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Minutes of Executive Board Meeting 92/120

10:00 a.m., October 5, 1992

R. D. Erb, Acting Chairman

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T. C. Dawson	J. M. Abbott, Temporary
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	A. Giustiniani, Temporary
	M. B. Chatah, Temporary
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	T. Kanada, Temporary
	S. Shimizu, Temporary
B. Goos	
J. E. Ismael	
A. Kafka	F. A. Quirós, Temporary
	I. Martel
	H. Golriz, Temporary
	J. Mafararikwa, Temporary
	J. Dorrington
G. A. Posthumus	
	D. Saha, Temporary
A. Torres	
A. Végh	A. G. Zoccali

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

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<u>Also Present</u>

IBRD: P. Suriyaarachchi, South Asia Regional Office; B. Tuncer, Latin America and the Caribbean Regional Office. Central Asia Department: N. Benjamin, O. J. Evans, D. J. Goldsbrough, M. Z. Khan, C. B. Mulder. Fiscal Affairs Department: D. Chua, E. Sunley. Legal Department: J. L. Hagan, Jr. Policy Development and Review Department: S. Kanesa-Thasan, L. Nielsen, J. P. Pujol. Secretary's Department: A. Leipold. Treasurer's Department: C. A. Hatch. Western Hemisphere Department: C. M. Loser, Deputy Director; M. E. Bonangelino, L. A. Cardemil, M. Garza, J. Gold, A. M. Jul, J. Levy, P. Neuhaus, R. Pearson, S. J. Stephens, A. J. Tweedie, M. Zavadjil. Advisors to Executive Directors: C. D. Cuong, S. K. Fayyad, B. R. Fuleihan, M. J. Mojarrad, B. Szombati. Assistants to Executive Directors: S. Al-Huseini, D. A. Barr, M. Blome, J. A. Costa, O. A. Himani, P. K. Kafle, K. J. Langdon, W. Laux, J. A. K. Munthali, L. F. Ochoa, R. K. W. Powell, L. Rodríguez, P. L. Rubianes, P. Salles, F. A. Sorokos, Tin Win, T. P. Thomas, J. W. van der Kaaij, S. Vori.

1. NEPAL - ENHANCED STRUCTURAL ADJUSTMENT ARRANGEMENT, AND EXCHANGE SYSTEM

The Executive Directors considered a staff paper on Nepal's request for an enhanced structural adjustment arrangement equivalent to SDR 33.5 million (EBS/92/142, 8/31/92). They also had before them a policy framework paper for 1992/93-1994/95 (EBD/92/106, 9/3/92).

The staff representative from the Central Asia Department made the following statement:

> Under the enhanced structural adjustment facility (ESAF) arrangement, the Government of Nepal is committed to setting petroleum product prices at a level that would avoid a loss by the Nepal Oil Corporation during 1992/93. To that end, the Government made a commitment to raise these prices sufficiently as a prior action.
>
> Accordingly, a 13 percent price increase of petroleum products was implemented in August and a 50 percent increase of LPG prices in September 1992. These adjustments, however, do not fully cover the projected losses of the Nepal Oil Corporation. The Government therefore intends to increase petroleum product prices further, so as to fully eliminate the losses. These increases will be made as soon as possible but, in any event, no later than by the next six-monthly price review in mid-January 1993. This matter will be given close attention in the ESAF review scheduled for early 1993.
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> The Government has also reaffirmed that it will not permit any budgetary subsidy for the Nepal Oil Corporation, and that the central bank will not lend to the Corporation either directly or through refinancing of commercial bank loans.
>
> We would also like to briefly update the Board on some developments in the two months since our last mission to Nepal. When we were in Kathmandu in July, there was optimism that this year's monsoon would permit a return to a normal harvest. However, the rains now appear to have been somewhat disappointing, with implications for food production and price developments. But at this stage we do not have enough information to assess fully the macroeconomic impact. I would note that inflation has dropped from a peak of 22 percent in the 12 months to mid-May to 17 percent over the year to mid-August, which is consistent so far with the staff's forecast of a reduction to single digits during 1992/93.
>
> Turning to policies, in response to decontrol of certain fertilizer prices in India, Nepal has raised the price of certain types of fertilizer by between 100 and 240 percent, with the

weighted average effect on our calculation at about 80 percent, allowing for some which were not adjusted.

On civil service reform, the Government has tabled the report of the Administrative Reform Commission in the Parliament and has appointed a former Governor of the central bank to spearhead implementation of its recommendations. His appointment bodes well for successful implementation of civil service reform.

On privatization, I understand that negotiations regarding the three enterprises offered for sale in 1991/92 have essentially been concluded, and, at this stage, steps in the process of offering for sale further public enterprises are on track.

Mr. Ismael made the following statement:

On behalf of my authorities, I would like to express my appreciation to the staff for their assistance and cooperation during the process of negotiation and design of the first annual arrangement under the ESAF. My authorities are in broad agreement with the thrust of the staff appraisal and recommendations.

The strategy of the first annual program under the ESAF encompasses greater reliance on market forces and a reduction in the size and scope of public sector economic activity. This statement highlights the objectives pursued in the four main policy areas, namely, fiscal policy, monetary policy, structural policy, and external sector policy.

It is the intention of the authorities to limit domestic financing of the budget deficit so that more resources will be available to finance private investment toward attaining higher economic growth. To this end, the central government deficit in 1992/93 is targeted at 8 1/4 percent of GDP and the associated domestic borrowing to fall to 3/4 percent of GDP. The Government intends to eliminate domestic financing of the budget altogether over the medium term. A combination of revenue and expenditure measures underpin the projected improvement in government finances.

On the revenue side, the Government has already announced significant new revenue measures to the tune of NRS 700 million, which is equivalent to 1/2 percent of GDP. These measures are oriented to broaden the tax base, to generalize rates, and to improve tax administration and control in order to reduce tax evasion. The introduction of a separate revenue service is particularly important for the strengthening of tax administration. In addition, should revenue over the first half of the financial year fall short of the target, my authorities will take additional revenue measures to bridge the shortfall. In this connection, developments in revenue and expenditure will be monitored on a monthly basis in order to detect any deviation from fiscal targets. On the expenditure side, the measures are aimed basically at containing expenditure growth. The Government will ensure that the reduction in the number of projects and improved selection criteria for new projects will increase the efficiency of the expenditure program. The authorities will also consult closely with external donors on prioritization of development spending.

With a view to reducing the budgetary burden, the main subsidies affecting the agriculture sector have been curtailed. In this connection, the Government has decided to permit private import of fertilizer under OGL and to remove the cap on the domestic price of private fertilizer.

With regard to monetary policy, the main objective is to tighten broad money and credit expansion. Monetary control will be exercised through indirect instruments, leaving financial institutions free to allocate credit in accordance with market forces. The authorities are committed to containing liquidity expansion, and in particular, domestic credit growth, reducing inflationary pressure, and protecting foreign reserves. To improve the effectiveness of monetary management, the Nepal Rastra Bank--the central bank of Nepal--is developing a system of reserve money programming, and, in this connection, a technical assistance mission from the Fund is expected shortly. Progress has been made in enhancing the role of market forces in the banking system. The authorities are seeking to establish a sound and viable commercial banking structure as an essential requirement for supporting private sector developments and improving the efficiency of monetary policy. Further efforts will also be undertaken to enhance the open market operations and develop the secondary market.

