problems in evaluating the growth of the economy. What seemed to have occurred between the two exercises that had been mentioned was that the estimated contraction in construction activity had been much more severe than originally estimated, and the decline in activity of certain service sectors had been sharper than expected.

There had been a number of comments on the differences in the inflation outlook presented originally in the program and the actual outcome, the staff representative recalled. While those differences clearly existed, the actual pattern of price changes had been largely in line with the staff's expectation. The staff and the authorities had anticipated a bunching of inflationary or corrective price adjustments early in the program, and generally the tendency had been for the rate of inflation to subside over time. As Mr. de Groote had noted, most of the inflation in 1989 had probably been the result of price corrections. There was no evidence that an inflationary process was under way. The underlying rate of inflation might be 1-2 percent a month, which was significantly lower than the index of inflation indicated for the first half of 1989. Some of the difference in the outlook compared with the actual outturn for inflation was attributable to uncertainties about the ongoing process of adjustment--that point was also applicable to the different assessments of the trends in output and the behavior of economic activity in general. In some respects also, the price liberalization in 1989 under the adjustment program had been more substantial than intended. For example, the degree of control over selective products and the associated initial liberalization were sharper than intended, as was the wage adjustment in March 1989. Those factors might explain some of the difference between initial projections and actual outturn. As to output in particular, the expectations mentioned by Mr. de Groote had been a factor: the great uncertainties arising out of the adjustment effort and the attempts to arrange external financing had affected the responsiveness of the private sector.

As to the wage adjustment that had recently been announced and which was to go into effect in January 1990, it had been anticipated that an adjustment of that order of magnitude would be granted when the program was designed, the staff representative said. The impact on the public finances appeared to be about as had been expected in the projections that were made at the time the program was reviewed. In June 1989 the staff had presented projections for 1990, and the size and scope of the wage adjustment projected at that time were not substantially different from the actual outturn. That issue was of course a topic for the review discussions with the authorities that had been initiated in December 1989. The staff felt that the wage adjustment could be compatible with the original projections for the fiscal program as long as continuing efforts were made by the authorities to adjust--for example, domestic fuel prices and other public enterprise tariffs--as had been planned.

A question has been raised by Mr. de Groote about what had happened to the real effective exchange rate since the time of the indicators reflected in the staff paper, the staff representative remarked. Basically, with the depreciation of the nominal exchange rate that had taken place in October and November 1989, the real effective exchange rate apparently had about recovered from the additional inflationary impact under the program; hence, the exchange rate in real effective terms had been kept broadly in line with what had been anticipated at the time the program was presented. As the exchange rate was basically market determined, that development was not in conflict with the objective of price stability, since exchange rate stability under the program for Venezuela was very much a function of the fiscal balance and low inflation rate. Hence, to the extent that the inflation rate continued to decline and remain low, the exchange rate should remain competitive, and that trend would be further advanced as the impact of the trade reform measures was felt.

As to the prospects for eliminating the interest rate band, the authorities had informed the staff that they intended to propose an amendment of the general banking law that required the Central Bank to set the interest rate limits, the staff representative explained. That step would be a part of the financial sector reform that was to be presented and implemented in 1990. That reform was being prepared and had been initially reviewed by a technical assistance team from the Central Banking Department. The staff had clearly recommended that the limits should be removed as soon as feasible. The authorities planned to have the reform measures ready by about April 1990, at which time further progress in negotiations with the World Bank and the Inter-American Development Bank on a financial sector reform loan could be made, so that the measures could be implemented around the middle of the year. The staff had consistently recommended that the author-ities should endeavor to widen the bands and therefore make them gradually less relevant to the behavior of interest rates in the market; there was mounting evidence that actual rates had tended to fluctuate above the mini-mum deposit rate or below the maximum lending rate.

