January 13, 2000
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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 98/75

10:00 a.m., July 13, 1998

Contents

Decisions Taken Since Previous Board Meeting

Executive Board Attendance

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

Executive Directors	Alternate Executive Directors
A.A. Al-Tuwaijri	J.G. Borpujari, Temporary
	C.X. O'Loghlin
	W. Szczuka
	A. Abdychev, Temporary
B. Esdar	W. Merz, Temporary
	L. Pinzani, Temporary
	J.N. Santos, Temporary
	J.P. de Morais
	P.A. Akatu, Temporary
K.A. Hansen	
A. Kafka	
	V. Rigász, Temporary
	B.S. Newman
J.-C. Milleron	R. Fernandez
	H. Paris, Temporary
	E. Jourcin, Temporary
	M. Daïri
	A. Lushin
	L. Palei, Temporary
	J. Shields
	K.S. Brownlee,
	H. Hagan, Temporary
A.S. Shaalan	M.H. Elhage
M.R. Sivaraman	A.G. Karunasena
	N. Jadhav, Temporary
G.F. Taylor	
J.J. Toribio	J. Guzmán-Calafell
J. de Beaufort Wijnholds	Y.G. Yakusha
	J.-C. Obame, Temporary
	K. Kpetigo, Temporary
Y. Yoshimura	
Zamani A.G.	Phan M.H., Temporary
Zhang Z.	
A.G. Zoccali	J.A. Costa, Temporary

R.H. Munzberg, Secretary
A. Mountford, Acting Secretary
A.S. Linde, Acting Secretary
P. Kunzel, Assistant
P. Cirillo, Assistant

São Tomé and Príncipe—1998 Article IV Consultation
Staff representatives: Ewenczyk, AFR; Ferran, PDR

Republic of Lithuania—1998 Article IV Consultation
Staff representatives: Berengaut, EU2; Leddy, PDR

Eritrea—1998 Article IV Consultation
Staff representatives: Kibuka, AFR; Hicklin, PDR

Also Present

IBRD: J.R. Edwards, Africa Technical Families; M. Giugale, Europe and Central Asia Regional Office; O.A. Meesook, A. Noman, and M.A. Verghis, Africa Regional Office. African Department: A. Basu, Deputy Director; G.E. Gondwe, Deputy Director; E. Hernández-Cata, Deputy Director; K. Christou, D.G. Cowen, P. Ewenczyk, J. Fajgenbaum, C.A. Francois, M. Katz, R.D. Kibuka, L.G. Kuijs, C.A. Leite, P. Neuhaus. European II Department: S.R. Bassett, J. Berengaut, D. Desruelle, M. Farahbaksh, M. Saito, T.A. Wolf. Legal Department: W.E. Holder, Deputy General Counsel; R.K. Gordon, I. Mouysset, D.E. Siegel. Policy Development and Review Department: J. Ferran, Deputy Director; T. Leddy, Deputy Director; J. Hicklin, B.J. McDonald. Research Department: M. Mussa, Director and Economic Counsellor; E.R. Borensztein, P. Garibaldi, R. Sahay. Secretary's Department: B.A. Sarr. Treasurer's Department: D. Williams, Treasurer. Office of the Managing Director: B.V. Christensen, J.A.P. Clément. Advisors to Executive Directors: W.F. Abdelati, M. Askari-Rankouhi, T. Brizuela, A. Giustiniani, C.M. Gonzalez, E.J.P. Houtman, A. Levy, M.F. Melhem, H. Mori, H. Ogushi, O. Otazú, M. Sobel, T. Turner-Huggins. Assistants to Executive Directors: A.S. Alosaimi, Awang G.G., S.A. Bakhache, M. Budington, I.-K. Cho, M.A. Cilento, J.C. Estrella, D. Fujii, N. Goffinet, N.K. Gueorguiev, H. Javaheri, K. Kask, T.-M. Kudiwu, K. Lai, Lu A., A. Lucenti, J. Mafararikwa, S.D. Melese-d'Hospital, F. Mercusa, D. Merino, J. Nelmes, J. Schaad, O. Schmalzriedt, T.T. Schneider, R.J. Singh, U.Y. Tilyayev, M. Vismantas, R.P. Watal, I. Zakharchenkov.

1. SÃO TOMÉ AND PRÍNCIPE—1998 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1998 Article IV consultation with São Tomé and Príncipe (SM/98/148, 6/22/98; and Cor. 1, 6/26/98). They also had before them a statistical appendix (SM/98/159, 6/26/98).

Mr. Yao and Mr. Obame submitted the following statement:

Recent economic and financial developments in São Tomé and Príncipe should be assessed against the narrow production base of the country, the heavy dependence on external assistance and the unsustainable external debt. Recurrent political difficulties have also contributed to the present unfavorable economic outcome. In 1997, reflecting mainly the drop in cocoa production, economic growth is estimated to have fallen to 1 percent, resulting in a further decline in per capita income, and inflation reaching about 80 percent was double that envisaged. However, the current external position, including grants, improved substantially. As indicated in the staff report, in 1997, the authorities tightened financial policies and strengthened structural measures. In the fiscal area, efforts were made to improve fiscal revenue through an enhanced collection of tax arrears. On structural reform, the land distribution supported by the World Bank proceeded satisfactorily. However, due to a limited administrative capacity combined with political uncertainties, the envisaged policy measures were partially implemented.

Against this background, the authorities have increased their policy efforts, which will focus on reducing inflation significantly in the short run and promoting growth. To achieve these objectives, the 1998 fiscal program set by the authorities seeks to eliminate first the primary budget deficit through strengthening budgetary procedures. In that context, revenue performance is expected to be improved owing to a forceful implementation of measures well outlined in Box 1 of the staff report. These measures include the strengthening of tax and customs administration, the streamlining of the present systems of customs duty exemptions, and the implementation of the automatic price adjustment mechanism for petroleum products. To foster consensus for reforms, a steering committee was appointed by the Prime Minister.

On the expenditure side, the authorities intend to follow a prudent wage policy: There will be no general wage increase envisaged in the 1988 budget, although the retroactive payments of salary increases granted in 1997 will be pursued as scheduled. Regarding nonwage current expenditure, efforts are being made to keep them in line with the priorities agreed upon with the World Bank, namely outlays related to primary education and health. The authorities will also finalize the quasi-fiscal deficit of the central bank as well as that of the water and electricity company. In this regard, the central bank will curtail its expenditure and cross arrears between the government and the electricity company will be settled.

The 1998 monetary policy aims at reducing the rate of inflation and strengthening the international reserves position. Thus, the policy calls for a significant reduction of broad money expansion. Furthermore, in line with the fiscal stance, the containment of net government borrowing will permit an increase in credit to the private sector, while an adequate sterilization of exceptional external financing will help to increase international reserves. Regarding the exchange rate, my authorities are committed to pursue a market-determined policy so as to reduce the spread between the official and the parallel rates. Moreover, export surrender requirement will be further lowered to 50 percent and the practice of allocating foreign exchange for imports will be ended.

On the structural reforms and the promotion of the private sector, additional steps are being taken to implement civil service reform, and to pursue the land reform program launched successfully in 1997. In the area of the privatization program, the drug importation and distribution company (ENAMED), the state-owned meat factory (ENCAR) and car insurance company (COMPENSADORA) have been liquidated, and the management of those enterprises remaining in the government's portfolio, namely the electricity and water company, is being privatized. Moreover, the government's share in the oil company has been reduced from 100 percent to 51 percent. In the process of attracting foreign investment, the preparation of the framework for the development of private sector activities will be accelerated. Furthermore, the government is actively considering setting up a free trade zone with the assistance of a foreign private company, while an agreement for oil exploration was signed with another.

The debt situation is worrisome. As stated in the staff report, the debt service stood at 72 percent of exports of goods and services, and at 131 percent of government revenue in 1997. These ratios clearly indicate the unsustainability of the debt burden. My authorities agree with the staff that even in the best case scenario of full policy implementation and application of existing mechanisms for debt relief, São Tomé and Príncipe's external viability will not be reached in the next two decades. Therefore, only an imaginative solution to the debt problem is needed.

In conclusion, the challenges facing the authorities of São Tomé and Príncipe are well exposed in the staff paper: the production base is limited, economic growth is sluggish, poverty is increasing, human resources and institutional capacity should be strengthened, and the debt burden remains unsustainable. Concerted efforts to address these shortcomings are urgently required. Delaying actions will only exacerbate the situation. It is my authorities' hope that with the coordinating team from various Ministries that has been put in place by the Prime Minister, and with appropriate and timely technical assistance from the Fund, the implementation of a long overdue ESAF program will be undertaken at an early stage. Meanwhile, it is also my authorities' strong expectation that urgent and bold solutions can be found with Fund assistance to alleviate the heavy debt burden facing their country.

Mr. Mori made the following statement:

São Tomé and Príncipe experienced another year of low GDP growth with a deceleration to 1.0 percent in 1997 as compared to 1.5 percent in the previous year, which represents a further drop in real income per capita. One major source of this weaker outcome was the drop in cocoa production caused by insect infestation. This is an unfavorable contingency faced by an economy with a narrow production base, concentrated in one product.

In addition, a lax fiscal stance and the accommodating monetary policy gave room for higher inflation and depreciation of the dobra. We agree with the staff's policy recommendations regarding the need for observing sound macroeconomic policies, supported by appropriate structural reforms, as these actions are prerequisites for a more stable macroeconomic environment and higher GDP growth rates. We see, however, that certain flexibility in the policy design and implementation is necessary to accommodate adverse impacts of supply shocks and imbalances caused by the excessive external debt burden given the particular circumstances of the economy.

In the structural area, we commend the authorities for the progress achieved in the land reform program, and conversion of management contracts for large government estates into long-term leases. These actions represent an important element for poverty alleviation. However, low productivity in the agriculture sector continues to be a concern. The staff in last year's report identified some reasons for this poor performance, such as small farmers' initial lack of experience with market mechanisms, lack of long-term leasing contracts, the high surrender requirement for export proceeds, and inadequate road infrastructure. Given the importance of the agriculture sector for the Sãotomean economy, developments in the sector deserve close monitoring.

The economy has also been hampered by deficiencies in financial intermediation. The staff noted that credit to the private sector declined in real terms, and credit expansion to the public sector has not been the only factor. The lack of a creditworthy client base is indicated as one difficulty for commercial banks not to increase their credit to the private sector. A more stable economic environment with appropriate monetary and fiscal policies is a precondition for a healthy expansion of bank credit to the private sector, but further improvements seem to be required in the financial sector regarding the institutional framework.

The external debt problem continues to be an impediment for higher and sustainable growth. As the staff pointed out, "even in the absence of major exogenous shocks, and with sustained implementation of a rigorous adjustment policy and full exploitation of existing mechanisms for debt relief, São Tomé and Príncipe would not be able to eliminate its residual financing gap and reduce its debt burden to a level consistent with external debt sustainability." Despite these adverse circumstances, it is essential for the authorities to reinforce their focus on fiscal and monetary issues, as well as on the structural reform agenda, as a track record of good performance will allow São Tomé and Príncipe to be considered for an ESAF-supported program.

We are encouraged by the authorities' commitment to take the required policy measures as indicated in the report, such as to increase the tax base and contain expenditures, with a care for nonwage current primary expenditure to be kept in line with the priorities, in particular for primary education and health care outlays. To support the authorities' efforts, technical assistance provided by the Fund and other institutions for capacity building and institutional reform has been instrumental in São Tomé and Principe's economic adjustment process, and needs to be continued.

Mr. Jourcin made the following statement:

While I broadly endorse the staff appraisal, I would be brief. Sao Tomé and Principe's performance continued to be poor in 1997 in most areas: economic growth slowed down, inflation rose sharply, sizeable slippages occurred on the fiscal front, as well as in the monetary area, and progress in the implementation of structural reforms was weak, except for the land reform program. Overall, it is obvious that Sao Tomé and Principe has not begun to establish a track record of improved performance.

Against this unfavorable background and taking into account the challenges ahead, I can share Mr. Yao's view at the end of his statement that efforts to address all these shortcomings are urgently required and that delaying actions will only exacerbate the situation. I understand that Mr. Yao's point of view is not different from the staff's analysis which considers that, in the absence of rapid and resolute steps to reverse slippages, Sao Tomé and Principe's economic and financial prospects for 1998 and for the medium term would deteriorate rapidly. In sum, it seems to me there is a common view that taking appropriate actions becomes crucial. In this regard, I strongly encourage the authorities to forcefully implement needed measures that are required to return the economy to the path of sustained adjustment. I welcome the commitment to go ahead that they expressed during the discussions with the staff, but at the same time, I fully support the staff's approach for which the concretization of this commitment is a prerequisite for consideration of an ESAF-supported program.