Regarding structural reforms, my authorities intend to implement the structural action program agreed with the Fund. In order to increase efficiency and reduce budgetary costs, they plan to either privatize or liquidate all industrial and commercial public enterprises, with the exception of a small number of public enterprises in strategic sectors. As part of this process, in 1991/92 the authorities have selected three enterprises for privatization, and the sales are close to finalization. Furthermore, four other enterprises will be offered for sale in 1992/93. For those enterprises slated to remain in the public sector, the Government is examining alternative ways of strengthening their commercial orientation. Moreover, in order to improve the Government's information system, a consolidated financial reporting system will be established for nonfinancial public enterprises.

My authorities are committed to introducing a major tax reform in the July 1993 budget and in this connection a technical assistance mission from the Fund will take place shortly.

Besides, the civil service reform strategy will be finalized soon and its implementation will begin.

Regarding external policies, my authorities are guided by the objective of achieving a fully liberalized exchange and trade system for current account transactions. In this connection, the Government introduced a dual exchange rate system in March 1992, as a key transitional step in the process of trade and exchange reform, and it took a further step toward convertibility in July with the export retention ratio raised from 65 percent to 75 percent. A majority of private imports were moved to OGL in March 1992, with the number of products under the import license auction falling from 126 to 43; this number was cut to 12 in July 1992. With the two steps of liberalization in March and July, 98 percent of private sector imports are now available under OGL.

In order to ensure smooth functioning of the free foreign exchange market and to periodically re-assess the official exchange rate, the premium between the official and free market rates is being monitored on a regular basis. The authorities also plan to gradually reduce the list of transactions receiving foreign exchange at the official exchange rate. It is the intention of my authorities to unify the official and free market exchange rates as soon as external conditions permit.

To conclude, let me emphasize that it is my authorities' hope that the proposed program under the ESAF would further consolidate the gains achieved under the recently completed programs under the SAF. They are of the view that the new era of political democracy prevailing in Nepal will facilitate the development of a genuine consensus in support of the adjustment program. In this context, continued support from the international community will be critical. I would, therefore, be grateful to receive the Executive Board's full support for the proposed decisions.

Mr. Dorrington made the following statement:

Nepal deserves congratulations on the economic adjustment measures it has already taken. If the remainder of what I say concentrates on what more needs to be done, that in no way belittles achievements to date.

The most urgent need is to reduce inflation, and the news we have just been given is obviously welcome in that regard. It is particularly important to reduce inflation as it is currently running well above the level in Nepal's major trading partner, India. A continuation of this differential would eventually threaten the maintenance of a fixed exchange rate, and it is important that both fiscal and monetary policy are appropriate to this end.

Broad money, which has been growing at about 20 percent for the past few years, needs to be brought under better control. To quote from the staff paper for the Article IV discussion in March, "the structure of interest rates will need to be monitored closely to ensure that positive real interest rates are restored, and that interest rates on Government paper are maintained at a level consistent with the overall tightness of monetary policy." I agree with that.

The exchange rate link obviously places some constraints on the extent to which interest rates can be increased, but it is not clear, to me at least, that this limit is even close, particularly given the dual exchange rate regime and the size of the premium in the free market. However, the effect of changes in interest rates on capital inflows and, if not sterilized, on broad money, can result in confusing signals. Perhaps staff could comment on the nature of this constraint.

It is not clear from the paper how the programmed reduction in broad money growth to 13.5 percent this year is to be achieved. In this regard, I have a few more specific questions. I note that growth in reserve money fell sharply in 1991/92, but how much confidence should that give us with regard to monetary conditions more generally? How effective is the temporary statutory liquidity requirement in practice, and what will be the effects of phasing it out? And how quickly can we look for help from the promised measures to develop further market-based methods of monetary control? Perhaps staff could comment on these matters.

Turning to the fiscal side, the programmed reductions in the deficit are distinctly pedestrian. The case for complete abolition of domestic borrowing is made in the paper, and the rapid achievement of this would have made a more appropriate target. There is no shortage of ideas as to what could be done. It is recognized that measures are needed in the areas of tax administration reform; expansion of the tax base; cuts in subsidies to loss-making public sector enterprises; cuts in staffing levels in the civil service; and privatization--hopefully with benefits in terms of enhanced competition and efficiency as well as direct revenue gains. I welcome the news this morning of the measures that are already under way, and also the assurances in the paper that further measures will be taken if fiscal performance looks to be turning out worse than projected. Perhaps the staff could give us a better idea as to what these contingency fiscal measures are.

The authorities will also have to be willing to take compensating measures if actual aid disbursements do not turn out at the levels assumed in the budget.

I certainly welcome the progress made to date with financial reform. And I would urge the authorities to move as speedily as possible to restructure the state banks and to complement this by the promotion of genuine competition, including foreign competition, together with effective banking supervision and internal controls. I would also be interested to know about progress with the development of the Himalayan Bank and how the Rural Development Bank will operate differently from the commercial banks.

I can support the dual exchange rate system that was introduced earlier this year as a necessary evil, but I would emphasize that this should only be a transitional measure toward full exchange rate convertibility. I also encourage the authorities not to be laggard in liberalizing import restrictions and tariffs. It is vital that policies and performance do not lag behind those of India and competitors, if competitiveness is to be maintained and capital attracted.

I turn now to the balance of payments. I would caution that the medium-term projections may prove to be optimistic--and my concerns about this have been reinforced by what was said this morning about the monsoon--given the uncertainties of monsoons, domestic supply bottlenecks, and other factors. And any slippages on implementing the programmed reforms could endanger capital inflows and, hence, export potential. There may therefore be a higher external financing requirement than is suggested in the paper. I would urge great caution in allowing any significant increase in commercial borrowing, and I hope that the staff will monitor closely any further buildup in Nepal's external obligations.

There is a question of whether there is a genuine balance of payments need for this arrangement. The role of the Fund is not to provide finance for all kinds of economic problems. Certainly if this was a nonconcessional stand-by arrangement rather than a concessional ESAF arrangement, I would be arguing that while the policies were needed, there was at present no need to draw on a Fund facility. However, there is a clear benefit to Nepal from receiving external finance on concessional terms. Nepal is a very poor country, but--like India--it has an impeccable debt-service record and has not allowed its debt to reach levels that make it difficult to manage. It should be praised, not penalized, for that.

In conclusion, therefore, I would have preferred to have seen a stronger fiscal program and stronger evidence that monetary intentions will be achieved. Nevertheless, I support the proposal.

Mrs. Martel made the following statement:

We welcome this first ESAF arrangement with Nepal. During the period that followed the election of a new Government, in mid-1991, Nepal embarked on a wide-ranging program of macroeconomic and structural reforms. Indeed, one of the most positive features of the arrangement that we are discussing today is the number and extensiveness of prior actions: the authorities moved, in March 1992, to a dual exchange rate system, under which nearly two thirds of exports will be benefiting from the newly free floating exchange rate; and significant trade liberalization measures have been taken, with the reduction of the number of quantitative restrictions and the elimination of obstacles to foreign direct investment. Indeed, in this field, Nepal has gone as far as permitted by its very close trade relationship with India.