The staff shared Mr. Filosa's concern that the actual interest rate spread in the financial system might reflect unduly large costs and inefficiencies in the system and was therefore a burden on the system, the staff representative continued. The staff had argued that competitive forces should be promoted to the extent possible so as to manage a reduction in that spread, which could result from two avenues. One was to make the Central Bank a more active participant in the market, and it had become evident from the end of November 1989 that the Central Bank had begun to become more active in open market operations. The Bank had recently introduced its own securities with maturities of 30 to 90 days, which had had the effect of lifting deposit rates in the system through higher yields. The other avenue that could over time affect the spread--and the one that the staff expected would be reflected in the contemplated reform--would be to open the system in certain ways to external competition.

The staff also agreed with Mr. Filosa that the rediscount rate, rather than being mainly an administered rate, should somehow follow or track rates set in the open market operations of the Central Bank, the staff representative said. There was some feeling that market trends should eventually be the indicator for determining all the various rates in the public financial system.

As to the performance of the Venezuela Investment Fund, the burden on that fund had been increased in part because of measures introduced by the Government, the staff representative remarked. Transfers to the fund had been reduced with a view to maintaining balance in the central government accounts. At the same time, there had been pressure on the budget from the public enterprises, because their revenues had not been as buoyant as expected because of higher costs and inflation; that development was an indicator of the need for some corrective adjustments in tariffs in 1990.

There might be evidence in 1989 that the reflows to Venezuela had been larger--approximately $1 billion--than originally estimated, partly because of a kind of forced reflow associated with the repayment of the letters of credit, the staff representative remarked. The Central Bank had presented evidence suggesting that the initial stock of letters of credit was higher at the end of 1989 than had been assumed earlier; given the pattern of import payments in 1989, the Central Bank evidence implied roughly a doubling of the decline in net financing from that source compared with the expectation under the program. Most of that additional repayment had been offset, and the reflows were mainly a residual. Given the way in which the estimates in that area had to be developed, most of that repayment has come about in effect by the use of private holdings abroad to cancel those obligations. Hence, the present estimates would be probably at least double what the staff had projected under the program. The staff would try to provide additional evidence in that area in the context of the next review.

It was true that activity in debt equity swaps had been somewhat slower than expected, the staff representative said. That trend might be explained partly by the uncertainties about the swap program, which had been started only recently. The Government had shifted from basically an administered system of direct conversions to a system based on auctions. The authorities had been trying to promote acceptance of and interest in the swap program, but the bids at the latest auction had been smaller than expected.

While it was true that, in principle, more adjustment could be promoted under the program, that approach would run the risk of slower growth, the staff representative commented. In the discussions between the staff and the representatives of the Economic Subcommittee of the Bank Advisory Committee, much time had been spent in trying to examine the implications of the different estimates of gaps and the medium-term projections for the growth prospects under the program.

In principle, there should be no problem in introducing recapture clauses into the debt negotiations, the staff representative said. Indeed, they might have a role to play when differences in gaps were a continuing source of debate in negotiations.

The Venezuelan authorities' September 1989 proposals to the Bank Advisory Committee had included a kind of contingency mechanism under which new money provided over the medium term would somehow be set in terms of an indicator interest rate, the staff representative noted. Hence, some thought had clearly been given--at least by the authorities--to the possible use of contingency mechanisms; if such mechanisms were employed, they should probably be symmetric and allow for movement in both directions to guard against uncertainties about medium-term projections.

The staff would wish to consider more carefully Mr. Evans' proposal under which Venezuela could retire all its external liabilities through a kind of massive debt conversion program, thus forcing the private sector to borrow abroad, the staff representative from the European Department commented. There could be practical problems in using such an approach. For example, the large size of the operations that would be involved might require significant increases in domestic interest rates to achieve the crowding out that would be required to stay within the monetary program and thereby in effect force private borrowers who were not accommodated in the credit program overseas to meet their needs. The proposed approach also might create problems vis-à-vis external creditors in the sense that some of those creditors who did not participate in cash buy-backs or debt equity swaps would prefer to hold external claims on Venezuela, and if they were all induced to accept domestic liabilities, there might be pressures through the exchange rate if some of those creditors sought to convert their claims once again into foreign exchange.