Mr. Santos made the following statement:

The performance of the economy of São Tomé and Príncipe since the last consultations fell short of the country's needs. The targets set for 1997 were not met, mainly reflecting policy slippages in both macroeconomic and structural adjustment areas. While the program set for 1998 seems appropriate, we are concerned about its full implementation, in particular because of the scheduling of elections toward the end of the year.

The performance of São Tomé and Príncipe has lacked consistency since 1989, when the Fund program with São Tomé and Príncipe went off track. Room for structural adjustment is getting narrower. However, in the end, adjustment will be inevitable, and the authorities will have to choose between a more sound and orderly adjustment driven by good policies or a disorderly adjustment driven by a lack of external financing that will lead to a drop in imports and a consequent disruption in domestic supply conditions. We hope that the authorities of São Tomé and Príncipe are up for the challenges that lie ahead.

Despite these more immediate challenges, the staff report raises a more fundamental question: that of the long run-viability of the economy of São Tomé and Príncipe. Thus far, the economy of São Tomé and Príncipe has been dependent on a substantial level of foreign support, which has financed both consumption and, particularly, investment expenditures. While in principle this is not a problem, in the case of São Tomé and Príncipe we have to question the wisdom of investment decisions, because high investment rates for over a decade have translated into an incipient economic growth. The poor efficiency of investment is well reflected in the level of the ICOR.

The most visible consequence of the strategy pursued thus far is an external debt amounting to more than 600 percent of GDP. It is difficult to see how this situation will change in the foreseeable future. Domestic production is still overly dependent on cocoa production, and the strategy to diversify production has not produced sizeable results. Hence, we do not understand the sources of the projected pick-up in growth over the medium term. Among other factors, the staff counts on the lagged effects of investment in the agricultural sector since 1991. We wonder, however, whether these investments should not have already matured and begun delivering sizeable results. Staff comments on this issue would be appreciated.

It should be borne in mind that the window of opportunity provided by the HIPC will not be available forever. The staff should therefore abstain from mentioning hypothetical decision points by mid-2002, in order to avoid raising unfounded expectations for the authorities.

Mr. Akatu made the following statement:

From the staff report, it seems that political difficulties have continued to plague efforts to address the difficult financial and economic situation in São Tomé and Príncipe. In this regard, I note that there were significant slippages in the implementation of fiscal and monetary policies which were put together by the authorities to this end in 1997. In the event, the situation has become even more difficult, with the sharp rise in the inflation rate to 81 percent, and the prospects of a further worsening of the already severe macroeconomic imbalances seems considerable in the absence of corrective measures. Under the circumstances, the authorities cannot afford further delay in taking actions that are needed to hold the spiraling inflation in check, and also establish the necessary basis for a comprehensive program of adjustment and reform that would receive the support of the Fund and the donor community.

As in 1996, the authorities have identified the appropriate policy priorities for addressing the immediate challenges facing the country. There is a recognition of the need for meaningful action on fiscal and monetary policies geared toward reducing what threatens to be a run-away inflation, and equally important, the need to strengthen structural reforms in areas that will help reverse the precipitous downward trend in per capita income. In this regard, I welcome the commitment of the authorities to implement the fiscal measures set out in Box 1 in the staff report. A conscientious implementation of these revenue and expenditure measures should bring about a significant improvement in the financial situation and ease the immediate pressures on domestic prices and the balance of payments. The problem remains that of implementation. Some progress seems to have been made regarding the issue of petroleum pricing, which is an important element of the package of policies. There has been an adjustment of prices and the government's share of equity in the petroleum company has been reduced significantly as mentioned by Mr. Yao and Mr. Obame in their comprehensive preliminary statement. However, in light of the failure of the National Forum, convened earlier in the year to reach a consensus on major economic and political issues, and the upcoming legislative elections in October, we are concerned that the overall outlook for substantial progress seems uncertain.

Given its very high debt burden and the existing social and political pressures, a program of largely financial austerity would not be viable for São Tomé and Príncipe and external support is crucial. We urge the authorities to move quickly, perhaps after the elections, if not before, to bring the country to the place where support of the international community would become available. The Fund's technical assistance is necessary, in the meantime, to help build the institutional and human capacities that would facilitate the success of an ESAF program.

With these comments, we wish the authorities of São Tomé and Príncipe success in facing the tasks ahead of them.

Ms. Brownlee made the following statement:

I would like to emphasize the need for the authorities to strengthen their fiscal policy, particularly through improving their tax and customs administration and through expenditure management, which has not been good in previous years.

Far stronger progress needs also to be made with civil service reform, although the authorities should make sure that they implement the reform measures properly to avoid the problems that have been experienced with the military redundancy program.

The government's poor record of economic management damages the prospects for economic growth, and places any hope of debt relief into the distant future. As long as the government does not increase its efforts, Paris Club rescheduling will remain out of reach. I am encouraged by the government's commitments to make more progress, but these commitments need to be translated into concrete action.

The staff representative from the African Department noted that since the mid-1980s real per capita income in São Tomé and Príncipe had continuously dropped. However, that had happened in a context of high inflation and currency depreciation that was brought about by the pursuit of an expansionary fiscal and monetary policy. The implementation of macroeconomic stabilization policies, together with the strengthening of the structural reforms, should create the conditions to reverse the decline in real per capita income over the medium term. The cocoa sector should be able to contribute to growth in the initial stages of recovery; other agricultural sectors and tourism should also eventually contribute to growth. The growth prospects could also change drastically if the oil exploration that was currently under way proved to be successful.

Performance had been poor in the cocoa and agriculture sector despite large investments, most of which were financed by foreign assistance, the staff representative noted. The background paper on recent economic developments prepared a year ago listed a number of reasons for the poor performance in the agriculture sector. The principal reasons had been that the trees planted since 1992 had not yet reached maturity, the fact that the extensive public involvement during the initial phase of rehabilitation had limited private incentives, the lack of experience of small farmers with market mechanisms, and delays in tightening the remaining exchange controls, including the high surrender requirement. In addition, the cocoa sector had suffered badly from infestation. An improvement could be expected in the coming years, provided that the reforms that were supported by the World Bank continued. Those reforms included a campaign against infestation, further privatization, and a removal of the exchange controls.

Mr. Obame noted that São Tomé and Príncipe must undertake economic reform to put the country onto a path of sustained economic growth and social development, in particular as poverty was increasing. The authorities were taking action in that direction. Some of the efforts were already producing tangible results on several fronts. For instance, inflation was being reduced, and growth was expected to be about 2 percent, or even in excess of that. The authorities were also making efforts to raise fiscal revenue, and they hoped that those efforts, if successful, could be followed by an ESAF-supported program. While it was understood that the process for economic reform rested primarily on the authorities, the case of São Tomé and Príncipe showed that the continued involvement of the international community, including the Fund, in helping to foster the consensus for reforms and ownership of a program could not be discounted. The authorities were aware that to qualify for an ESAF-supported program, it would be essential to lower the heavy debt burden. However, São Tomé and Príncipe would need more than the current debt relief mechanism if the country hoped to achieve external viability. An imaginative solution to the debt situation facing São Tomé and Príncipe was therefore called for.

The Acting Chairman made the following summing up:

> Executive Directors agreed with the thrust of the staff appraisal. They expressed concern that São Tomé and Príncipe's already difficult economic and financial situation continued to weaken in 1997, with falling real GDP growth and rising inflation. They were disappointed that the authorities had failed to establish a good track record of policy implementation, as significant slippages had occurred in the fiscal and monetary areas, and progress in structural reforms remained slow. Directors stressed that, in the absence of policy corrections, there would be a risk of further rapid deterioration of São Tomé and Príncipe's financial situation. Therefore, they urged the authorities to tighten fiscal and monetary policy and accelerate the pace of structural reforms so as to position the economy on a path of sustained adjustment and growth. Directors also encouraged the authorities to pursue prudent external

debt management and borrowing policies in order to avoid a further increase in the large external financing gaps that are in prospect for the foreseeable future.

Directors stressed the importance of significantly strengthening fiscal policy in 1998. They encouraged the authorities to introduce, without delay, the measures necessary to lend credibility to the budget framework. They emphasized, in particular, the need to strengthen tax and customs administration so as to avoid a recurrence of the shortfalls experienced in recent years. Directors called on the authorities to strengthen expenditure management and improve transparency, and emphasized the need for containing wage increases and other nonpriority current outlays, so as to provide room for the needed appropriations for health, education, and investment.

Directors emphasized the need to strengthen the fiscal program, which should help reduce inflation while permitting higher bank credit to the private sector. Directors welcomed the decision to discontinue the practice of allocating foreign exchange for imports, and urged the authorities to phase out the export surrender requirement.

Directors encouraged the authorities to rigorously implement the envisaged structural reforms to liberalize the economy and establish the foundations for sustained growth. Noting the disappointing performance of the agricultural sector, they welcomed the government's intention to continue the land reform program. They emphasized the need to implement the redundancy program in the public service sector and to adjust petroleum prices.

Directors stressed that São Tomé and Príncipe needed a sustained implementation of the measures envisaged for 1998 to help restore confidence of the private sector and enhance the prospects for higher growth. Those measures would also help to establish a good track record, which would be a prerequisite for an eventual Fund-supported program, and to attract much needed concessional financing, including debt relief.

Directors also encouraged the authorities to continue to strengthen the country's human and institutional capacity for economic management, and in this regard they urged the authorities to make good use of the technical assistance provided by the Fund and other institutions.

Directors noted that São Tomé and Príncipe, being an Article XIV member, maintained multiple currency practices and restrictions on the making of payments and transfers for current international transactions. The authorities were encouraged to remove those as soon as possible.

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

The Executive Board took the following decision:

1. The Fund takes this decision relating to São Tomé and Príncipe's exchange measures subject to Article VIII, Section 2(a) and 3, and in concluding the 1998 Article XIV consultation with São Tomé and Príncipe, in the light of the 1998 Article IV consultation with São Tomé and Príncipe conducted under Decision No. 5392-(77/63), adopted April 29, 1977, as amended (Surveillance over Exchange Rate Policies).

2. As described in SM/98/148, São Tomé and Príncipe maintains restrictions on the making of payments and transfers for current international transactions in accordance with Article XIV, Section 2, except for the restriction on allocations of foreign exchange for imports of certain essential goods through the Chamber of Commerce that is subject to Fund approval under Article VIII, Sections 2(a) and 3. São Tomé and Príncipe also maintains multiple currency practices arising from the existence of spreads of more than 2 percent between the official rate and the parallel market rates, which are subject to Fund approval under Article VIII, Section 2(a) and 3. The Fund encourages the authorities to eliminate all remaining restrictions and multiple currency practices as soon as possible.

Decision No. 11759-(98/75), adopted
July 13, 1998

2. REPUBLIC OF LITHUANIA—1998 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1998 Article IV consultation with the Republic of Lithuania (SM/98/150, 6/19/98; and Sup. 1, 7/8/98). They also had before them a paper on selected issues in the Republic of Lithuania and a statistical appendix (SM/98/156, 6/25/98).

Mr. Hansen made the following statement:

Lithuania has successfully continued its transition towards a stable and fully-fledged market economy. The worldwide effects of the Asian crisis and the recent turbulence in the Russian markets had little visible effect on the performance of the economy. Prudent fiscal, monetary and external debt policies, as well as absence of sophisticated financial instruments and speculative investors allowed Lithuania to remain in a safe haven of the global financial ocean.

Almost all macroeconomic results have improved in 1997, and similar progress continued in 1998. The Lithuanian authorities have been making great strides in putting the real economy on the stable grounds in order to pave a smooth way for the implementation of the structural reforms. Although not without setbacks, which are unavoidable in the transition process, the authorities have persevered with the progress on the structural front, as well. As a result, foreign capital flows in the form of foreign direct investments and portfolio investments, respectively, doubled and tripled in 1997 compared to

1996, and are projected to double this year. Foreign lending to the Lithuanian government, banks and non-financial institutions has been active. A number of syndicated loans and Eurobond issues were registered in 1997 and in the first part of 1998 at favorable interest rates, taking an advantage of prevailing opportune market conditions and showing a growing trust of external creditors in Lithuanian firms and the economy as a whole.

The budget execution in 1997 exceeded the projected targets. Before closing the year with a deficit of 1.8 percent of GDP, the budget was near balance until December, when the bulk of expenditures has been made. The authorities recognized the underlying weakness in expenditure management and came up with the necessary initiatives to prevent the spending units from depleting their savings accumulated throughout a year.