This being said, it seems that the success of the program is highly dependent on achieving a number of conditions, most of which relate to public finances. There is, in this sector, a number of uncertainties.

The main uncertainty relates to the evolution of the revenue side of the budget. In the short run, achievement of the fiscal target seems to be dependent on improvements in the collection of tax arrears, and I would appreciate comments as to the quantitative impact of these specific assumptions; in the longer run, Nepal will have to manage the transition from a mainly custom tariff-based to an internal tax-based system of public revenue. This might prove a very difficult endeavor. I have noted that the staff projections incorporate an increase in internal taxes of approximately 0.5 percent of GDP annually, and I would be interested in knowing what are the main categories of measures that could be envisaged to that effect. Finally, I have noted the commitment by the authorities to take additional fiscal measures if any slippage occurs in the deficit projections. And like Mr. Dorrington, I wonder whether it is, at this stage, substantiated by any specific measures that are envisaged. I wonder also whether the constraints placed on development spending have not reached their limits, and whether further moves in that direction would not jeopardize prospects for future long-term growth.

A second uncertainty is, of course, as very well underlined in the staff report, related to monetary policy. Already, significant measures have been achieved to improve the day-to-day management of money supply. However, the success in this field is contingent on the capacity of the authorities to reduce credit to the nonfinancial public sector, so as to allow for sufficient noninflationary growth of credit to the private sector. It is not clear how this is going to be achieved in the period covered by the program, and what could be the inflationary impact of eventual price increases which might be necessary. I would certainly appreciate some comments by the staff.

A third set of questions relates to the trade and current account balance. I have noted that the program targets a reduction of the annual growth rate of import volumes to 6 percent in the years to come, after 13 percent in the present fiscal year. However, GDP growth is projected to stay stable. I understand that a surge of imports this year can be explained by the extensiveness of trade liberalization undertaken. But as the prolongation of this liberalization trend is one of the cornerstones of the ESAF program, I wonder whether the projections of import growth are not too optimistic.

All in all, Nepal certainly qualifies for the strong support of our institution during this first year of the ESAF arrangement, especially taking into account the strength and magnitude of measures already taken. For the program to be a success, nevertheless, the momentum must be sustained, and further and strong actions might be necessary. We can approve the proposed decisions.

Mr. Abbott made the following statement:

The ESAF proposal before us today for Nepal is well designed and comprehensive. Extensive prior actions already taken confirm the young democratic Government's commitment to a strong agenda of growth-enhancing reforms. We are happy to support today's proposed decision for a three-year ESAF program for Nepal.

Macroeconomic stabilization will need continuing attention as structural reforms are brought on stream. Although some progress has been made recently, inflation remains a concern. Even taking into account the special problems of digesting the 1991 devaluation and the effects of a poor monsoon, it is disappointing that the expected close convergence with Indian inflation trends has not yet been re-established. Based on the March Article IV review, we had expected that by now consumer inflation would be in the low teens rather than only beginning to drop below 20 percent. The policies Nepal is now following--financial discipline and moderated public sector demand for credit--are certainly the right recipe for inflation suppression. Still, we would be interested in any further thoughts the staff has on the pattern and pace of inflation deceleration in Nepal, particularly in the staff's response to the pertinent questions raised by Mr. Dorrington regarding the functioning of monetary policy in Nepal.

Minimizing public sector demands on domestic financial markets is a crucial element in the economic strategy Nepal is adopting. We are pleased that public finances are assigned a very high priority, and that the program calls for both close monitoring and additional fiscal measures in case of slippage. In the current fiscal year, domestic borrowing has already been brought down considerably, to 1.3 percent of GDP. Under the ESAF it would be virtually eliminated by the end of the program. We think this is entirely appropriate. Foreign assistance on concessional terms is available to cover most budgeted development expenditure, so there seems little justification for public sector domestic borrowing on commercial terms, even if such borrowing could be done on a noninflationary basis.

We fully endorse the emphasis the program gives to improved resource utilization in the public sector. This shows up in several areas. The civil service reform and retrenchment that are under consideration are quite sweeping. Implementing such a policy will require a great deal of political determination, and we strongly encourage the authorities to persevere in this important effort.

The backlog of aid indicates Nepal now has more assistance available than it can readily absorb. Programs that are planned to improve the management of development expenditures will require sustained attention but can bring both important budgetary gains as well as improve the contribution aid makes to Nepal's development. We welcome the involvement of the World Bank and the Asian Development Bank in efforts to sharpen priorities and to discipline execution of development programs.

Plans for rationalizing public sector enterprises still appear to be somewhat unformed. Articulation of a reform strategy is not expected until the middle of 1992/93 and implementation could only begin later. We would strongly encourage the authorities to adopt a strategy that minimizes the involvement of the public sector in the operation of commercial and industrial enterprises. Early privatization or liquidation of such activities is likely to provide the greatest boost to Nepal's development.

Reforms that are being introduced in the areas of industrial licensing, foreign trade, foreign investment, and agriculture should all enhance both the productivity and the opportunities available in the wealth-generating sectors of the economy. These reforms seem well focused but are just beginning. Steady progress across a broad front will be necessary if the ambitious objectives of the ESAF are to be achieved.

Regarding the financial sector, we fully support the aims of introducing more indirect instruments of monetary control and enhancing the role of market forces in the banking system. These objectives are interconnected. The benefits expected from the reorientation of monetary control will only be achieved if the domestic financial markets are effectively competitive. The staff report suggests the financial sector is still dominated by a small number of government entities, and there is still some hesitancy about establishing true competitive conditions. For example, on page 9 it is stated that "they [the authorities] intend to restructure the two major government-owned commercial banks with a view to a more commercial orientation." This strikes us as a very modest ambition. The further statement that "private participation is one of the options" reinforces the impression that the authorities are taking a very tentative approach to financial sector reform. Prudence is required in financial sector reforms, but we believe a bolder approach is warranted. In particular, much greater scope for private initiative in the financial sector should be fostered.

We would be interested in any further thoughts the staff has on the extent to which competitive conditions are being established in the financial sector.

The staff representative from the Central Asia Department said that, with respect to the question whether Nepal was an appropriate case for the Fund to be involved in, it was certainly true, as was shown in the staff papers, that there were no pressing, immediate foreign exchange difficulties in Nepal, and the staff projections included a comfortable reserve cover over the program period. It was fair to say that, in dealing with the case of Nepal, the staff had taken a fairly broad view of the role of the Fund, although, of course, balance of payments need remained an important part of the assessment. Nepal was a poor country that was embarking on an ambitious agenda of structural reforms as outlined in the staff papers. A crucial aspect of the authorities' reform agenda was substantial liberalization of the trade and exchange systems, with a view to achieving over time unification of the exchange rate system and reduction in the large current account deficit. Those efforts would involve removing the direct controls and quantitative restrictions that in the past had been a principal means of maintaining the reserve cover. The staff believed that the present level of reserves provided a necessary cushion for the ESAF-supported adjustment to go forward, and that the authorities' efforts would move Nepal significantly along the way toward a viable medium-term external position, which was in keeping with the purposes of the ESAF.