The staff representative from the Exchange and Trade Relations Department recalled that a number of Directors had called for a reassessment, on another occasion, of the policy on financing assurances. Those speakers had agreed with the staff that, in the present case of Venezuela, it was of primary importance to protect the implementation of the adjustment program. But in reaching that conclusion the Directors had raised a number of broad questions, which the staff would not attempt to deal with at the present stage, particularly as the answers to the questions would probably involve consideration of other country cases as well.

The next review under the arrangement with Venezuela would probably be brought to the Board's agenda for March or April 1990, and the next purchase by Venezuela would become available after mid-February, the staff representative from the Exchange and Trade Relations Department remarked. In that connection, one speaker had raised the question of how the banking community would be informed of the Board's views on Venezuela's program. In addition, there seemed to be a broad desire among Directors that, as a general rule, the staff should report to the Board in more detail than hitherto on proposals that were made by either the authorities or the banks during debt negotiations like the ongoing negotiations between Venezuela and its commercial bank creditors. He assumed that, pending the Board discussion at a future date on the financing assurances policy, that call for increased information in staff reports on proposals under discussion in debt negotiations should apply, if needed, to the current case of Venezuela.

Mrs. Filardo commented that the liberalization of prices and tariffs had been even more substantial in fact than the authorities had initially anticipated under the adjustment program. Hence, an important element of the inflation had been in the form of price corrections. Real wages had deteriorated dramatically during the past ten years. During the latest discussions on wage increases in Venezuela, the trade unions had said that they wondered why the Government was trying to internationalize prices but not wages. The Government had tried hard to reach a wage agreement consistent with the program despite the distress felt by the trade unions and the private sector.

With respect to interest rates and the financial reform, there seemed to be some feeling among Executive Directors that expected inflation was an elusive concept, Mrs. Filardo remarked. It might be helpful to discuss what might be the best indicator for defining real positive interest rates. In Venezuela, a substantial interest rate adjustment had clearly been made: lending rates had been increased from 13 percent to 45 percent. The impact of such an adjustment on economic activity and the financial sector had to be carefully assessed; there could be a sizable economic contraction, and, if the financial system was not healthy, as reflected in the existence of a number of nonperforming loans, there could be major problems in terms of the implementation of the adjustment program. As some speakers had noted, the Supreme Court decision affecting interest rate determination by the Central Bank constituted a significant constraint on the authorities' persistent intention to maintain sound monetary and interest rate policies. The Congress had passed a law to protect mortgage rates, and there was a danger that another law would be enacted to protect the agricultural sector, which could jeopardize the authorities' efforts to implement a comprehensive financial reform. The authorities believed that, in terms of expected inflation, real interest rates were positive.

She did not agree with Executive Directors who had suggested that the private sector's response to the incentives in the adjustment program had been slow, Mrs. Filardo said. It had been necessary first of all to provide a cushion against the adjustment. Thereafter, once the credibility of the program was clearly established, the private sector would respond more positively. It was important to note that the authorities had repaid $4.5 billion in trade line credit to commercial banks, and that, as the capital account had been in deficit by nearly $2.6 billion, the difference had been financed by capital repatriation.

It had been suggested that Venezuela's approach to estimating its financing need and to the negotiations with the commercial banks had been unrealistic, Mrs. Filardo recalled. In the past, the Fund had been criticized for promoting programs that were designed to achieve adjustment but not investment and growth as well. The Fund had finally decided that adjustment programs should promote growth in the medium term. Usually the financing gap of a country being assisted by the Fund was fully covered at the time an arrangement with the Fund was approved by the Board, which had also discussed the methodology for evaluating the different options that could be proposed to commercial banks. For programs that were not fully financed, there were, according to Mr. Dawson and Mr. Cassell, several possible options. One option was to require additional adjustment; however, she wondered whether that option was viable for a country like Venezuela and which needed to achieve increased investment and more rapid economic growth. A second option was to require the country to reduce its international reserves. However, Venezuela clearly needed to increase its reserves, and, at the same time, the Fund had to keep in mind the need to protect its resources by ensuring that the member countries used Fund resources efficiently and would be in a position to make scheduled repurchases.