In the first months of 1998, the national budget performed marginally better than planned. Budget implementation thus remained on track to achieve a fiscal deficit of around 1 percent of GDP. On an indeed positive note, the government undertook a revision of the draft 1999 budget and proposed a balanced budget for the next year. On the structural side of the fiscal sector, tax administration will be further strengthened, by making it more transparent, clearer and easier to interpret. A number of new fiscal initiatives, which are expected to have long-lasting positive effects, is in line to be implemented.

Already during the last Board discussion on Lithuania, the issue of the Savings Restitution Plan was touched upon. At this juncture, as the privatization proceeds are materializing, the issue requires yet more serious consideration. The authorities are committed to disburse two-thirds of the total privatization proceeds to the population who lost their ruble savings due to hyperinflation at the outset of the transition process. The total amount of restitution is estimated at 3.2 billion litas. The authorities fully agree with the staff's view that the disbursement process and amounts must be well thought and prudent in order to avoid negative macroeconomic consequences. A detailed procedure of disbursement is close to being completed by a group of experts from the central bank, Ministry of Finance and other official entities, with due regard paid to the indicated concerns. Furthermore, measures may be implemented which would encourage savings of the plan proceeds by the beneficiaries.

The implementation of the exit strategy from the currency board arrangement is proceeding smoothly as planned. The Lombard facility has been put in place at the end of June. Also, the central bank has indicated that in the last stage of the exit, the litas will most likely be pegged to a U.S. dollar/euro basket with both anchor currencies having equal proportions. This vision of the central bank is based on expected changes in Lithuania's trading patterns and practices. The euro is thought to take a significant share of the trade payments from the presently highly dollarized basket of payments as the trade with the EU countries will further increase.

On the legislative front, the amendments to the Law on the Bank of Lithuania have been prepared and will be discussed in the parliament after the summer recess. Once approved, they will guarantee the operational independence of the central bank, allowing the latter to follow its main objective of price stability by implementing a discretionary monetary policy in the post-currency board arrangement era.

Bank credit to the private sector grew at a healthy speed last year and was on the upward trend in the first quarter of this year. More than anything, this fact showed a rebound in economic activity of the private companies, with longer-term loans taking a growing share in the overall loans. On the other hand, there was a robust growth in banks' foreign currency borrowings from non-resident banks after the central bank allowed the local banks to lend in foreign currencies last fall. The central bank has counterbalanced this increase by putting all banks' borrowings—from the domestic and foreign sources alike—on the equal footing for the purposes of required reserve calculation. Previously, the reserve requirement used to be placed only on the domestically raised funds.

The external sector has remained a concern for the authorities. The process of transforming the economy into a modern, new-technologies-based mechanism is far from over. Lithuania, a country with limited natural resources, specializes in adding value to imported intermediate goods which are then exported. This explains the need for high level of imports of machinery and transport equipment which are used in forming a base for manufacturing, construction and transportation services. The import levels of these two items grew by over 40 percent last year. As the products of heavy manufacturing are not produced in Lithuania, and neither are oil and gas, there is little doubt that without importing them at a growing rate, Lithuania would not be able to build a modern economy at a pace seen so far. A strong increase in foreign direct investment, among other factors, facilitated import growth. The situation leaves the authorities to follow the developments very closely and to facilitate an environment conducive for using as much of the imports as possible for investment purposes, with a potential to generate future export earnings.

The authorities are very cognizant of the risks that a high current account deficit poses to Lithuania as an emerging market, and have been considering a set of measures to improve the situation, including a balanced budget starting next year and prudential measures which would lessen the economy's appetite for external, especially short-term, borrowing. This is especially pivotal having in mind that Lithuania has not yet experienced a real boom in lending for private consumption and real estate acquisitions, which could have been witnessed in other transitional countries and which, if overlooked, could quickly drive the current account to unsustainable levels and prop up inflation and asset price bubbles. (The domestic banks have been rather reserved and prudent in their lending practices since the banking crisis, but an increasingly competitive environment is now forcing the banks to look for new products and ways to sell them.) On the other hand, a high current account deficit calls for an increase in the level of national savings. The authorities are working in this direction, too. One could note the draft law on private pension funds which is pending the parliament's approval. Also, the capital market is being refined to make it able to better generate and intermediate savings of the population.

The banking sector has been developing reasonably well since the crisis of 1995/1996, although the growth and development potential for the banks and other financial institutions remains underused. The sector as a whole was profitable in the first quarter of this year. This achievement followed the periods of consolidated loss of the sector, mainly due to a poor condition of the state banks, especially the weakest of the three—the State Commercial Bank. The latter has been closed this spring. The two other state banks have improved their financial health considerably, compared to where they were a few years ago, and are getting ready for privatization. The privatization process for the Agriculture Bank is in a high gear now, with the potential buyers acquiring the tender information package, and a plan for state divestiture from the Savings Bank has been announced recently.

An open door policy for the foreign financial institutions has already resulted in two foreign banks having their branches opened in Vilnius, while two other banks are on the doorstep of the Lithuanian banking market. Five more banks have their representative offices opened in Lithuania. All banks operating in the market are well capitalized and are in general compliance with the prudential regulations. Banking supervision has been continuously improving along with sophistication of the banks themselves. The central bank has started a consolidated supervision of the bank groups which now also include leasing, investment and insurance companies. This exercise, however, will require further refinements in division of responsibilities among various supervisory institutions, as well as legislative changes.

The staff report contains an official estimate of the non-performing loans which seems to be rather high at over 28 percent of the total loans at the end of 1997. It should be noted that the closed State Commercial Bank had had a large share of the non-performing loan cargo. Upon liquidation, its non-performing loans were transferred to a state-owned asset management company. Also, there seems to be a considerable difference in non-performing loan estimation methods among various transition countries. Therefore, one should be wary of directly comparing a very conservative and transparent estimate of the Lithuanian authorities to the corresponding figure in other countries, where very small numbers of non-performing loans can be found. It should also be emphasized that all non-performing loans of Lithuanian banks are fully provisioned in accordance with the prudential rules set by the Basle Committee.

The privatization process has taken a major leap with the sale of the Lithuanian Telecom. Several other major companies—Agriculture Bank, Lithuanian Insurance, the oil sector companies, etc.—are in line for a sell-off already this year. The proceeds from the sale of the Telecom have been placed in an escrow account with the central bank, thus following the prudential strategy of protecting the money aggregates from huge surges potentially arising from the current and future privatization inflows.

By proposing to extend support to certain and strictly eligible private companies facing financial difficulties, the authorities are attempting to strike a fine balance between the market forces which require insolvent firms to go bankrupt, and those facing short-term financial mismatches, but whose closure would have significant social impact on individual geographical regions. In Lithuania, where despite a small size of the country labor mobility is extremely slow, particularly in rural areas, unemployment varies among various locations from 3 to 16 percent. A closure of one relatively larger company in a location further away form the major cities might change the social picture of the region drastically for the worse. In this regard, however, I should stress that the authorities are taking a tough stance to withstand truly protectionist pressures which stem from the old-fashioned managers fond of memories of the old system.

Mr. O'Loghlin made the following statement:

Many positive developments have occurred in Lithuania in 1997. Despite restraint in public capital spending, overall investment continued at a level well above that observed in the majority of developed countries. Aided by that restraint, the fiscal balance narrowed sharply. Inflation was reduced further, and is now in the single-digit range. These latter developments were rewarded by a further appreciable drop in nominal interest rates, which was one of the factors underpinning the strength of private investment. Overall employment and, more importantly, that outside the state sector continued to expand, and appreciable progress seems to have been made on structural reform, in particular, in the banking sector.

Foreign direct investment inflows have been rising, but domestic savings remain far too low, leading to a major deficit on the current account of the balance of payments. This is being largely financed by a rapid increase in the burden of public and publicly guaranteed debt. I agree with the staff that this is a source of concern, even if the bulk of external borrowing is medium term in nature. There is a degree of optimism in the medium-term balance of payments outlook presented by the staff, which foresees double-digit export annual growth in the dollar value of exports after the year 2002. Securing growth of that order from traditional CIS market will not be easy. Unless countries like Russia and the Ukraine are successful in transforming their economies, there is a risk that their capacity for imports will not expand rapidly enough. On the other hand, if they are successful, their own exports will challenge those of Lithuania. If double-digit export growth is to emerge from the EU markets, Lithuania will need to achieve sustained strong productivity increases over the next several years. Perhaps the staff could indicate how it perceives the balance of risks in this regard.

The key requirements for Lithuania are to curtail the external deficit, to limit the build-up of external debt in the short run, and to work toward a situation where investment can continue to be high but where it is financed by stronger domestic savings and supported by external financing.

The staff's call for greater fiscal restraint in 1998 and 1999 is appropriate to raise national savings. This restraint should be sought from the expenditure side of the budget. Public spending is relatively high for a country at Lithuania's stage of development.

Even if the prevailing fiscal balance in Lithuania seems small, it is threatened in the years ahead by demographic developments and the unsound public pension scheme. The appropriate course at present, notwithstanding the political implication, must be to raise pension ages. Private savings also need to be enhanced. I, therefore, welcome the intention to enable the establishment of private pension funds and hope the discussions about eliminating double taxation of investment funds will lead to positive steps on that front.

In the long run, enough investment needs to be sustained to enable national productivity growth, and to allow Lithuanian living standards to catch up to those of Western Europe. Fiscal and inflation achievements to date provide a sound foundation in that direction. Lithuanian banking needs to be further strengthened to support growing private sector activity. Bankruptcy law reform is needed to ensure that market discipline prevails and drives businesses to perform. Privatization efforts need to be deepened to avoid that weak state firms undermine the prospects of sounder businesses. Finally, trade liberalization needs to be enhanced to emulate the productivity of the industrialized world which Lithuania clearly desires to join.

Lithuanian policy to date has enabled it to get onto a path of solid growth. To garner further gains into the future, the policy to date needs to be deepened.

Mr. Yakusha made the following statement:

The staff report draws an impressive picture of macroeconomic stability and accelerating growth in Lithuania. Inflation has sharply fallen, GDP growth exceeded 5 percent over the last year, and currently unemployment is less than many EU countries. Foreign investment is beginning to flow in large amounts, promising sustained high growth for years to come.

The authorities should aim for a balanced budget in 1998 as well as in 1999. This is important for alleviating pressures on the current account and for reducing the potential for a reversal of capital flows. Balancing the budget in 1998 can be done by carefully reviewing discretionary spending and net lending plans. The handling of the distributions under the savings restitution plan has to be consistent with macroeconomic stability and fiscal transparency. I agree with the staff that the best way to do this is to incorporate these outlays in the budget starting next year.

We understand the authorities' motivation in devising the medium-term strategy for an exit from the currency board arrangement. It stems from the desire to join the EU as soon as possible and to enable the authorities to use monetary policy for offsetting nominal and external shocks. At the same time, the authorities should be extremely careful in implementing this plan. All necessary preconditions, including monetary, fiscal, and institutional need to be in place to safeguard public confidence.

I would like to support the views expressed by Mr. O'Loghlin regarding the medium-term sustainability of the current account as being on the optimistic side. While there have not been visible effects from the regional turbulence on the markets in Lithuania, the country's export performance is vulnerable to possible exchange rate volatility in the region. Could the staff comment on the size of the share of Lithuanian exports to Russia, especially agricultural exports. We would encourage the authorities to continue resisting protectionist pressures.

Mr. Costa made the following statement:

In the first place, I congratulate the authorities for the sustained progress of the Lithuanian economy which has so far being able to avoid contagion effects from the Asian or the Russian crisis. The rate of GDP growth continues to rise while inflation and interest rates and the fiscal deficit observe a steady decline. A serious weakness, however, is the low rate of national savings, which reached a little over 13 percent in 1997. According to the staff's projections private savings as a percentage of GDP in the year 2002 will be practically the same as the one observed in 1995, all the projected improvement of the gross national saving rate will come from the public sector. This effort will only serve, however, to bring the current account deficit down to 7.4 percent of GDP. It seems necessary therefore that more emphasis be placed on encouraging private savings. In this regard the two structural areas where progress has been slow, the privatization of small and medium size enterprises and the implementation of pension reforms, are precisely those that could contribute the most to incentivate private savings. In addition, it is noteworthy that real deposit interest rates have remained consistently negative throughout all these years and the paper does not clarify whether the staff's advice was given to reverse this situation.