As to the operation of monetary policy in Nepal, and particularly the envisaged reduction in broad money growth, it was useful to recall that in financial year 1991/92, the growth of reserve money had diverged substantially from the growth of broad money, the staff representative commented. It was the staff's understanding that, because the excess liquidity in the banking system had effectively been mopped up by the actions outlined in the staff papers, reserve money and broad money growth in the current financial year should move more or less in step with one another during 1992/93. The banking system no longer had excess liquidity available to permit broad money to grow much faster than reserve money. Therefore, if the central bank took the appropriate measures to rein in reserve money growth to the targeted level, broad money growth should be in line with the growth of reserve money. As to the ability of the Nepal Rastra Bank to control money growth, the authorities had requested technical assistance from the Monetary and Exchange Affairs Department, and a mission was scheduled to travel to Nepal in the coming weeks.

As to the constraint on monetary policy resulting from the fixed exchange rate, the staff representative remarked, interest rates across the board in Nepal were currently 1/2 to 1 percentage point higher than the rates in India. The rates in Nepal were essentially freely determined, and the staff hoped that, over time, there would be a return to positive real interest rates across the board; that would likely take place as the rate of inflation wound down after the substantial supply shock-related jump in food prices in the past financial year. But the constraints on the external side were real ones: the staff's analysis suggested that if the Nepalese were to raise interest rates sharply, there could be offsetting capital inflows, which would complicate domestic monetary policy.

The staff did not yet have detailed information on the Himalaya Bank and would attempt to answer the questions about it on a bilateral basis, the staff representative commented. As to the new rural development banks, it was the staff's understanding that they were to be set up to take over some of the priority lending that commercial banks had been asked to undertake in the past.

The details of the contingency fiscal measures that the authorities planned to introduce, if necessary, at the time of the midterm review, had not yet been formulated, the staff representative said. There had been a relatively small estimating difference between the staff and the authorities at the time of the discussions with the authorities; at that stage, the staff had felt that it was most important to receive a strong commitment from the authorities that, if necessary, at the time of the midterm review they would introduce additional measures. There was a clear and quantitatively precise understanding about the magnitude of additional measures to be introduced, if necessary. The precise measures to be taken, if needed, would be determined at a later stage.

The staff would not wish to prejudge the possible sources of the additional revenue that the authorities aimed to achieve each year over the course of the three-year arrangement, the staff representative commented. The authorities had requested technical assistance from the Fiscal Affairs Department for a major tax reform effort to be made at the time of the next budget, in July 1993. That technical assistance mission would likely visit Nepal in November. Clearly, the thrust of the effort in that area would be to find additional domestic revenue sources, so that trade liberalization and, thus, import tariff reduction could proceed while the revenue targets were met. One likely source of additional revenue was a more broad-based indirect tax.

The authorities had been attempting over the past several years to rehabilitate the two large government commercial banks in Nepal, with the support of a loan from the World Bank, the staff representative noted. In that connection, the authorities had made some progress--more progress in one institution than in the other. The staff felt encouraged by developments in that sector, but more clearly needed to be done. The Government was looking into what additional steps could be taken to increase the commercial orientation of the government banking institutions, and privatization and increased private sector participation in these government banks were among the options being considered. The staff felt that a strong case could be made for increased private participation in those banks to improve their operation, and the staff would encourage the Government to consider that option in a positive manner.

The question had been raised whether the medium-term balance of payments projections were too optimistic in view of the possibility of a strong surge in import volume, the staff representative from the Central Asia Department commented. That was a matter of judgment and was particularly uncertain as it depended in part on the response to trade liberalization, adding an additional dimension of risk. The size of the increase in imports built in to the projections for the current financial year might turn out to be too large or too small. The staff planned to visit Nepal several times during 1993, and the staff would of course review the projections carefully to determine whether any revisions might be warranted.

Mr. Jonas made the following statement:

> We welcome the request of Nepal for the first annual arrangement under the ESAF. It should provide a good opportunity to consolidate the achievements under the SAF programs. However, despite the progress made, many distortions and imbalances persist. Dealing with them will provide a busy agenda for programs under the ESAF.
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> One of the weak elements of the SAF program was improper public expenditure management, which contributed to higher fiscal deficit and also to higher inflation. Therefore, the emphasis on improved public expenditure management under the ESAF program is fully justified. In this respect, the reduction of domestic

financing of government budget in 1991/92 is a welcome development. Together with mopping up the liquidity, this should also assist in reducing the inflation to a level that will be comparable with inflation in major trade partner countries, and it will assist in preserving the competitiveness of Nepal producers.

Crucial for the success of the medium-term reform strategy will be the ability of the authorities to reconcile fiscal consolidation with trade liberalization. As the most important factor contributing to a sustainable fiscal position in the medium term will be solid economic growth, and because a liberalized trade system is a crucial condition for such growth, there is no intrinsic conflict between these objectives.

Even if the authorities are fully committed to pursuing measures agreed in the policy framework paper, there are still some uncertainties with respect to the medium-term projections. Both output and inflation can be negatively influenced by exogenous factors, like the climatic situation or economic development in India. For this reason, the authorities should be ready to respond with a sufficient degree of adjustment in the event of adverse developments to keep the program broadly on track.

Another risk to program targets, mainly to inflation reduction, can come from substantial capital inflows, which are projected to be $1 billion over the ESAF period. This will put high requirements on sterilization of excess liquidity under conditions of limited ability to do so. Technical assistance provided by the Fund will be important in this respect.

Prior actions taken by the authorities so far point to sufficient commitment to comprehensive structural reforms and strong stabilization. Medium-term balance of payments projections provide a satisfactory guarantee that Nepal will continue the good tradition of meeting its obligations vis-à-vis the Fund. For these reasons, we support the request for the first annual arrangement and wish the authorities success.

Mr. Solheim made the following statement:

Like previous speakers, I am pleased to note that Nepal, after a period of political transition, now stands ready to tackle its economic and financial problems. The Government has already proved its determination to reform and develop the economy by taking impressive prior actions in several areas. In order to continue the positive performance, Nepal will, however, need substantial assistance from the Fund in the coming years, not only financially, but, perhaps even more so, also technically. In this connection, I welcome the authorities' request for an ESAF arrangement, which should serve as the main basis for the authorities' forthcoming medium-term policy strategy.

Both Nepal's economic performance and degree of policy maneuverability are--for good and ill--very dependent upon developments in India. With India's efforts to liberalize its economy, scope is created for corresponding market-oriented measures in Nepal. The comprehensive policy measures envisaged in the ESAF arrangement should contribute to stronger performance of the Nepalese economy, and thus improve the living standards of the population. However, in the June Board discussion of India, concerns were raised about the slow pace of implementation of reforms in certain areas. Even though the staff representative has partly touched upon this in his response to the lead speakers, the staff may have some further comments on the extent to which Nepal's reform program on exchange and monetary issues is dependent upon, inter alia, the progress in these areas in India.

The high rate of inflation remains a major problem in the Nepalese economy. According to the forecasts, it is to be brought down sharply, from 20 percent to 8 percent, within a year or so. One helpful factor in bringing down inflation may be that India at present has a markedly lower rate of inflation than Nepal. However, India's inflation rate is still running at about 15 percent. Even with restrictive fiscal and monetary policies, one may wonder whether the projected deceleration of inflation will be possible to achieve.

Although the foreign reserve position appears comfortable, partly due to foreign aid and unrecorded capital inflows, the relatively large current account deficit may represent a potential problem. In this area, India also plays an important role. In order to strengthen Nepal's trade balance and make it more stable, the authorities should aim at diversifying exports geographically and in terms of products. I would appreciate some comments from the staff concerning the prospects for such a development.