The Executive Board then approved the following decision:

1. Venezuela has consulted with the Fund in accordance with paragraph 4 of the extended arrangement for Venezuela (EBS/89/107, Sup. 2) and paragraph 40 of the authorities' letter of May 24, 1989 attached thereto in order to review the progress Venezuela has made in securing

external financing and in implementing understandings on interest rate policies, and to reach understandings with the Fund regarding the circumstances in which purchases by Venezuela may be resumed.

2. The letter dated December 1, 1989 from the Minister of Planning and the President of the Central Bank of Venezuela shall be annexed to the extended arrangement, and the letter dated May 24, 1989 from the Venezuelan authorities shall be read as supplemented and modified by the letter dated December 1, 1989.

3. The Fund decides that the second review contemplated in paragraph 4(b) of the extended arrangement is completed, and that notwithstanding the nonobservance of the end-September 1989 performance criteria on the net international reserves and the net domestic assets of the Central Bank, Venezuela may proceed to make purchases under the arrangement.

Decision No. 9335-(90/1), adopted
January 3, 1990

The Chairman said that he fully shared the concern that many Executive Directors had expressed. It was important for Venezuela, the Fund, and the international community to have the Fund continue supporting the adjustment program, but the present situation was certainly difficult, and it was regrettable that a satisfactory agreement had not been reached with the banks and that Venezuela might not be able to fully service interest payments to the banks in the coming period; nonpayment was not a long-term solution and it undoubtedly involved risks for the authorities.

It seemed desirable, as several Executive Directors had suggested, for him to communicate to the Chairman of the Advisory Committee the sense of the present meeting and express the strong wish that the banks would quickly resume negotiations, and that both sides would show a spirit of compromise in searching for a realistic solution, the Chairman continued. In addition, he could note the Board's satisfaction with Venezuela's economic performance and express the concern that the bank agreement should be consistent with Venezuela's external financing requirements as endorsed by the Executive Board. He could indicate that, as usual, the Fund stood ready to assist all the parties concerned in their efforts to reach an agreement if such assistance was thought by them to be appropriate. If they wished, the Fund could meet with the Chairman of the Advisory Committee and the Venezuelan authorities to review the situation and to explain, if necessary, the staff's analysis and the Board's views.

The Executive Board need not meet in the immediate future to discuss the implications of the decision on Venezuela adopted at the present meeting, the Chairman considered. That topic could be taken up at the time of the next discussion of the debt strategy. Meanwhile, the Fund should monitor the situation very closely and try to help to resolve the impasse in the negotiations.

The Fund had consistently avoided becoming involved in debt negotiations, and it should continue to do so, the Chairman commented. Mr. Dawson had suggested that the Fund should be engaged actively in monitoring negotiations; in that connection, it might be possible for the Fund to try to assess proposals at an earlier stage for the information of the Executive Board, and possibly help the country to react quickly to proposals. Several speakers had suggested that, in future cases, there could be a meeting at an early stage involving representatives of the Fund, the member country, and its commercial bank creditors in order to convey a realistic view of the country's balance of payments situation and to try to help both parties to take more realistic initial negotiating positions. That suggestion should be analyzed further. Other ideas had been mentioned and also should be considered further--for instance, setting deadlines for the completion of negotiations between a country and its commercial bank creditors. It would be particularly important to consider the suggestion of Mrs. Filardo and Mr. Posthumus for establishing more precise minimum parameters for negotiations. In addition, there was interest in the possibility of making more active use of recapturing clauses.

Mr. Dawson said that he strongly opposed the idea, in both form and substance, of sending a communication to the banks: sending a communication to just one of the parties involved in the negotiations would be clearly seen as taking sides; and it would nonetheless involve intervention by the Fund in an ongoing negotiating process. The Chairman had mentioned that one of the points to be made in the communication was the hope that the banks and the Venezuelan authorities would resume their discussions soon. In fact, they already planned to meet in early January. The proposed communication would be taken as a step to introduce a new party to the negotiating process. It was important to distinguish between monitoring by the Fund, which should be undertaken, and communicating what could be taken as a position of the Fund that would in effect serve to favor one side over the other. There was in any event no need for the Managing Director to communicate with the authorities specifically to enable them to learn of the outcome of the current Board discussion; the banks would be able to receive that information through other channels, including in particular Mrs. Filardo's office.