With respect to the size of the current account deficit, which in 1997 reached 10.3 percent of GDP, the staff limits its comments to pointing out the fact that Lithuania's goods remain competitive abroad and that the current account gap is being financed mainly by foreign direct investment and long-term loans. This would suggest a medium-term external sustainability, which I broadly share, particularly as Mr. Hansen points out in his informative preliminary statement that Lithuania is not experiencing a credit led boom in consumption or asset price inflation in general.

The over-performance of the fiscal sector in 1997 is worth highlighting as is the fact that more than three-fourths of the entire deficit was concentrated in the month of December. This supports the view that the authorities could indeed accelerate the process of fiscal consolidation to achieve balance not just in 1999 but even in the present year, as suggested by the staff. The changes to the budgetary process approved by the government last April, which seem to have been inspired by the Code of Good Practices on Fiscal Transparency should contribute to a more efficient public expenditure management and toward achieving fiscal balance. I concur with the staff on the need to reduce and phasing out remaining subsidies and to cut net lending to public enterprises and programs to assist certain private companies facing financial difficulties. On the revenue side, improvements in tax administration should be complemented by greater uniformity in the interpretation of the tax laws.

Regarding monetary policy and despite the staff's positive assessment of the implementation of the first stage of the currency board arrangement exit strategy, the authorities seem now hesitant as to the need to speed up the process and point to the advantages of the currency board arrangement as an anchor for policy discipline and low inflation and even to the substantial room the currency board arrangement provides to the BoL to respond to monetary shocks. I share this assessment on the part of the authorities, which confirms the doubts raised in last year's Board discussion by this and other chairs on the wisdom of preannouncing an exit from a currency board arrangement. Nonetheless, the staff has encouraged the authorities to continue with such a strategy based on the argument that exchange rate flexibility is needed to accommodate real exchange rate appreciations stemming from rapid productivity growth. Could the staff clarify the meaning of the suggestion in paragraph 41 of the main report that in the present circumstances flexibility in the exchange rate arrangement should be considered as long as there remains scope for a real appreciation of the litas, and whether this is indeed a desirable outcome.

In this regard, I am concerned by several factors. In the first place, with a trade deficit reaching 11 percent of GDP appreciations of the exchange rate should be avoided. Continued adherence to the peg, in the context of Lithuania's supportive macroeconomic framework would have the advantage of avoiding unwanted nominal appreciations associated with situations of high capital inflows, while the real appreciation stemming from inflation differentials would be offset by productivity growth and slowly reduced through inflation convergence. Second, Lithuania's strategic goal of EU membership would suggest the desirability of a fixed exchange rate. In this way economic agents would be better prepared to face a more competitive environment by learning to rely more on productivity gains and on flexible labor and product markets than on nominal adjustment of the exchange rate, a policy instrument that they would lose anyway in the event of EU membership. Third, if there is an example of a small open economy, for which theory recommends a fixed exchange rate, it is the Lithuanian economy with an external sector representing more than 120 percent of GDP. It should be self-evident that this type of economy can ill afford uncertainty or increased volatility in what for all practical purposes is its most important economic variable, that is, the nominal exchange rate.

With these remarks I wish the authorities well in their endeavors.

Mr. Merz made the following statement:

Lithuania's progress in the transition process is remarkable. It is encouraging that the authorities are committed to go ahead with their reform agenda. However, there are some downside risks, as pointed out by the staff, which can hamper development in the medium term. The most concerning risk is the persisting high level of current account deficit. This makes the country vulnerable to regional contagion.

This chair had advocated at previous occasions to look into alternatives for the currency board arrangement. We, therefore, welcome the official three-stage approach for an exit from the currency board arrangement as shown in Box 2 of the staff paper. Such an exit strategy will move the real exchange rate toward its equilibrium level and will provide a good basis for joining the European Union. The exit strategy should contain the following elements.

First, the necessary changes to the litas's credibility law should avoid any weakening of the independence of the Central Bank. Second, decisions about further steps toward flexibility should not depend on a time schedule but more on the current economic conditions. Third, all steps should be made transparent and explained by the central bank in detail to avoid uncertainties in the financial markets. Fourth, the exit should include a deepening of the financial markets and a strengthening of the banking system.

With regard to financial markets, the various measures to promote development of the financial system will facilitate liquidity management of the central bank, and promote domestic savings. It will be crucial to strengthen banking supervision, particularly by creating an independent supervisory body to privatize the remaining state-owned banks and to facilitate market access of foreign banks.

We are convinced that the authorities are able to tackle all these challenges and wish them much success.

Mrs. Paris made the following statement:

At the outset, I would like to thank the staff for having provided us with a concise report on Lithuania and an interesting background paper. I broadly share their positive assessment and agree with most of their recommendations. I will limit my statement to two short comments, one on fiscal policy and the other on the exchange rate policy regime.

While I understand that it is the role of the Fund to err on the rigorous side and I acknowledge the need for higher domestic savings, I do not see a very strong case for further fiscal tightening as advocated in the staff appraisal. Indeed, it seems to me that the important reduction of the fiscal deficit in 1997, which went beyond the program target, the pursued improvement in 1998 and the objective of the balanced situation in 1999, is a satisfactory stance. I agree with Mr. Costa that more would need to be done to encourage private savings, mostly through structural reforms. More importantly on fiscal policy, attention should be paid to the public spending composition, between current and capital expenditures: the modernization of public infrastructure and the need to improve the economy's long-run potential may require an increase in public investment. In this regard, I welcome the undertaking of reforms in the area of public expenditures and the development of a three-year fiscal policy framework.

As regards the exchange monetary policy, I would certainly not contradict the staff when they stress the need for "exiting the currency board without a loss of credibility". Yet, the statement is uncontroversial and vague enough to leave it open to various interpretations. The continuation of a prudent fiscal policy, a strong and independent monetary policy geared towards low inflation and a further strengthening of the banking sector and its supervision system should constitute a good recipe for success. Yet, the staff has raised an interesting issue related to the precise features of the exchange rate arrangement that will replace the current fixed link with the dollar. I noted in particular the suggestion made to consider giving flexibility to the exchange rate regime as long as there would remain scope for real appreciation. I wonder in this respect whether the staff could provide its assessment, if any, of a possible undervaluation of the litas, and the scope for further relative price adjustments between nontradables and tradables.

Mr. Rigász made the following statement:

The Lithuanian authorities' determined implementation of prudent policies has resulted in continued macroeconomic stability and significantly boosted market confidence. With the economy growing at a healthy 6 percent annually, and inflation in single digits and still declining, the main challenge now is to deal with the very high current account deficit.

According to the published data, the current account deficit grew from around 10 percent of GDP in the first quarter of 1997 to 13.5 percent of GDP during the first quarter of this year. The higher deficit and more difficult conditions in the international financial markets have increased Lithuania's vulnerability to external shocks and call for a tightening of domestic financial policies.

The benefits of balancing the budget in 1998, as recommended by the staff, can hardly be overstated, but to achieve this goal would seem to require further monetary action. Even though Lithuania's economy is relatively undermonetized, there is a serious question whether an economy with so large an external imbalance can afford to allow private credit to grow at an annual rate of by 40 percent or so. The number of monetary instruments available to the Bank of Lithuania is limited, but growing expectations of a devaluation need to be reined in by an immediate monetary tightening.

The authorities are prudently striving to create a fiscal cushion, but we would like to point out that this goal cannot be achieved solely by downsizing public investment programs. According to some reports, less than half of the government's investment plans for 1996 and 1997 were carried out. Table 6 of the staff report clearly shows a declining trend in the capital spending of the consolidated general government, from 3.8 percent of GDP in 1995 to 2.5 percent of GDP in 1998. The authorities need to increase public investments, not decrease them, to remedy the deficiencies of public infrastructure. The energy sector in particular will require considerable investment given the government's plan to close Lithuania's nuclear power plant. This facility, which supplies an impressive 86 percent of Lithuania's electricity demand and also brings in substantial export earnings, cannot be replaced imported energy without exploding the trade balance. I would be very interested to learn from the staff what are the government's plans for energy sector development and what investments this will require.

With these remarks, I wish the authorities the best.

Mr. Szczuka made the following statement:

Let me start by congratulating the Lithuanian authorities for their progress in stabilizing the economy, for accelerating growth, reducing inflation, and for the recent effort to reduce the budget deficit.

I am concerned about the medium-term balance of payments scenario, which is not fully consistent with the intended strategy of exiting from the currency board arrangement and appears overly optimistic. It is not advisable to exit from the currency board arrangement when the current account deficit is over 8 percent, when the reserve level is below three months of imports, when there are problems in the fiscal sector, and when the issues of the banking weakness have not been fully addressed. Furthermore, reserves are growing at a slow pace, the short-term debt to foreign exchange reserves ratio is scheduled to increase, and foreign direct investments appear overly optimistic. While the privatization of Telecom and the oil company are expected to yield high inflows, there are not that many large companies which can be privatized with foreign participation. The assumption that the foreign direct investment will stay at the level of 6 percent of GDP or even grow further seems to be overly optimistic.

While the staff does not appear worried about the growth in real wages, it is undermining the level of competitiveness of the Lithuanian economy, even though the absolute level of wages is still low.

In last year's recent economic development paper the staff strongly encouraged the authorities to increase foreign borrowings because it was cheaper and more flexible. In this year's paper the staff is recommending restraining foreign borrowing and increasing borrowing on the domestic market. That is to some extent consistent with the reduction of interest rates on the domestic market, although the reduction of interest rates is proceeding too fast and should be avoided. I also see some signs of problems on the foreign borrowing side. The decision to postpone foreign borrowing because of market conditions may be a sign that there is some impact of the crisis on the Lithuanian economy. In addition, the increase in spreads from 105 to 220 basis points on the Lithuanian bond, is an indication that there is a deterioration of the conditions to access to the foreign market by the Lithuanian borrowers.

Finally, I would like to fully endorse the staff recommendation to incorporate all the extra budgetary funds into the budget.

Mr. Palei made the following statement:

This was the first Article IV consultation for Lithuania since the expiration of the EFF in October of last year. Economic indicators point to the success of the program. The growth of GDP is a robust 6-7 percent; inflation is decreasing; interest rates are relatively low; the external debt indicators are healthy; and the budget deficit at less than 2 percent of GDP is better than expected. The authorities are to be commended for their tireless efforts to achieve living standards comparable to those in the European Union. The staff also deserves praise for their continuing, although now less formal, involvement in the economic policy making in Lithuania.

I broadly share the staff's evaluation of the Lithuanian economy. The privatization of small and medium enterprises; the elimination of the remaining impediment to agricultural land trade; the balancing of the pension scheme; the politically feasible fiscal consolidation; the abolition of the export taxes, and other issues, certainly have to be at the center of the authorities' attention. At this stage of the discussion there is no need further to elaborate on these tasks. My specific comments refer to the envisaged exit from the currency board arrangement and to the restructuring of the financial sector in Lithuania.

In my view, the exchange rate regime is one of the core policy issues for Lithuania. It is widely acknowledged that the currency board arrangement has served Lithuania well, and there should be serious reasons to justify ceasing its further use. At the outset I would like to emphasize that, in the end, it is up to the Lithuanian authorities to decide on the merits of a particular exchange rate regime. But like Mr.Costa, I did not find in the staff's paper a clear-cut case in favor of exit from the currency board arrangement. Allow me to explain why this chair continues to doubt the benefits of exit from the currency board arrangement.

In the staff's paper, I found several considerations regarding exit from the currency board arrangement. One argument in favor of exit from the existing currency board arrangement is aimed at allowing the real exchange rate to move toward its equilibrium (see paragraph 68). As far as misalignments are concerned, I did not find any evidence of danger. The staff states that, at this juncture, nothing points to overvaluation of the litas. Lithuanian wages are still below the levels of the neighboring countries, and Lithuanian exports remain competitive. Appreciation of the real exchange rate most likely reflects gains in productivity and relative price adjustments. Yes, there is a current account deficit close to 10 percent of GDP that could be a matter of concern, and I will return to this issue later. What is important, though, is the fact that the current account deficit is financed by long- and medium-term loans, and, to a large extent, by foreign direct investments. Moreover, the medium term balance of payments projections show that the level of FDI is expected to double in 1998 and to further increase in subsequent years. Short term external debt amounts to only about one percent of GDP. To summarize, firstly, there are no signs of a dangerous overvaluation of the currency now, and there are no expectations of any major misalignments in the future. Secondly, the capital inflows do not appear to be speculative and are likely to be sustainable in the medium term.