All in all, the Nepalese authorities should be commended for their determination to implement this ESAF arrangement. If actual developments deviate from the medium-term reform program, the authorities should not hesitate to introduce additional adjustment measures to close any development gaps. Finally, I support the proposed decisions.

Mr. Goos made the following statement:

I can go along with the thrust of the staff appraisal. Nonetheless, I should like to raise a couple of issues bearing on the eventual success of the authorities' adjustment effort. Let me say first that I certainly do not wish to question the authorities' commitment to adjustment and reform; but I have some doubts whether the program before us strikes an appropriate balance between macroeconomic adjustment and structural reform.

In explaining my concern, I would note that it is obvious that the welcome program of import liberalization can be expected to develop its full potential only if it is supported by an appropriately tight macroeconomic environment. In the case before us, I wonder whether the ground has been sufficiently prepared; I have in mind in particular the inflation rate in Nepal, which, although declining, is still at an historically high level. Nepal's inflation rate is also substantially higher than that of India, even allowing for differences in the composition of the consumption baskets. At the same time, interest rates appear to be significantly negative in real terms, which is not particularly conducive to demand restraint and savings.

Curtailing inflation, therefore, is correctly identified in the paper before us as the most urgent task the authorities need to tackle. While the room for maneuver in the area of monetary policy might be limited by the existing close linkages with India, at least as far as interest rates are concerned, it is especially important that fiscal policy should play a decisive role in demand management. However, looking at the tables in the staff paper, I feel that the envisaged pace of adjustment falls considerably short of requirements.

The overall deficit is expected to decline by a mere 0.9 percent over the ESAF arrangement period and by just 0.4 percent in 1992/1993. At the same time, expenditures are expected to increase by approximately 19 percent this fiscal year--well above the projected increase in nominal GDP. I find it somewhat hard to reconcile these facts with the need for tight financial policies or, for that matter, with the requirement of strong stabilization policies as the basis of ESAF arrangements.

Also, the announced timetable for the unification of the exchange rates appears less ambitious than desirable in view of the inefficiencies and distortions normally associated with such a system. The main reason for the long transition period envisaged for unification seems to be the intention of the Nepalese authorities to closely shadow events and decisions in this area in India. The staff might perhaps elaborate somewhat on why Nepal could not pursue a more independent exchange rate policy.

Finally, given the healthy level of reserves and the favorable medium-term balance of payments outlook--which includes a surplus in each year of the projection period--I found it rather difficult to identify Nepal's balance of payments need. In this context, I was surprised by the last sentence in the staff appraisal: "While there are no pressing foreign exchange difficulties in sight, the staff and the authorities see Fund support for Nepal's reform process as crucial for maintenance of macroeconomic discipline and external viability over the medium term." This strikes me as a rather innovative approach to Fund lending, in that it appears to ignore the fundamental requirement of a balance of payments need. There are, of course, other forms of Fund assistance that could have been employed to help maintain macroeconomic discipline and external viability, such as monitoring of the adjustment program by the Fund.

Unless I am mistaken in my analysis of Nepal's balance of payments situation, I wonder whether it would not be appropriate for the authorities to forgo drawings under the proposed arrangement. I would, of course, be glad to hear the staff's comments on this issue.

Mr. Shimizu made the following statement:

Like previous speakers, I welcome and support Nepal's request for an ESAF arrangement, and I support the proposed decisions.

Clearly the most immediate challenge for the authorities is to reduce the rate of inflation, which rose to some 21 percent in 1991/92. While I welcome the staff's report that inflation has declined recently, the authorities need to take vigorous steps to reduce inflationary pressures through tight fiscal and monetary policies. I welcome the measures taken to increase revenues; however, given the weak tax collection capacity, much effort is needed to strengthen tax administration and broaden the tax base. In this regard, technical assistance would be most helpful, and I therefore welcome the Fund's technical assistance in this field.

On the expenditure side, strict prioritization and close monitoring of expenditure to prevent overruns are crucial. Excessive wage increases should be avoided.

In the area of monetary policy, the authorities have used open market operations to control liquidity; however, they were not sufficient. It is important to strengthen the central bank's ability to control monetary aggregates. Also, it is important to restrict credit to public enterprises to make room for the private sector. In addition, positive real interest rates should be maintained to force interest rates to play their role in allocating resources efficiently.

Another important agenda item under the ESAF arrangement is structural adjustment. Structural adjustment is essential to reduce the role of the public sector and increase the scope for private activity. In this regard, I welcome the prior actions taken recently to liberalize the trade and exchange systems. However, much remains to be done. In particular, the importance of public enterprise reform and civil service reform cannot be overemphasized. I would urge the authorities to expedite the formulation of the reform program and proceed with it as quickly as possible.

The achievement of steady growth of the real sector of Nepal's economy is also an important task for the authorities in order to improve medium-term economic viability. As the agriculture sector is the core of Nepal's economy, much attention should be given to this sector. In this regard, I welcome the authorities' intention to establish a rural development bank, as commercial banks sometimes fail to provide reasonable credit to farmers.

Let me comment very briefly on Nepal's balance of payments needs and the Fund's financial assistance. I understand Nepal's needs with respect to reform and the Fund's expertise in this regard. However, like other speakers, I still have some doubts whether Fund financial assistance is really needed.

Mr. Al-Tuwaijri made the following statement:

I join previous speakers in commending the Nepalese authorities for their ambitious and comprehensive structural reform program. I particularly welcome the wide array of prior actions, which include reforms in the exchange and trade system, the industrial licensing and foreign investment code, the financial sector, as well as the initiation of a privatization program. Furthermore, the authorities intend to complement these measures with major civil service and tax reforms. Collectively, these measures should dramatically improve economic efficiency and invigorate private sector activity. As I broadly concur with the staff's appraisal, I shall make a few remarks for emphasis.

The authorities' fiscal strategy entails an addition to domestic resource mobilization of 0.5 percent of GDP in each year. This resource mobilization effort may appear somewhat modest in light of the 1991/92 fiscal deficit of about 8.7 percent of GDP. However, in practice, this effort should be regarded as reasonable, given that Nepal has one of the lowest per capita incomes in the world and a limited natural resource endowment. Therefore, I concur fully with the authorities' objective of eliminating domestic financing of the fiscal deficit and relying purely on concessional external assistance to finance development projects. Clearly, for this strategy to bear fruit, the returns from development projects have to increase significantly. Hence, I endorse the authorities' attempts at enhancing the overall efficiency of public expenditure. While still on fiscal policy, I welcome the authorities' explicit commitment to additional revenue measures by the time of the midterm review to ensure that the full-year revenue target is realized.

Policy design in Nepal is significantly constrained by the substantial interlinkages between Nepal and India. In many respects, the success of Nepal's structural reform program is largely influenced by successful reforms in India. This link is most apparent in the trade, exchange, and monetary areas. Here, the authorities cannot afford to lag behind developments in India, nor is there much scope to outpace Indian reforms. Clearly, given the long border between the two countries, tariff and exchange regimes need to be very similar. In addition, Nepal cannot raise domestic interest rates well above India, as that would create potentially destabilizing capital inflows, nor can it realistically reduce inflation well beyond inflation levels in India. This being said, Nepal can and should proceed vigorously with public enterprise reforms, including privatization and civil service reforms.