Mr. Posthumus stated that, in principle, he had difficulty in accepting the Chairman's suggestion to send a communication. In any event, the text should not call for a compromise, because that would indicate to the banks that Venezuela should give in to some extent or meet the banks half way; he doubted whether the authorities had room under the adjustment program to make such a move. The text of a communication would have to be considered very carefully.

Mr. Cassell said that he, too, felt that the text would have to be reviewed with great care. In addition, any meeting with representatives of the banks and the authorities would have to take place soon or risk holding up the process of negotiations. In any event, bank advisory committees always seemed to be well informed of developments in the Fund, and he had assumed that the committee for Venezuela would be as well, perhaps through some regular official Fund channel of communication.

The Chairman commented that he typically received a telephone call from the chairman of a bank advisory committee seeking confirmation of information that the committee might have received. His own intention in the present case of Venezuela was to convey to the bank representatives merely factual information, namely, that a decision had been approved by the Executive Board, that the authorities had taken certain policy steps, and that the Executive Board was satisfied with what Venezuela had done; in addition, he would convey the Executive Directors' wish for an early resolution of the remaining difficulties in concluding the debt negotiations. He doubted whether such a communication would be identified as taking sides.

Mr. Landau remarked that he doubted whether the press should be used as the media for expressing the Board's concern about the negotiations between Venezuela and its creditor banks. The suggested direct communication be tween the Managing Director and the banking community could be clear and very informal. He strongly supported the suggestion that the general sense of the meeting should be expressed in that way; the communication could mention the facts that the Board had concluded that Venezuela's program was on track, and that Execute Directors had expressed some concern about the country's inability to meet certain performance criteria related to reserves because the financing package had not been finalized.

Mr. Dawson said that he continued to feel strongly that the proposed communication would be inappropriate. In the normal course of events, a review under an arrangement with a member was not followed by a press communiqué issued by the Fund. An extraordinary communication in the present case of Venezuela would be even more noticeable than a press communiqué and would therefore send a strong signal. In addition, he shared Mr. Posthumus's concern about mentioning the desirability of reaching a compromise between the authorities and the banks. The proposed communication or the suggested meeting involving representatives of the Fund, the authorities, and the banks would give the impression that the Fund was taking sides. The banks should receive word of the outcome of the current discussion on Venezuela, but they should receive that information in the usual manner following a review under an arrangement with the Fund. Suggesting a compromise, or holding a meeting in which the Fund would be involved as a formal party--rather than merely as a source for a briefing on recent economic developments--would be unacceptable.

The Chairman said that he had not meant to suggest that the Fund should be a formal party to the negotiations between Venezuela and its commercial bank creditors. His suggestion was merely to brief bank representatives about the situation if that was thought by both sides to be helpful. The Fund would not take sides.

Mrs. Filardo recalled that in other recent cases--Mexico, for instance--there had been a dinner involving representatives of the Fund and the banks as well as of the U.S. Treasury Department at which the Fund had communicated to the banks information on recent developments.

The Chairman commented that it was not at all unusual for the Managing Director to communicate with commercial bank representatives; he and his predecessors had met with bank representatives on a number of occasions, and he often sent letters to bank representatives at the request of member countries or the banks themselves. If Venezuela, for instance, were to ask him to send a letter to the Chairman of the Advisory Committee describing the situation after the present Executive Board meeting, he would not be in a position to refuse to do so.

Mr. Dawson said that he was concerned that a communication to the banks might be seen by them as a kind of threat to the banks by the Fund rather than as a mere provision of information.