The staff recognizes the importance of the credibility of the monetary policy in Lithuania. They point to a set of sensible steps designed by the authorities to preserve the hard-earned existing credibility of their monetary policy. Still, exit from the currency board arrangement leads to more discretion and, hence, less credibility in the area of monetary policy. Is this risk worth taking? The exit strategy was designed at the beginning of 1997, before the Asian crisis. In light of the experience in Asia, I see a serious case for the authorities to reconsider their decision to scrap the working currency board arrangement. The speed and the degree of the exchange rate swings in Asia, as well as the apparently unsuccessful attempts by national authorities to manage the developments in the exchange markets caused a major shift in conventional thinking about the appropriate exchange rate policies. In particular, more experts now favor the extreme arrangements, either a very clean float or a currency board arrangement. Both of them imply the absence of a discretionary policy. It follows from the staff report that the Lithuanian authorities refer to "the possibility of an initial strict peg...and the subsequent introduction of a trading band around the peg"(paragraph 41, p.26) as opposed to the introduction of a floating regime. The authorities' approach may send confusing signals to the markets and their exchange rate policy in the case of an exit from the currency board arrangement would be more discretionary and less credible.

Yet, one more argument in favor of an exit from the currency board arrangement is the base currency. The authorities claim that their goal is eventual membership in the EMU with the use of the EURO in Lithuania. This argument is reasonable, especially if one looks at the increasing share of the EU in Lithuania's exports and imports. In addition, the use of the dollar as a reference currency could lead to a higher than warranted appreciation against the European currencies. Figure 3 on page 10 does, indeed, show the extent of the real appreciation of litas against the German mark. This could be one of the major factors behind the higher current account deficit mentioned earlier. Overall, the currency of reference is a legitimate concern. But an exit from the dollar currency board arrangement does not necessarily mean an exit from the currency board arrangement itself. Why doesn't Lithuania simply switch to the EURO-based currency board arrangement from the dollar-based one? It could be the best and direct way to prepare for the eventual introduction of the EURO.

Whether Lithuania introduces a more flexible exchange rate regime or not, the financial sector reforms should be carried out expeditiously. In case the authorities decide to keep the currency board arrangement, the urgency is, probably, even more obvious. I fully support the weight put on the financial sector in the reform agenda outlined by the staff in the main paper and in Chapter IV of the Selected Issues paper. The authorities derived valuable lessons from the banking crisis of 1995, now they might learn from the mistakes of countries pulled into the currency crisis in 1997-1998. For the small open economy of Lithuania, it would be prudent to go beyond the Basle standards. The improvements in prudential regulation and supervision should constitute the core changes. In addition, the introduction of longer-term debt instruments is due not only at a national level, but at the level of individual financial institutions as well. Both a presence in the international debt markets and the development of domestic instruments are needed. Equally vital are better corporate governance in the financial sector; privatization of the state banks; and transparency of the participants' operations.

Mr. Hagan made the following statement:

As I agree with the thrust of the staff appraisal, I would just want to emphasize one point, and align myself with Mr. Merz's comments on the exit from the currency board arrangement.

I wonder whether the authorities' wish to move to a peg with the euro is driven by their wish to accelerate the negotiations they are having with the European Union at the moment. A peg to the euro is not necessarily in the interest of the authorities at this stage. There are many elements which would help the authorities in their EU accession negotiations, in particular moving quickly on structural policies. However, having monetary policy and exchange rate policy dictated by the link to the euro is inappropriate.

The staff representative from the European II Department noted that Directors had expressed concern about an overly optimistic medium term balance of payments scenario. About 45 percent of Lithuania's exports were to the CIS countries, and Russia by itself accounted for about one fourth of total exports. Lithuania also imported substantially from CIS countries, mainly energy. Another important element of the balance of payments scenario was that foreign direct investment continued. Whether or not the assumptions underlying the balance of payments scenario were optimistic was difficult to say. With sufficient foreign direct investment, with reasonable conditions in the major export markets, and with a continuation of structural reforms in the enterprise sector, the staff's projections were achievable.

Whether the staff was being optimistic on the foreign direct investment projections, was difficult to say, the staff representative considered. There was substantial uncertainty in the 1998 projections about the timing and amounts of investment, in particular with respect to the privatization of major enterprises, including Telecom. That transaction had been carried out on schedule. The amount involved for the privatization of Telecom was large, so that foreign direct investment would be higher than anticipated in the projections. If reforms continued in the enterprise sector, the scope for foreign direct investment would be substantial.

The medium-term exit strategy from the currency board had been planned for quite some time, and was part of the program that was supported by the EFF, the staff representative explained. No deadline had been set under the exit strategy and all the preconditions needed to be met before implementing an exit from the current peg. One important consideration in the decision to exit from the peg was the turbulence in world financial markets. The project was being implemented in a cautious way, and the staff was supportive of this cautious approach.

The strategic objective of the authorities was to have a full integration with all the institutions of the European Union, including the euro, the staff representative noted. The staff had suggested that consideration be given to increased exchange rate flexibility. The basis for that advice was that adjustment in the price level in Lithuania still needed to be carried out.

The staff was not in a position to estimate the scope for real exchange rate appreciation, the staff representative indicated. That type of estimation was not easily done, because the structure of the economy was changing rapidly.

As reforms of the financial system were completed, the spread between lending and deposit rates would decline, the staff representative noted. The rates of return on different financial instruments would then be brought into line with what was needed for developing financial markets.

The energy sector was important to the Lithuanian economy, the staff representative observed. The authorities were planning the diversification of this sector in terms of sources of energy and ways in which energy was produced. One large nuclear power plant currently accounted for a large proportion of power produced. The authorities were also trying to increase the participation of foreign investors by privatizing a number of energy sector enterprises.

Although wages were growing, the level of wages was still quite low, the staff representative noted. The staff was concerned about two main areas. One was the wage bill of the government—the advice had been to make wages one of the expenditure areas where greater restraint should be applied. The other concern was that wage growth in the enterprise sector often took place in enterprises that were not financially able to finance it. That was a substantial problem, and the staff's advice on bankruptcy procedures and the privatization of government stakes in small and medium enterprises was related to that problem.

Two years ago the staff had advised the government, which had relied almost exclusively on domestic financing at high interest costs, to diversify by financing the budget in part through foreign markets, the staff representative recalled. That had been done quite successfully. In the recent round of discussions the staff had advised to put greater emphasis on domestic sources of financing, because of the need to develop domestic financial markets.

Mr. Costa observed that it was possible to add some instruments of monetary policy without exiting from the currency board. The authorities apparently recognized this possibility, as they had created the Lombard facility. While the staff the previous year had said that the choice of the exchange rate regime was that of the authorities, it was currently advocating a move toward a flexible exchange rate. As Mr. Palei noted, the Asian crisis demonstrated the price of moving away from fixed exchange rate systems. The staff should reconsider it advice in view of the recent crisis.

The Deputy Director of the Policy Development and Review Department considered that, while many lessons had been learned from the Asian crisis, whether or not to move away from a fixed arrangement was not one of them. A significant part of the problem in the Asian crisis was the retention of pegs for far too long, and the subsequent departure from a peg in the midst of crisis.

The staff representative from the European II Department noted that the staff had not departed substantially from its advice on exchange rate policy. The staff had merely recognized the authorities' desire to integrate with the monetary institutions of the European Union, and that there was room to consider exchange rate flexibility in that process.

Mr. Szczuka stated that he favored increasing exchange rate flexibility but only in the medium term. Lithuania's desire to join the EU was a long-term objective. At the current stage, however, it was probably not warranted to move toward increased exchange rate flexibility.

The Acting Chairman agreed with Mr. Szczuka that the sequencing of the exit strategy was important. The right preconditions must be met for there to be an orderly exit

Mr. Borpujari said that he wished to associate his chair with the concerns expressed by Mr. Costa on the matter of moving at this stage toward greater exchange rate flexibility.

Mr. Hansen made the following closing remarks:

> First of all, I want to thank you my colleagues around the table for the active participation in this discussion. The views expressed here are indeed valuable and will be submitted to my Lithuanian authorities.
>
> The staff has made my job easier by comprehensively and clearly answering questions which have been asked here today. I could add that, in general, in all their work, the Lithuanian authorities have been heading firmly toward their main objectives of narrowing the economic, social and institutional gaps between Lithuania and the developed European countries. On the way to an eventual membership in the European Union, there is a sober recognition in Lithuania that the EU integration process will require long and conscious reform efforts.
>
> There are certain signs in Lithuania that the authorities not only want to implement some reforms, but they consciously look for the best international experience in different fields. Among the structural reforms of the fiscal sector, the program budgeting concept, similar to that of the OECD countries, is going to radically improve the way of budget planning, preparation, implementation and control, with particular emphasis on expenditure management. A sophisticated treasury and debt management system will be supplied by one of the Scandinavian countries and will be put in place this year. Finally, a further boost to fiscal transparency will create a concept of the "citizens' budget", as more information will be released to the public, including publication of the draft budget prior to its deliberations in the parliament. This goes in line with best international practices in the fiscal field.
>
> On the external side, exports and imports grew at a robust rate last year, highly exceeding the growth rate of the GDP and thus making the economy more and more open for the international trade. The trade openness

indicator is now high, with the total of exports and imports reaching 120 percent of the GDP.

A balanced budget in 1999, or one year ahead of the envisaged strategy, is a natural step in improving the current account situation. In addition, encouragement of export will be given a strong priority. There is still a lot to be done in strengthening Lithuania's international image and building presence in the international markets, and the authorities are determined to place increased attention in this area.

I would note that this meeting on Lithuania was the first in the history of Lithuania's membership in the Fund where Lithuania was discussed without having a formal arrangement with the Fund. Nevertheless, quarterly staff visits to Lithuania will continue in the future as the authorities are interested in keeping a close dialog with the staff.

It cannot be overemphasized that, even after the expiration of the EFF last fall, the authorities, and the Lithuanian markets, for that matter, attributed a high value to the Fund's advise, suggestions and criticisms. On behalf of my Lithuanian authorities I, therefore, would like to thank the staff for their frankness and high professional expertise shown during the Article IV consultations, and for the clear and balanced set of papers written for this Board discussion. It was especially interesting to find information in the staff report which provides a comprehensive set of indicators of external sector vulnerability. It is my strong believe that similar tables should become a part of all country reports, both for individual country evaluations and for country comparison purposes.

The Board on several occasions has discussed ways and means to enhance transparency, openness and ownership. I want to take this opportunity to mention to the Chairman and the Board that the staff met with parliamentarians and the press in Vilnius and, I think, they did an excellent job in explaining the policies of this institution.

The Acting Chairman made the following summing up:

Executive Directors agreed with the thrust of the staff appraisal. They commended the authorities for their successful implementation of policies under the Extended Arrangement that was concluded last year and welcomed their willingness to continue to cooperate closely with the Fund. Directors noted that Lithuania's overall good policy implementation record had resulted in a generally positive economic performance marked by robust growth, and by low and declining inflation and interest rates.

Directors observed that the key challenge faced by the authorities was sustaining the favorable economic performance, and in this connection, they stressed the risk posed by the present level of the current account deficit and the need to raise the rate of national saving. While, to date, there had been little contagion from the Asian crisis or the turbulence in the Russian financial markets, there was no scope for complacency. Accordingly, Directors called for determined action to reduce the vulnerability of the economy to external shocks, especially through the capital account.

While acknowledging progress to date in budgetary consolidation, several Directors called for a further tightening of fiscal policy. In particular, Directors recommended that the target date for balancing the budget set by the government for 1999 be advanced to this year and, at a minimum, that fiscal balance be maintained in 1999. Such a strengthening of the fiscal position would, Directors stressed, send a clear signal of the authorities' commitment to prudent macroeconomic policies over the medium term and create a cushion that would reduce the government's vulnerability to disruption in financing.

Welcoming the progress in improving revenue performance, Directors recommended that further fiscal adjustment be focused on the expenditure side of the budget by limiting the growth of current expenditure, especially the wage bill. Directors expressed concern about delays in reforming the Social Security Agency (SoDra), and called for the speedy implementation of measures to deal with its cash flow problems by improving tax administration and strengthening its medium-term financial sustainability by accelerating the schedule for raising the retirement age.

Directors welcomed the government's proposal to increase the transparency of the budget process and to adopt an explicit medium-term framework for its implementation. Directors recommended, however, that the process be strengthened further by incorporating all extra budgetary funds, including SoDra, into the budget process. Directors agreed with the staff's recommendations to place greater reliance on domestic financing.