I support the proposed decisions.

Mr. Golriz made the following statement:

Recent economic developments in Nepal have been marked by problems characteristic of a transitional economy among which are high inflation owing to price liberalization and low output due to restructuring. Despite various constraints, the authorities have managed in the past two years to accelerate the adjustment and reform efforts. The current economic challenge is synchronous with similar adjustments in Indian economy as the major trading partner of Nepal.

Since we are in broad agreement with the thrust of the staff's appraisal, our remarks will be brief.

To achieve the program's main objectives, particular attention must be paid to the implementation and monitoring of the demand-side policies, especially with regard to bank financing of the public sector deficit. To this end, revenue generation based on revised tax system and expenditure cuts based on public sector reforms should go hand in hand, and, unlike in the current year, current expenditures should be restrained instead of development spending. The Government's bold policy of civil service retrenchment, as well as the privatization of state-owned companies, will hopefully reduce the burden on the budget. We wonder, however, whether there is a transparent safety-net program planned to protect the released civil service and public enterprises workers.

On monetary reform, we endorse banking system reorganization designed with the World Bank's cooperation. In this context, monetary instruments should all be used to mobilize domestic private savings needed for development purposes. With the inflation rate relatively high, interest rates should be kept positive to fill the deep gap between savings and investment shown in Table 2 of the staff paper.

On external sector policy, we welcome the steps taken so far toward liberalization. However, unification of exchange rates needs to be expedited to keep pace with the Indian rupee. In this connection, we note that the authorities intend to unify the exchange rates by 1994/95, while the proposed decision foresees a February 1993 date for unification. Could the staff comment on that?

Finally, the real annual growth of 9 percent for exports projected for the next five years seems overoptimistic owing to limited capacity of traditional exports and the fact that present exports incentives will result in longer-term progress. Therefore, the alternative scenario assuming an annual growth of 6 percent seems more realistic.

With these remarks, we support the proposed decisions.

Mr. Arora made the following statement:

I would like to compliment the Nepalese authorities for their work in what Mrs. Martel characterized as a very wide-ranging and comprehensive adjustment and structural reform program, which I support. In addition, Mr. Ismael's statement was very helpful in presenting the issues before the Board today.

Questions have been raised about whether the need for financing exists and, therefore, whether the Fund should come to support Nepal, and whether in fact the macroeconomic policy framework proposed in the program is adequate for solving some of the long-standing problems. It seems to me that, given the difficult situation in Nepal and the fact that there is a democratically elected government for the first time in many years, it would appear that trying to push the pace of reform faster than is contemplated already under the program may not be very productive and could lead to serious problems in the political field. We have therefore to be cognizant of the fact that the program as presented today, and with, of course, the contingency arrangements that the staff has already pointed out, is fairly adequate. Otherwise, there could be serious problems for a very poor country.

In that context, and given the fact that the authorities have already been very responsive and the program does contemplate actions on all fronts--inflation, monetary policy management, fiscal reform of a daring kind, and trade and exchange liberalization of a fairly radical nature--the authorities need a confidence level. I would point out that Mrs. Martel rightly posed the question whether the projections for import growth in the program are not insufficiently optimistic--imports may grow more than the staff has programmed. Therefore, the authorities need a confidence level, which would be provided only by a Fund program and Fund financing at this stage.

I would like to draw your attention to one question that has been referred to in the staff paper, on page 13, about the overall impact of the program on poverty. It is well known that Nepal has a very poor natural resource base, and the population is huge. About 90 percent of the people are involved in agriculture or agriculture-related activities, and the situation of many of them is very precarious. If the macroeconomic framework now being adopted and being implemented in Nepal is to have any chance of success, it is essential that other policies, apart from privatization and liberalization be put into effect to improve productivity.

In this regard, I wonder whether actions are contemplated with regard to the whole question of agricultural productivity. A World Bank report on incomes and poverty in Nepal was published about two years ago, and it contains several sensible and constructive suggestions. I hope that the staff, while auditing the progress in the various areas of macroeconomic reform, would also look at how that is proceeding. Otherwise, the policies of austerity will only increase tensions in the countryside. Along with that, of course, is the question of the population growth in Nepal, which has reached the rate of 2.7 percent per annum and is quite clearly wiping out all the other gains that are being made in the economy. Therefore, in that area too--and this is very important for addressing the poverty question--I hope that the staff would focus attention while assessing the results at the time of the review of the program.

Mr. Posthumus made the following statement:

I also support the program, but I wonder whether it warrants ESAF support, which is the basic question I would like to raise today. Like most other speakers, we may have some remarks here or there, but in principle the program seems to me a good one. What is not good is the justification in the staff report; indeed, there is hardly any justification for ESAF support. I therefore have a few questions on this issue.

In the first place, there is obviously no balance of payments need, and the staff gives extensive information about that. I would in this connection mention only one point, made on page 17 of the policy framework paper, namely, that there are increasing amounts of foreign assistance, long-term concessional loans, and official grants in the ESAF arrangement period.

This raises the second question. Because assistance and private investment are flowing into the country in sufficient amounts to close the balance of payments gap, there is obviously no catalytic role of the Fund--a role we usually like the Fund to play.

A third question is whether a decision in this case would mean that all ESAF-eligible countries, which are in principle IDA-eligible countries, would then have a right to receive support in the form of ESAF funds, whether or not those countries had an external financing need.

As Mr. Goos noted, on page 25 the staff notes that the ESAF is "crucial for the maintenance of macroeconomic discipline and external viability over the medium term," which I think is insufficient support for an ESAF credit, because this is obviously too loose a term; it even brings into question whether the Fund can give any advice to countries if it is not supported by Fund financing.

This program is not just a lenient approach to a specific situation; it is a change in the policies governing the use of the ESAF. I therefore request the staff to provide a supplement to the staff papers with a full justification for this ESAF request.

Mr. Deng said that he basically agreed with the staff appraisal and fully supported Nepal's request for the first annual arrangement under the ESAF. With the successful completion of the program under the SAF arrangements, Nepal faced greater challenges in further adjusting its economy. As highlighted in the staff report and Mr. Ismael's statement, reducing the macroeconomic imbalances--particularly inflation and public debt--remained a priority for reinforced policy actions. Furthermore, if fundamental improvement of the economy was to be achieved, there must be intensified efforts by the authorities to move forward with extensive structural reforms.

He welcomed the progress made thus far in economic stabilization and structural reforms, and he appreciated the authorities' full commitment to various policy measures aimed at achieving program targets and sustaining economic reforms, Mr. Deng continued. Therefore, he encouraged the authorities to make further efforts to keep the program on course. In that connection, external support remained crucial for the program to succeed, given the current stage of economic development in Nepal. The ESAF arrangement would provide timely support for Nepal's adjustment efforts, and he fully endorsed the proposed decisions.

The staff representative from the Central Asia Department commented that the most fundamental issue that had been raised was the rationale for the proposed arrangement. He had not meant to give the impression that there was no balance of payments need for Nepal to use Fund resources. It was true that there was no pressing foreign exchange crisis, but Nepal was embarking on a major medium-term reform program with a heavy content of trade and exchange liberalization. His understanding was that, in other cases, trade and exchange liberalization over the medium term, with a view to moving toward a more viable balance of payments position over a number of years, was an element of the assessment of balance of payments need.