The Chairman commented that it should be clearly understood that there was certainly no intention either to threaten the banks or to take sides. But the banks needed to know about the Fund's situation vis-à-vis the member country in question. It might well be convenient for that country to have the presentation of what had happened in the Fund be made by the Chairman of the Board rather than through some informal channel outside the Fund. Hence, while he would not necessarily initiate such a communication, he would send a letter to the Chairman of the Advisory Committee if he was asked to do so by the Chairman or the authorities, and the letter would of course be circulated to the Board.

Mr. Yamazaki remarked that, as he understood it, in the past informal contact between management and commercial banks had taken place on occasion. He wondered whether, in the present case of Venezuela, the Managing Director intended to make the usual kind of communication or a special, unusual communication. He understood the concern that Mr. Dawson had expressed about a special or unusual communication in the present case.

The Chairman commented that the communication he had in mind would be consistent with the communications that were traditionally made in such cases. Any departure from that tradition would have to be discussed during the Board's general consideration of the debt strategy. His communication in the present case would be limited to factual statements that might be needed in answer to questions raised by bank representatives.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/89/169 (12/22/89) and EBM/90/1 (1/3/90).

4. NINTH GENERAL REVIEW OF QUOTAS - INCREASES IN QUOTAS - GOVERNORS' VOTE

The Executive Board approves the report of the Secretary (EBD/89/369, Sup. 1, 12/29/89) on the canvass of votes of the Governors on Resolution No. 44-5, effective December 28, 1989, with respect to Increases in Quotas of Fund Members - Ninth General Review, approved by the Executive Board (EBM/89/154, 11/28/89) for submission to the Board of Governors. The Governors' vote on the Resolution is recorded as follows:

Total affirmative votes	920,566
Total negative votes	0
Total votes cast	920,566
Abstentions recorded	0
Other replies	0
Total replies	920,566
Votes of members that did not reply	18,759
Total votes of members	939,325

Decision No. 9337-(90/1), adopted
December 29, 1989

5. PANAMA - OVERDUE FINANCIAL OBLIGATIONS - REVIEW FOLLOWING DECLARATION OF INELIGIBILITY - POSTPONEMENT

Paragraph 4 of Decision No. 9205-(89/85) G/S, adopted June 30, 1989, shall be amended by substituting "by January 31, 1990" for "not later than six months from the date of the decision." (EBD/89/406, 12/26/89; and Cor. 1, 12/28/89)

Decision No. 9338-(90/1) G/S, adopted
December 29, 1990

6. KENYA - TECHNICAL ASSISTANCE

In response to requests from the Kenyan authorities for technical assistance in the fiscal field, the Executive Board approves the proposal set forth in EBD/89/403 (12/21/89).

Adopted December 27, 1989

7. POLAND - TECHNICAL ASSISTANCE

In response to a request from the National Bank of Poland for technical assistance in the central banking field, the Executive Board approves the proposal set forth in EBD/89/405 (12/26/89) and Correction 1 (12/27/89).

Adopted December 29, 1989

8. RULES AND REGULATIONS - AMENDMENT OF RULE N-12

The Managing Director shall inform the Executive Board at least two weeks in advance of any action to appoint or dismiss any person to or from a position graded equal to or above that of a division chief. Such information shall not be necessary for other appointments or dismissals by the Managing Director. (EBAP/89/3 05, 12/20/89)

Adopted December 27, 1989

9. APPROVAL OF MINUTES

a. The minutes of Executive Board Meetings 89/58 through 89/62 are approved. (EBD/89/393, 12/18/89)

Adopted December 26, 1989

b. The minutes of Executive Board Meetings 89/63 through 89/67 are approved. (EBD/89/395, 12/19/89)

Adopted December 27, 1989

c. The minutes of Executive Board Meetings 89/68 through 89/71 are approved. (EBD/89/396, 12/20/89)

Adopted December 28, 1989

d. The minutes of Executive Board Meetings 89/72 and 89/73 are approved. (EBD/89/398, 12/21/89)

Adopted December 29, 1989

10. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/89/292, Supplement 1 (12/28/89), EBAP/89/307 (12/27/89), and EBAP/89/308 (12/29/89) is approved.

APPROVED: October 19, 1990

LEO VAN HOUTVEN
Secretary