Directors noted that the currency board arrangement had served Lithuania well. Some Directors supported the Bank of Lithuania's medium-term strategy of preparing an orderly exit from the currency board arrangement, but a few other Directors thought it might be advantageous to keep the currency board arrangement or recommended some caution regarding the timing of the exit. Directors observed that, to this date, the exit strategy had been implemented with pragmatism and without undue reliance on rigid deadlines. All Directors stressed the importance of fully meeting the necessary preconditions for an exit, including a strong and independent central bank, a deepening of financial markets, and a reduction in the current account deficit. In this connection, they agreed with the Bank of Lithuania on the need for strengthening the legal basis for central bank independence and for establishing price stability as the central bank's overriding objective. They called on the Bank of Lithuania to set its objectives and operating procedures in a transparent manner and to maintain at all times adequate external reserves. Several Directors agreed with the staff's view that, over the medium term, consideration might be given to introducing a degree of flexibility in the exchange rate arrangement.

While acknowledging that the situation in the banking system has improved, Directors stressed that a further strengthening was needed, and called on the authorities to address the remaining weaknesses, especially those related to state-controlled banks. Directors recommended their speedy privatization, and emphasized the need to ensure that their operations in the meantime are in full compliance with prudential regulations and are carried out on a strictly commercial basis. Directors called on the Bank of Lithuania to remain vigilant in guarding against excessive reliance by the domestic banking system on short-term inflows from abroad.

Directors commended the authorities for their forceful approach to the privatization of large enterprises in the telecommunications, transport, and energy areas. They emphasized, however, the need to revitalize the privatization program of small and medium-size enterprises. Directors called on the authorities to speed up restructuring by the strict forbearance from bailouts of any sort, enforcement of a new bankruptcy code, and elimination of ownership restrictions on agricultural land.

Directors commended the authorities for their efforts to improve the availability of statistical information, citing in particular the decision to subscribe to the Special Data Dissemination Standard, to publish the International Investment Position on a quarterly basis, to strengthen the monitoring of short-term debt exposure of resident banks and nonbanks, and to provide a wide range of current information on the Internet.

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

3. ERITREA—1998 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1998 Article IV consultation with Eritrea (SM/98/155, 6/25/98). They also had before them a paper on selected issues (SM/98/161, 6/29/98).

The staff representative from the African Department made the following statement:

The following information has become available since the issuance of the staff report for the 1998 Article IV consultation with Eritrea (SM/98/155; 6/25/98).

The border conflict between Eritrea and Ethiopia has continued, but there has been an agreement to cease air strikes, and skirmishes on the ground have been minimal as a result of several peace initiatives. The most notable of these initiatives is the June 26 UN Resolution—which has been accepted by both countries—calling on Eritrea and Ethiopia to "immediately cease hostilities" and on the Secretary General to mediate peace. However, it has been reported that both sides have been fortifying positions along the 1,000 km long border.

As a direct result of the conflict, trade between Eritrea and Ethiopia has come to a halt and Ethiopia has diverted the shipment of all its exports and imports from Eritrean ports, especially Assab (which accounted for the bulk of shipments), to neighboring Djibouti and has halted flights and telecommunications links with Eritrea. The de facto blockade of Eritrea's airspace and ports is no longer effective, as the Eritrean authorities report that some flights have resumed and the port of Massawa has continued to handle goods destined for Eritrea.

The immediate financial and economic impact of the conflict on Eritrea is emerging mainly in the trade flow area, which has resulted in higher prices for goods, especially a number of food items, that were previously imported from Ethiopia. The important receipts from port fees and charges have been adversely affected and will result in lower budgetary nontax revenue and adverse developments in the external current account. However, the authorities indicated that in the short run, they expected that the higher private remittances expected from the large Eritrean community in the Middle East, Europe and North America will offset the adverse impact of the port fees and charges on the external current account. The budget is also under pressure from the direct cost of the war, including payments for partial mobilization.

Other costs of the conflict to the economy entail absorption of an estimated 6,000–10,000 Eritreans who have been expelled from Ethiopia and others displaced by fighting at the border. There have also been interruptions in the operations of the government and other institutions, which have exacerbated the limited institutional capacity in the country. With the evacuation of expatriates in late May, the Fund removed an FAD long-term expert in the Customs Department and has indefinitely postponed an FAD mission to Asmara, inter alia, to install another long-term expert in tax administration.

These developments do not change the substance of the staff appraisal.

Mr. Morais made the following statement:

My Eritrean authorities are thankful to the Fund and the donor community who have been providing technical assistance, concessional financing and policy advice. These resources and policy dialogues have been invaluable in shaping the development process in Eritrea. Regarding the border conflict, there are signs that tension is easing and economic and social activities are returning to normal. The authorities are committed to a peaceful resolution of the conflict and have indicated their intention to continue cooperating with the peace initiatives spearheaded by the UN and the OAU. They are currently assessing the impact of the conflict on the economy with a view to ensuring the maintenance of macroeconomic stability and the momentum of reforms.

Since independence in 1993, Eritrea has been implementing a program of social rehabilitation and economic reconstruction based on a homegrown framework. The initial emphasis has been the rehabilitation of physical and economic infrastructure, institutional and human capacity building and the transformation of the economy from centrally planned to market based with vibrant private sector activity. Over the years, the authorities have made major headway. The Government was practically reinvented, creating a lean, decentralized and well motivated and committed civil service to spearhead economic reforms. The Ministry of Finance was restructured to gear it for macroeconomic management and the tax departments were strengthened. A comprehensive legal framework for the financial sector was put in place, facilitating the introduction of an independent central bank in 1997, charged with licencing, regulating and supervising the financial sector. New financial institutions were licensed to promote competition in the financial sector while others, including foreign banks will be licensed soon. The exchange system has been liberalized and unified and tariffs have been reduced. Towards the end of last year, the authorities introduced their own currency, with the benefit of Fund technical assistance.

Following the establishment of a privatization agency together with the legal framework, about 700 small-scale entities and 39 big and medium-scale state manufacturing enterprises have been privatized. Prices were decontrolled while differential interest rates between the private and public sectors were eliminated. Consequently, the role of the private sector was boosted, resulting in buoyant growth in manufacturing and services exports.

With the benefit of these reforms, real output growth averaged 7 percent during 1993–96 and rose to 8 percent in 1997, translating into significance growth in per capita income. Fiscal revenues increased sharply and there was a strong accumulation of foreign exchange reserves. The annual average rate of inflation was maintained at less than 4 percent during 1993–96. In 1997, inflation remained substantially subdued in the first half of the year. In the second half, inflation increased particularly in the months of November and December due to supply constraints. However, the average annual rate of inflation for the whole year was maintained at around 2 percent.

In 1997 there was a sharp turnaround in the fiscal position. Government expenditure was reduced by about 10 percentage points, reflecting the completion of some programs and the intention of the authorities to bring down the deficit to sustainable levels in order to instil confidence in the new currency. Revenue went up by 6 percentage points, buoyed by the broadening of the tax base and the ongoing strengthening of the collection effort. As a result the deficit came down sharply from 16.4 percent in 1996 to 5.5 percent of GNP in 1997. Reflecting the fiscal turnaround, credit to Government declined sharply, creating room for more lending to the private sector.

The external current account also improved in 1997, reflecting the sharp increase in private remittances and some decline in imports while external reserves reached the equivalent of almost 5 months of imports of goods and nonfactor services. The authorities have pursued a prudent external borrowing policy, relying on concessional assistance and have strengthened their debt management skills. Foreign debt and debt service remain low.

The authorities have adopted a forward looking strategy and have come up with a National Economic Policy Framework and Program (NEPFP) for 1998–2000. The medium-term targets of real output growth of 6–7 percent per annum, annual rate of inflation of 3–5 percent and a build-up of reserves to 5.5 months of imports are quite ambitious and consistent with the authorities' track record of perseverance with implementation of good economic policies.

High on the agenda is the promotion of macroeconomic stability, conducive to stimulating private sector activities and accelerating output growth and the creation of employment opportunities. The process of fiscal consolidation, already underway, will be strengthened through a rigorous and computerized expenditure control system, and improved revenue collection. The authorities are also preparing for the formalization of the budgeting process. The central bank will pursue an independent monetary policy geared toward maintaining stable prices, relying on indirect instruments of monetary management. Structural reforms will be deepened, including the privatization of the remaining public enterprises, which have since been commercialized. The authorities will remain committed to a flexible exchange system and a liberal and open trading system.

While the recent developments relating to the border conflict could have an impact on the authorities' policy objectives, it is their intention to revisit these issues in the context of their medium-term macroeconomic framework and economic and financial strategy under the NEPFP and, as before, they hope to draw on the support of the Bank, the Fund and other bilateral partners.

Eritrea possesses all the essential ingredients for a fast economic take-off, an administration that is strongly committed, with a strong track-record in implementing prudent macroeconomic policies and no tolerance for corruption, and, a low debt burden. What is critically needed is the continued provision of technical assistance for institution building, staff training and improvement of the statistical data base in order to strengthen the capacity for policy formulation and macro-economic management. Equally important is the country's access to concessional financial assistance in order to supplement the authorities' meager resources and accelerate the process of development.

Mr. Al-Tuwaijri made the following statement:

Eritrea made further economic gains over the past year. Impressive progress was made in the fiscal area and external reserves rose. Moreover, economic activity strengthened further despite the impact of inclement weather on agriculture. Those developments could not have been achieved without the authorities' commendable efforts to rehabilitate the economy, strengthen macroeconomic performance, and reform the institutional framework.

This said, it is clear from the staff report that substantial challenges remain. Unfortunately, these challenges have been compounded by the impact of recent developments in the region, as noted in the staff supplement.

Therefore, early and forceful action is needed to consolidate the progress already made and achieve the medium-term objectives.

The commendable improvement last year notwithstanding, the fiscal position remains weak and vulnerable to developments in external grants. Here, I am encouraged by the authorities' cognizance of the need for further strengthening of both the fiscal position and the budgetary process. The staff makes a number of useful suggestions in that regard. However, I agree with the authorities that contemplating a VAT at this stage may be premature given the administrative capacity constraints and the agenda for other tax reforms.

On monetary and exchange rate policies, I join the staff in commending the authorities for the smooth introduction of the Nakfa. Maintaining smooth operations in the exchange markets, however, requires prudent fiscal and monetary policies in conjunction with substantial efforts to strengthen the functioning of the financial sector. Here, I can agree with the suggestions made in the staff paper and support the provision of technical assistance. However, in view of the weak administrative capacity, including in the areas of supervision and regulations, it is not clear that the competitive benefits of splitting the CBE into smaller banks outweigh the risks. It may be more effective to focus on increasing the efficiency of this bank, through privatization, while increasing competition by licensing more banks. Indeed, while the CBE is very large by Eritrean standards, it is small when compared to the international banks that will likely enter the market. Staff comments will be appreciated.

Meeting the challenges facing Eritrea also requires structural reform in other areas. While good progress has been made on a number of fronts, including privatization, more efforts are still needed. The authorities' commitment to reform, and the progress made thus far sends a reassuring signal.

With these remarks, I wish the authorities success.

Mr. Jourcin made the following statement:

I agree with the staff appraisal on the fact that over these past years the Eritrean economy has made a significant recovery. There were commendable achievements in many areas: strong GDP growth, sharp reduction of the overall fiscal deficit, implementation of civil service reform, the introduction of a new currency, and an improvement of the current account and external reserves. In this way, a good basis for sustainable economic growth was established and prospects were encouraging.

Unfortunately, the recent border conflict between Eritrea and Ethiopia introduces great uncertainties. The economic and financial impact of this conflict has not yet been assessed, but it could be very important and deeply affect the macroeconomic outlook, as well as the feasibility of the National Economic Policy Framework and Program (NEPFP). For instance, Ethiopia was the main client for Eritrean exports, composing about two-thirds of the total, and since a few months this trade has practically come to a standstill, as confirmed by the staff representative. In addition, the evacuation of expatriates has weakened the country's capacities in many areas. More generally, the current context is obviously a major impediment to private sector activity and to the implementation of donors' support.

I note that the staff team advised the authorities to convene a consultative group meeting with a view to mobilize large external resources and fill the gap within the framework of the NEPFP. Of course, organizing such a meeting would require two prerequisite conditions: first, a speedy and peaceful solution to end the conflict (which everyone wishes); second, an assessment of the situation and a revised economic and financial framework for the period 1998–2000. I hope these steps to be achieved as soon as possible and I encourage the authorities to make every effort in this direction.

Mr. Jadhav made the following statement:

Our chair would like to compliment the Eritrean authorities for their vigorous policy efforts which have resulted in strong economic recovery, lower inflation, reduction in fiscal deficit, improvement in current account situation and stronger external reserve position. Operationalization of a comprehensive legal financial framework enabling establishment of a national currency nafca, rationalization of the tax system and its administration, civil service reform—reinventing the government as described by Mr. Morais in his excellent preliminary statement, initiation of a privatization program and above all, formulation of National Economic Policy Framework and Program (NEPFP) for 1998–2000 are some of the notable achievements that augur well for the future of the economy.