In addition, the staff representative went on, paragraph 1 of the ESAF Trust stated that "the Trust shall assist in fulfilling the purposes of the Fund by providing loans on concessional terms (hereinafter called 'Trust loans') to low-income developing members that qualify for assistance under this Instrument," and, he would stress, "in order to support programs to strengthen substantially and in a sustainable manner their balance of payments position and to foster growth." The staff would submit that that was precisely what the proposed arrangement for Nepal was intended to do; therefore, the proposed arrangement deserved the Fund's support. A distinction should be made between the absence of a pressing short-term foreign exchange crisis on the one hand, and the objective of moving toward a more viable medium-term balance of payments position on the other. The substantial trade and exchange liberalization that the authorities in Nepal planned to implement clearly suggested that the country was moving toward a more viable medium-term balance of payments position.

Mr. Goos said that it was true that a standard argument was that if a country liberalized its economy and opened its borders, there was a risk of balance of payments pressure and, therefore, the Fund could be willing to provide financial assistance. But the staff appraisal stated in part that "there are no pressing foreign exchange difficulties in sight," despite the adjustment measures that the authorities had implemented and were committed to implementing. If there was no such difficulty in sight, despite the reform and liberalization measures to which the authorities were committed, then there was unlikely to be a balance of payments need. Hence, the staff should either stick to the conclusion in the staff appraisal that he had mentioned, or that conclusion should be replaced by a somewhat different reasoning than had been provided thus far in support of the proposed arrangement. In sum, he doubted whether the comments by the staff representative were consistent with the description of the situation in Nepal in the staff appraisal.

The argument had also been made that ESAF resources should be made available because of the poverty in Nepal and the concessional nature of the ESAF resources, Mr. Goos commented. It had even been argued that regular Fund financing would not have been appropriate in view of the favorable balance of payments outlook. The ESAF decision clearly stipulated that a balance of payments need was a precondition for Fund financial support.

Mr. Arora remarked that his understanding was that the current situation in the Fund with respect to the provision of financial assistance was the following: if a country was undertaking structural reforms like those of Nepal, or even if it were not undertaking such reforms but the evolution of its balance of payments suggested that it might face a problem not too far down the road, then the country had the right to approach the Fund, and the Fund had an obligation to meet the country's temporary balance of payments need. The situation with respect to the provision of Fund financing had been drastically altered by the introduction of the structural adjustment component of the Fund's balance of payments support. It would be odd--and totally untenable--to say that the Fund should come to a country's assistance only if the country faced a dire crisis. Nepal's program was comprehensive, and while the difficulties a country might encounter over the coming months could not be foreseen, a country that did not currently have foreign exchange difficulties in sight could conceivably face such difficulties in, say, six months. A much wider perspective on what constituted a balance of payments need was needed in dealing with a country like Nepal, which had a very low per capita income.

Mr. Posthumus recalled that in his initial comments the staff representative from the Central Asia Department had said that the staff had taken a somewhat broader view of the role of the Fund in the case of Nepal than in other cases, which suggested to him that the case and situation of Nepal were not normal--a conclusion that, to a large extent, was underscored by Mr. Arora's comments. Mr. Arora had argued that the Fund should maintain in effect continuous programs in most of the ESAF-eligible countries, because each of them could, at some stage or other, have a balance of payments crisis that could be addressed through access to the ESAF. Those points went to the heart of the policies governing the ESAF. For that reason, the justification for the proposed arrangement with Nepal should be set out in an additional paper; the case presented therein should not rest solely on the specific case of Nepal.

Mr. Evans said that his position was similar to that of Mr. Arora. He had not commented earlier in the discussion because he was content with the staff's recommendation. It was important not to confuse concerns about the concessionality of ESAF resources with the issue of the need for a stand-by arrangement or a medium-term program. Nepal was clearly implementing a medium-term program with an important liberalization component. One of the two medium-term scenarios in the staff paper contained an optimistic forecast of 9 percent average export growth that would produce external viability, but the other scenario, based on a more realistic export growth forecast of 6 percent on average, did not foresee external viability. In fact, the second scenario showed a current account deficit in excess of 10 percent after 1996-97 and a decline in reserves through the whole period of the scenario. Hence, there was a clear need for a medium-term arrangement. Whether or not that arrangement should be an ESAF arrangement was a separate question; but Nepal was an ESAF-eligible country, and that fact in itself was sufficient justification for Nepal's using the ESAF rather than, say, the extended Fund facility.

The staff representative from the Policy Development and Review Department remarked that it was clear from the discussion that the staff report had not been as explicit as it should have been in presenting the case of Nepal. A balance of payments need was required for every use of Fund resources--ordinary and ESAF resources alike. He was fully confident that Nepal had a balance of payments need to use Fund resources. The balance of payments projections showed substantial and continuing current account deficits over the coming several years, and the financing of those deficits would depend heavily on external financing of one sort or another. The principal financing resource assumed was official concessional assistance. It was true that Nepal had a large amount of external aid in the pipeline, and, therefore, one might be led to assume that there was certainty about Nepal's external official financing in the coming period. However, there was no complete and absolute certainty that the external official financing would definitely materialize. In addition, the balance of payments projections assumed a certain level of private capital inflows. It was true that a substantial volume of such inflows had been recorded in recent years. While it was also true that the amounts of private capital inflows assumed in the projections were less than had been recorded in the past several years, one could not take it for granted that the forecast volume of capital inflows would actually occur. And even on the basis of optimistic export growth and the projected private and official capital inflows, Nepal would still have an overall balance of payments that was not more than basically in balance. The other scenario, based on less optimistic assumptions about the balance of payments for the coming three years, forecast overall external deficits. Therefore, given the overall picture, in terms of the projected current account deficits, the staff's own projection of an overall deficit under the less optimistic scenario, and in light of the nature of the economy and the authorities' efforts to implement structural policies under the program, Nepal seemed to have a clear balance of payments need.

Mr. Goos said that it was regrettable that a discussion on a general issue concerning ESAF policy was taking place on the basis of Nepal's request for an ESAF arrangement. On page 15, where the question of balance of payments need was explicitly addressed in the context of the alternative medium-term scenarios, the staff stated that "an alternative balance of payments scenario prepared by the staff indicates that the balance of payments would remain viable over the medium term, even if the growth of export volume were substantially lower than assumed in the baseline--6 percent annually instead of 9 percent." He wondered how that conclusion was meant to square with some of the comments by the staff during the current discussion. He was inclined to feel that, in countries like Nepal, there could never be complete assurance that the balance of payments was viable over the medium term. Such countries always faced external influences--such as the monsoon season in Nepal--on trade and other variables. He wondered how the staff would define a case in which there was to be no balance of payments need.

The staff's explanation at the present meeting suggested that all countries always faced a risk that the balance of payments would come under pressure and, therefore, that it would be appropriate to provide Fund financing, Mr. Goos continued. The need for that kind of contingency was met by the traditional stand-by arrangement, under which a country made a drawing only when it actually had a balance of payments need to do so. He wondered whether that same kind of procedure could not be applied in the context of the ESAF. If not, that possibility should be examined on the occasion of the next ESAF review. He did not wish to pursue the matter further at the present stage, but having listened to the staff, he had growing sympathy for Mr. Posthumus, who had requested that the staff prepare a supplementary paper explaining the reasoning for the proposed Fund financial support for Nepal; he was worried that approval of the proposed arrangement for Nepal would result in a change in the policy governing access to the ESAF.