We broadly agree with the staff assessment that the broad based reconstruction and reform efforts have laid a good basis for sustainable economic growth and what is needed now is reinforcement of these endeavors by pursuing prudent financial policies and deepening structural reforms.

That said, our chair would like to make a number of observations in the spirit of constructive criticism:

As pointed by Mr. Jourcin, the staff report has not assessed the possible impact of the recent border conflict with Ethiopia. In view of the fact that during 1994–97, as much as 62 percent of Eritrean exports were destined to Ethiopia, it is clear that the impact could be severe. Since the medium-term baseline scenario (1998–2000) prepared by the staff contemplates a substantial increase in exports, which may no longer be attainable in the changed situation. We would welcome staff comments on this important issue.

Social demographic indicators presented in Appendix V of the Report reveal that Eritrea has a long way to go in raising the standard of living of the people. Low adult literacy rate, high infant mortality rate, poor access to safe water and inadequate coverage of immunization are symptomatic of the formidable challenges that lay ahead for the authorities and the need for resolute and sustained policy efforts in mitigating them.

The National Economic Policy Framework and Program (NEPFP) has candidly recognized the human resource deficiencies and inadequate institutional capacity in Eritrea in the administrative, legal, commercial, judiciary as well as in macroeconomic policy formulation and implementation areas. While we agree that technical assistance by the Fund could play an important role, it may be noted, however, that over the medium term, the accent of the strategy should be on endogenizing such capacities. In this regard, we are greatly encouraged that the government is now able to attract the best university graduates in its fold.

Following the impressive fiscal adjustment in 1997, the authorities must step up their efforts to move away from the present cash-rationing system to a system of publicly announced comprehensive annual budget. Apart from fostering the coordination of economic policies in a transparent manner, it would also boost the market confidence in macroeconomic policies in general and in the new currency, in particular.

While consolidating the fiscal position, broadening of the tax base may be accorded a high priority. It is disheartening to note that despite the relatively high level of external tariffs, the custom duties accounted for a meager 11 percent of total revenue during 1995–96, reflecting substantial undervaluation, exemptions and/or tax evasion.

With the containment of fiscal deficit and the consequent sharp decline in bank credit to the government, the financial sector can now move away from financial repression toward liberalization and the monetary policy can come into its own. Accordingly, the authorities should expedite the development of a framework and instruments for the conduct of monetary policy. A vibrant, competitive and dynamic financial sector subject to appropriate prudential regulation and supervision would greatly facilitate a more efficient allocation of financial resources in the economy.

Table 1 (p.25) indicates that velocity of broad money has steadily declined over the period 1993 through 1997. Does it simply reflect the increased public confidence or there is more to it? If the decline represents increased confidence, it is not clear why the medium term projections provided in Appendix IV (p.39) assign a constant value for the velocity over the period 1998 through 2000. The staff may wish to clarify this aspect.

The saving-investment projections presented in Table 6 (p.#39) raise many questions: What are the implications of the proposed sharp step up in investment against the backdrop of negative gross domestic savings? The massive increase in investment seems to emanate mainly from net private transfers. Given the heightened uncertainties, what is the degree of confidence associated with these projections and what does it portend for the resilience of the economy?

We would welcome staff comments on these issues.

With these remarks, we wish the authorities continued success in their policy endeavors.

Mr. Elhage made the following statement:

First, we would like to commend the authorities for the prudent financial management and the significant progress made in restructuring the economy and preparing the next phase of transition. This was reflected in the continued improvement in the economy in 1997 when, not withstanding the increase in inflation which was mainly due to exogenous shocks, GDP growth reached 8 percent, the fiscal situation was remarkably strengthened both in terms of the overall budgetary deficit as well as the quality of measures to achieve the deficit reduction, and the current account improved and turned into a surplus. To sustain these welcome and impressive developments which clearly reflect the authorities commitment, four areas should, in our view, rank high on the authorities agenda. First, as the staff points out the macroeconomic stabilization achieved so far needs to be preserved and strengthened. Second, a careful selection of structural reforms that takes into account the institutional capacity and limitations there in will support the growth momentum and stable economic environment evidenced in 1997. Third, the provision of technical assistance to strengthen the implementation capacity of the economy will be crucial in creating long term conditions conducive to the introduction of further reforms. Here I have in mind in particular, and this is my fourth point, the need to accelerate financial sector reform. In this regard, the first draft of the National Economic Policy Framework and Program addressed many of these elements and we wish the authorities success in its implementation.

As we are in agreement with the well stated and clear staff analysis, we will limit our comments to few areas.

The fiscal adjustment in 1997 was, by any standard, impressive and credible. In this regard we note the decline in recurrent expenditures which more than offset the increase in capital spending and the steps taken to increase earnings from port fees and charges. Moreover, the improved fiscal situation owes much to sizeable reduction in military and civil service outlays. Fiscal consolidation would benefit further from the introduction of formal and comprehensive budgetary process and broadening the tax base. This is particularly important in view of the proposed limits on government recourse to domestic bank financing which clearly necessitates the establishment and enforcement of spending controls. Actions to broaden the tax base and to enhance revenues will accommodate potential increase in interest cost arising out of liberalization of interest rate policy as well as from financing important infrastructure activity.

On monetary issues, we are encouraged by the smooth introduction of the national currency and the enactment of the Bank of Eritrea and Financial Institutions Proclamations in 1997 which indicate the authorities' intentions to develop a framework for the conduct of monetary policy. However, the discussion on these matters in the staff report highlights the policy rigidities and capacity constraints that prevent effective policy implementation. These constraints need to be addressed in order to create an environment where the decontrol of interest rates will be effective. This will be an important precondition for a successful introduction of treasury bills which, aside from enhancing the central bank's monetary control, is urgently needed to absorb the substantial commercial banks' reserves. However, since it is premature to attempt to rely on indirect monetary instruments, we strongly concur with the staff on the need to rely on reserve requirements and credit ceilings to control expansion of liquidity.

Removal of interest rate controls is one of the many steps needed to improve the functioning of the financial sector and its role in mobilizing savings. It is also imperative at this juncture to enhance the development of a more competitive market by reducing the dominant role of the Commercial Bank of Eritrea and licensing new institutions as well as to strengthen bank regulation and supervision. These steps would promote the development of deeper financial markets which would in turn enhance the authorities' ability to manage the market-determined exchange rate system. Here, I was rather surprised that the staff is recommending consideration of a gradual capital account liberalization. This is premature and must await the implementation of considerable financial sector reform.

Finally, further progress on structural reforms is essential for attracting foreign direct investment as well as stimulating private sector activity. In particular, the authorities need to further improve infrastructure, labor force skills, and speed up and extend the privatization program.

With these remarks we wish the authorities every success in meeting the challenges that lie ahead.

The staff representative from the African Department, in response to questions posed by Executive Directors, made the following remarks:

On the question on the benefits and costs of splitting up the Commercial Bank of Eritrea, it is correct that, by international standards, this is a small bank, but within Eritrea itself, it is a very dominant bank. The staff's feeling is that if the authorities are going to succeed in creating a money market, as well as a vibrant foreign exchange market, they will need a lot of competition within the economy. That is why we thought it would be important to break up the bank into smaller units. Of course, that would make it somewhat difficult to supervise, given the capacity constraint at the central bank, but to the extent that the foreign banks could buy parts of this commercial bank, and assuming these banks are already well supervised, that, in fact, would make it much easier for the authorities to move faster with regard to promoting appropriate bank supervision.

There was a question on the impact of the recent conflict on exports. Indeed, the staff had projected a very rapid recovery in exports in 1998, mainly because there was a major export decline in 1997, and we had assumed that under normal conditions there would be a rapid recovery from that decline. However, the situation will have to be reassessed. We are not in a position at this moment, given that the conflict has not ended, to be able to reassess the entire macroeconomic framework. The authorities themselves indicate that they would like to revisit the issue as soon as they are able to do that, and it may be necessary for us to visit Eritrea to be able to undertake such a comprehensive review of the macroeconomic framework.

There was a question on velocity, that it declined in the early period, and it is projected to remain fairly constant in the outer period. The critical issue here is one of confidence. Eritrea emerged from a period of war for over 30 years—the so-called War of Liberation. During that period, movement was very restricted, limiting access to the banking system up to the time of liberation. With the normalization of conditions, plus the reconstruction effort which has been undertaken by the government, enormous confidence has been built in the economy, including the banking system. The favorable impact of this recovery would have been realized within the first 6–8 years as reflected by a declining velocity. We would not expect that situation to continue in the outer years and therefore expect velocity to be little changed.

On the question of high projected level of investments, particularly in the private sector, despite the negative domestic savings, the assumption is that there will be considerable direct foreign investments by the private sector. In fact, there are a number of very promising sectors, particularly the hydrocarbon sector, where the exploration stage has been completed; and drilling is about to commence. There are also some very encouraging prospects in the mining sector, in the fisheries, and horticulture area. There is also the possibility that if the government is able to complete some of the envisaged privatization, there could be very significant foreign investments coming into the economy. Of course, that would need to be looked at in the context of a revised macroeconomic framework later on.

The staff representative from the Policy Development and Review Department noted that, with respect to the medium-term projections, clearly the staff had been in a difficult position, because the discussions had taken place before the conflict had arisen. In providing a medium-term assessment on that basis, the staff had given some indication of the authorities' and the staff's views of how the economy would develop, assuming that the current conflict was short-lived. In that context, the assessment remained useful for the current Board discussion.

Ms. Pinzani made the following statement:

First of all, let me join others in commending the Eritrean authorities for having continued to implement the process of economic reform in the aftermath of the independence and for the smooth introduction of a new national currency. Now, as indicated by the staff, there is the need to build upon this promising premise and to go ahead with the peace process. We are in broad agreement with the staff, and therefore we would like just to make a couple of remarks.

On fiscal policy, although in 1997 the budget deficit was substantially reduced, the situation is still fragile. Of particular concern are the following facts: Most of the budget correction was originated by an increase in nonrecurrent nontax revenues, the budget deficit is projected to widen again, and dependence on foreign savings (i.e., grants and external financing) is expected to increase; fiscal developments should be, therefore, carefully monitored, and it is essential that the increasing domestic and external debt is kept in line with the country's capacity to mobilize the resources required to service it.

Still on fiscal policies, we share Mr. Al-Tuwaijri's comment that it is premature to speak about the introduction of value-added tax, given the limited administration capacity and the already heavy tax reform agenda. In the present context, we believe that priority should be given to strengthening the implementation and administration of the current tax structure through the provision of appropriate technical assistance.

With respect to monetary policy, we share the staff's recommendation to decontrol interest rates to keep them positive in real terms, to strengthen supervision, and to improve the legal system and institutional arrangements so as to promote collateral and loan recovery procedures. However, we are still not totally convinced by the staff proposal of licensing additional banks in order to further develop the interbank foreign exchange market. While we certainly acknowledge the merits of such a proposal and we agree with its objective, we are inclined to believe that, in the present circumstances, the usual gap between stability and enhancing competition in the financial system should tilt more in favor of the former. This comment should not be read as favoring an undefined delay of the reform, it just supports a more defined sequencing.

In conclusion, the Eritrean authorities have to be commended for the results already achieved and for the new program they are committed to undertake. Given the serious institutional capacity and database limitations, which impede effective economic policies, we strongly favor the Fund's readiness to provide technical assistance. However, in order to make such assistance as effective as possible, we urge the authorities to indicate their priorities and formulate a detailed timetable for the implementation of specific requirements.

Mr. Kpetigo made the following statement:

Just after independence Eritrea's authorities took a series of strong actions to rebuild the country's physical infrastructure and reform the trade system that contributed to a rapid economic recovery. Subsequently, output growth improved in 1997, led by construction and manufacturing sectors while inflation jumped to 10.6 percent from 3 percent in 1996 due to limitation in food production and to trade disruptions with Ethiopia. Also, the demobilization of the military, the retrenchment in the civil service and the resettlement of the veterans resulted in a large fiscal deficit despite a comprehensive expenditure program and a substantial increase in revenue.

We note that with Fund technical assistance the Eritrean authorities have successfully introduced their new currency, the nakfa, to replace the birr notes that so far Eritrea and Ethiopia had shared in common. Furthermore, the authorities have set up new financial institutions, liberalized the exchange system, abolished surrender requirements and unified the official exchange rate. Finally, last May, the authorities completed the establishment of their new exchange system by allowing a market determination of the exchange rate. We commend the authorities for these comprehensive achievements and encourage them to persevere in their efforts.

I share most of views expressed by the staff and previous speakers and will make a few comments for emphasis.

In the fiscal area, the authorities implemented appropriate fiscal adjustments during the transition period that were critical for the rapid economic recovery. As a result, revenue collection was impressive. However, we note that due to administrative capacity limitation, the Government undertook the hiring and training of university graduates to fill the gap. We encourage the authorities to persevere in the training of young skilled civil servants that could help strengthen the institutional capacity of the country. Furthermore, we concur with the staff that for the consolidation of the fiscal position, it is important for the authorities to develop without delay annual budgets in order to improve transparency and foster the market confidence. We are of the view that the fiscal sector should be further rationalized, through swift structural reforms in order to resolve the problems of undervaluation, tax exemptions and evasion, and to further improve customs duties and revenue collection, in general.

In the monetary area, for the nakfa introduction to be successful, a set of measures should be taken to avoid slippages. These will include prudent credit policies accompanied by improved capacity building of the Bank of Eritrea. Monetary objectives are to achieve positive interest rates in real terms in order to promote savings. While liberalizing the interest rates the authorities should take all necessary actions to avoid excessively high rates.

In the external sector, the Eritrean authorities' external policies should seek more direct foreign investments, further liberalization of trade and a diversification of its partners. Until recently, the major market for Eritrean exports has been Ethiopia. We urge Eritrea to strengthen the regional cooperation in order to diversify its trading partners. We hope for a prompt settlement of the ongoing conflicts so that the two countries could resume soon their development efforts.

Mr. Abdychev made the following statement:

We wonder whether, under the current situation of an armed border. conflict, it is the right moment to discuss the macroeconomic performance of Eritrea. As the staff points out, the impact of the conflict on the macroeconomic situation still needs to be assessed.

Fiscal performance in 1995 and 1996 was very bad, partly due to one-off expenditure after integration of soldiers into civilian life. With the conflict and new mobilization, the excellent improvement in fiscal performance in 1997 does not mean much anymore. Furthermore, despite an improvement in the current account due to a drastic increase in remittance, the current account position has become more fragile in the medium and long-term perspective, if we consider the bad relations of Eritrea with its traditionally single most trading partner.

Having said this, the staff report shows some encouraging developments, not only in the macro performance, namely GDP growth of 8 percent and improvements in the fiscal consolidation and monetary policy, but also in the institutional aspects. We acknowledge the Eritrean authorities' activities in drafting the national economic policy framework and program, and their demand for more technical assistance from the Fund. We would encourage the Fund to expand its technical assistance program with Eritrea. However, we share the staff's view that such technical assistance should be based on a timely determination of priorities by the authorities. Including clear objectives and timetables, and followed by specific requests. Technical assistance will certainly be necessary for Eritrea to achieve the Fund's recommendation of furthermore fiscal consolidation and the broadening of the tax revenue base. Technical assistance will be necessary for the formulation of an appropriate monetary policy.

With these remarks, we wish the authorities all the success in their difficult endeavors.

Mr. Phan made the following statement:

It is encouraging that macroeconomic performance of Eritrea in 1997 was generally favorable with a continued strong recovery, owing primarily to the rebuilding of the infrastructure and the improved availability of essential imports in the previous years. In addition, the fiscal deficit was sharply reduced, following the completion of the ambitious expenditure program together with a large increase in total revenue. Net bank borrowing by the government fell by more than five times in comparison with 1996. However, inflation went up significantly due to reduced food production and the disruption of trade with its neighboring country.

We are encouraged by the fact as given in the staff's preliminary statement that in the border conflict between Eritrea and Ethiopia, there has been an agreement to cease air strikes, and skirmishes on the ground have been minimal as a result of several peace initiatives. The authorities are called upon to make every efforts to put a complete end to the border conflict with Ethiopia if they are to sustain the fruits obtained in promoting macroeconomic growth in recent years. Given enormous challenges facing the country, early efforts to introduce the National Economic Policy Framework and Program for 1998–2000 is a welcome move.

I would like to join the staff in commending the authorities for the impressive fiscal adjustment in 1997. However, it is imperative to consolidate the fiscal position, including through the formulation of publicly announced comprehensive annual budgets. The broadening of the tax base is a key to the improvement of revenues. Tax administration should be strengthened within the context of tax reforms. The fiscal picture could be improved by containing current expenditure. It is quite right to recommend that future wage increases need to be limited to control the wage bill and maintain external competitiveness.

The enaction of the Bank of Eritrea and Financial Institutions Proclamations in April 1997 and the subsequent issuance of several regulations contributed to the establishment of a comprehensive legal financial framework. The authorities took a bold action in introducing their own domestic currency in November 1997. Efforts should be exerted to reach agreement with Ethiopia on the treatment of the birr notes retired in Eritrea. The continued maintenance of a relatively liberal exchange system is encouraging. This achievement has been complemented by the unification of the official exchange rate and the preferential exchange rate and the introduction of a mechanism to provide for a market determination of the exchange rate. In addition, cautious monetary and credit policies should be pursued during 1998–2000 if the authorities are to achieve the inflation and external sector objectives. Over the medium-term, the eventual decontrol of interest rates should be sought together with the introduction of indirect monetary policy instruments, especially through open market operations as recommended by the staff.

Turning to structural reforms, the authorities are congratulated for making large efforts in implementing significant structural reforms in recent years, including the reconstruction of infrastructure, the decontrol of most prices, rationalization of the tax system, and easing of restrictions on labor mobility. To sustain these achievements, the privatization of public enterprises including electric utility and telephone companies should be prioritized in the years ahead.

As noted by the staff, institutional capacity and database limitations remain serious in Eritrea. The authorities should firmly address these problems in a timely manner including seeking further technical assistance from multilateral and bilateral institutions if they are to be able to make effective conduct of economic and financial policies.

In conclusion, I wish to commend the staff for providing this comprehensive report and for their efforts to help the authorities in updating the National Economic Policy Framework and Program for 1998–2000. I would like to wish the authorities every success in dealing with challenges ahead.

The staff representative from the African Department clarified that the staff was not advocating introducing a value-added tax (VAT) immediately. Rather, the authorities should begin a study on the feasibility of introducing a VAT, because it was important to anticipate that, at the next stage of economic reforms as external tariffs were reduced, there would be a need to expand the revenue base.

With respect to the licensing of additional banks, in addition to his earlier comments on the possibility of bringing in foreign banks that were already well-supervised, another consideration would be to strengthen the central bank's capacity through the provision of the appropriate technical assistance.

Mr. Morais made the following concluding statement:

I thank the staff for their hard work on Eritrea and I would like to thank Executive Directors for their useful comments and suggestions which I will promptly convey to my authorities.

Indeed, my Eritrean authorities made tremendous achievements during this transitional period, while priorities were the setting up of sovereign institutions and addressing problems related to resettlement of displaced population, and reintegration of ex-combatants to civilian life. They deserve credit for the strong adjustment measures to bring the public finances under control and create the favorable environment for private sector-led growth. At the same time, there has been a great deal of ownership in their economic policies. They have put technical assistance to good use after carefully reviewing their institutional weaknesses and their capacity to absorb the external advice.

At this moment, my authorities cannot provide this Board with details of the impact of the current boarder conflict. The macroeconomic indicators do not yet give us clearly discernible trends that warrant actions other than those that are precautionary. Nevertheless, any possible adverse impact of this conflict will certainly be cushioned by the ongoing national campaign to raise agricultural activity. Thousands of young Eritreans are assisting farmers throughout the country in agriculture activities. Manufacturing activities are also proceeding normally. Rehabilitation of basic infrastructure is continuing unhindered and defense forces have been mobilized to continue improving roads and building new bridges to enhance the mobility of goods and services.

I would like to stress the commitment of the Eritrean authorities toward the resolution of the conflict by diplomatic means. They also realize how important peace is in order to continue mobilizing external financed technical assistance. I urge the international community to continue and increase their assistance to Eritrea, particularly in this very crucial moment.

The Acting Chairman made the following summing up:

Executive Directors agreed with the thrust of the staff appraisal. They welcomed the broad-based reconstruction and reform efforts undertaken by the authorities, which, together with the substantial fiscal adjustment in 1997, had facilitated the successful introduction of the nakfa. A good basis for sustainable economic growth had been established, but moving ahead would also require reinforcement of prudent financial policies and a deepening of structural reforms. However, Directors expressed concerns about the recent border conflict with Ethiopia. While the economic and financial impact of the conflict has yet to be fully assessed, they emphasized that an early, peaceful settlement of the dispute is essential to permit the pursuit of growth and poverty-alleviation policies within a stable financial environment.

Directors commended the authorities for the preparation of the National Economic Policy Framework and Program (NEPFP), which provides a frank assessment of the impediments that must be addressed in the context of the medium-term economic strategy, outlines key measures and policies to address them, and provides a basis for the needed greater policy coordination.

Directors urged the authorities to further consolidate the fiscal position to underpin sustainable macroeconomic conditions. They observed that this would require a timely introduction of a formal and comprehensive budgetary process, and containment of the growth of recurrent expenditure, particularly the wage bill. Broadening of the tax base and enforcement of tax compliance, especially in the area of customs, also were considered important, although a few Directors felt that it might be premature to introduce a value-added tax. These measures would help limit government recourse to domestic bank financing, maintain interest payments at manageable levels, and, more generally, facilitate the conduct of a prudent monetary policy.

Directors urged the authorities to expedite the development of a framework and instruments for the conduct of monetary policy, including the creation of a market for treasury bills at market-determined interest rates. This development will facilitate the necessary mopping up of commercial banks' excess liquidity, while contributing to a more efficient allocation of financial resources in the economy. Directors welcomed the steps taken to strengthen the Bank of Eritrea, including the establishment of the Bank Supervision Department. Timely actions must now be taken to attract new banks and reduce the role of the dominant public Commercial Bank of Eritrea in order to enhance competition. More generally, to promote a sound financial system, it will be important to: promptly issue prudential and other regulations for financial institutions; take steps to improve the scope, quality, and timeliness of their reporting of financial data; and introduce on-site and off-site supervision of financial institutions. Similarly, there is a need for concurrent steps to improve the legal system and other institutional arrangements in order to promote the use of collateral and facilitate loan recovery.

Directors commended the authorities for adopting a market-determined exchange rate regime. They urged a strengthening of the soundness and supervision of the financial system along with further liberalization of the exchange system.

Directors encouraged further progress in structural reforms—including a reduction in the number of import tariff bands and in the maximum rate to a level consistent with best practices in the region by 2000—and the implementation of complementary tax reforms. Continued improvement of the infrastructure should help remove supply constraints and diversify the economic and export bases. The emphasis on agricultural developments—which account for the livelihood of most Eritreans—is an important part of the efforts to promote growth and poverty alleviation. Moreover, the authorities have appropriately targeted the social sector, particularly health and education, as key for the development of the country and for improvement in the living standards of the population; in this context, Directors welcomed the steps to strengthen the social database.

Directors noted that Eritrea faces serious institutional capacity and economic database limitations that impede the effective conduct of economic and financial policies. They urged firm and timely measures to address these problems, noting that following the recent civil service reform, Eritrea was well placed to effectively utilize technical assistance. Directors said that it would be important for the authorities to designate priority areas and make specific requests that include benchmarks for monitorable progress to fill those needs. They urged greater coordination in technical assistance among the various sectors and agencies.

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

The Executive Board took the following decision:

1. The Fund takes this decision in concluding the 1998 Article XIV consultation with Eritrea in light of the 1998 Article IV consultation with Eritrea conducted under Decision No. 5392–(77/63), adopted on April 29, 1977, as amended (Surveillance over Exchange Rate Policies).

2. As described in SM/98/155, Eritrea maintains exchange restrictions, in accordance with Article XIV, Section 2, on the making of payments and transfers for current international transactions, comprising limits on travel, medical, and education allowances. The Fund encourages Eritrea to eliminate these restrictions as soon as possible.

Decision No. 11760-(98/75), adopted
July 13, 1998

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/98/74 (7/10/98) and EBM/98/75 (7/13/98).

4. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 97/36 and 97/84 and are approved.

5. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors and by an Assistant to Executive Director as set forth in EBAM/98/126 (7/9/98) is approved.

6. TRAVEL BY MANAGING DIRECTOR

Travel by the Managing Director as set forth in EBAP/98/71 (7/10/ 98) is approved.

APPROVAL: January 21, 2000

SHAILENDRA J. ANJARIA
Secretary