Mr. Dorrington considered that Mr. Posthumus and Mr. Goos had raised important general issues that went far beyond the case of Nepal. To some extent he sympathized with the staff representatives participating in the current discussion: the general issues raised during the present meeting had undoubtedly been under discussion within the staff, and it was only by chance that those issues had surfaced during the Board's current examination of Nepal's request to use ESAF resources. The general issues concerning the ESAF--including the limited size of the facility's resources--would have to be addressed on another occasion; in that sense, Nepal should be seen as one example of ESAF use, but the discussion on the general issues should not focus exclusively on Nepal.

Mr. Posthumus remarked that the staff had presented a number of arguments during the present discussion that clearly applied to the specific case of Nepal. Therefore, he continued to feel that the staff should be asked to provide a supplementary paper containing the justification for the proposed ESAF arrangement. He was prepared to accept the proposed arrangement, but the staff should nevertheless provide an additional paper.

Mr. Solheim said that he sympathized with Mr. Goos and Mr. Posthumus, but in light of the extremely low living standards in Nepal and the comfortable reserve position projected for the coming years, one could raise the question whether Nepal's adjustment program was ambitious enough in light of the apparent room for economic growth.

Mr. Abbott said that he wondered what the procedural implications of Mr. Posthumus's proposal were. There seemed to be broad support for approving forthwith the proposed ESAF arrangement for Nepal. If the proposed arrangement was approved at the present meeting, what would happen if the supplementary paper requested by Mr. Posthumus were to suggest that a balance of payments need did not exist and the arrangement was not fully warranted? It seemed best to treat the general issue of balance of payments need separately from the consideration of the proposed ESAF arrangement for Nepal. He recognized the merit in requesting such a narrowly focused paper.

Nepal's program clearly did involve medium-term structural adjustment, Mr. Abbott continued. Substantial trade and foreign exchange reforms were already under way, the dual exchange rate still had to be corrected over time, and the country was still heavily dependent on foreign assistance. Mr. Posthumus had raised the issue of the catalytic role of the Fund, and he himself considered that Nepal's program provided for a catalytic effect by reinforcing the case for the continued provision of donor assistance over the medium term. That element of the particular type of case under discussion should not be neglected. Without that continuing donor assistance, medium-term viability simply would not exist.

Mrs. Martel said that she agreed with Mr. Evans. The staff's case in favor of the proposed ESAF arrangement for Nepal was convincing. Therefore, she saw no reason to ask the staff to provide a supplementary paper.

Mr. Posthumus commented that he doubted whether the staff would change its conclusions concerning the ESAF arrangement for Nepal in the supplementary paper that he had requested. Even if the staff did change its mind, the arrangement for Nepal could be seen as an exception to the rule. If, as Mrs. Martel had noted, the staff's case was strong, the preparation of an additional paper should not be difficult.

The Acting Chairman said that he understood the wish of Directors to separate the question of the criteria for using the ESAF from the question of the appropriateness of Nepal's specific request for an ESAF arrangement. Continuing the current debate at the present meeting was unlikely to be fruitful. The staff was in the process of preparing the paper for the next scheduled review of the ESAF, and the general issues that had been raised at the present meeting could be addressed in that paper.

Mr. Posthumus said that he continued to feel that the justification provided in the staff paper under discussion for the proposed ESAF arrangement was insufficient. His view had been supported by other Directors. The points that he had raised should be addressed in a supplement to the staff paper under discussion and should not be considered separately from the case of Nepal.

Mr. Abbott commented that, for procedural reasons, and as there seemed to be a consensus in favor of the proposed ESAF arrangement for Nepal, it would be best to accept the Acting Chairman's proposal.

The Acting Chairman noted that a majority of Directors seemed to be prepared to support Nepal's request and accepted the justification for the request that was set out in the staff paper. It would be unusual to agree that a supplementary paper raising a question about a request for an arrangement should be prepared after the arrangement was approved. It seemed best to address the general issues raised thus far in the context of the next review of the ESAF.

The staff representative from the Central Asia Department commented that one of the premises of the medium-term balance of payments projections was the catalytic effect of Fund financing on other institutions expected to provide additional official foreign assistance. The World Bank and the Asian Development Bank provided roughly 60 percent of Nepal's official foreign assistance, and it was the staff's understanding that those institutions were eager to see the Fund become involved in Nepal. Their future level of assistance would bear some relationship to the approval of the proposed ESAF arrangement. At the aid group meeting in Paris in April 1992, a number of bilateral donors had expressed support for the possibility of Fund financial involvement in Nepal; they had indicated that such involvement would influence their own activities in Nepal. Hence, the catalytic role of Fund financing in the case of Nepal was important.

As to the pace of privatization of public enterprises in Nepal, the staff representative continued, sales of three enterprises were almost completed, and another four were scheduled to be taken up soon. In judging the pace of that effort it was useful to bear in mind that there were some 60 nonfinancial public enterprises in Nepal, and that the Government was committed to the principle of privatizing or liquidating all industrial and commercial public enterprises, except for a short strategic list. In that connection, the procedures were well defined and the process was already well under way. An important statement, to be issued by mid-January 1993, would lay out the strategy and timetable more comprehensively. The list of the enterprises to be privatized or wound up and those on the short strategic list would be finalized, and there would be a timetable of action.

Developments in India were an important constraint on progress in some areas in Nepal and were less important in other areas, the staff representative commented. An example of the constraint was monetary policy, as Nepal's central bank could not engineer an increase in short-term interest rates without the possibility of triggering destabilizing capital inflows. There was also a limitation relating to the unification of the dual exchange rate system: in brief, the staff's analysis was that it would be difficult for Nepal to move more rapidly and unwise to move more slowly than India on unification. In that area, Nepal should be moving in step with India. In the area of trade reform, the long open border with India meant that import tariffs in Nepal could not be substantially lower than those in India because of the risk of diversion and consequent loss of hard currency reserves. On other aspects of Nepal's reform, the constraints were less important. The pace of the privatization program would be determined by domestic considerations. The implementation of civil service reform, another important plank of the reform program, was a domestic issue. Finally, developments in India probably would not have a significant effect on the pace of fiscal adjustment in Nepal.

Questions had been raised about the pace of overall fiscal adjustment under the proposed arrangement, the staff representative recalled. The staff felt that if the authorities were able to eliminate domestic borrowing of the fiscal deficit--a key target under the ESAF arrangement--then the remaining deficit would be covered by concessional foreign financing. That financing would be used for needed social and infrastructure investments having an expected rate of return beyond their highly concessional cost. The staff considered that pressing the authorities to reduce needed government investment in order to engineer a further reduction in the overall fiscal balance would have been counterproductive. A stable government domestic debt, declining relative to GDP--as the program targets implied--would be a substantial achievement.

As to Mr. Solheim's question whether the program should not be more ambitious in view of Nepal's poverty and the external position, the staff considered that the program was already ambitious on a number of fronts, the staff representative said. The scope of the trade and exchange reforms currently under way was very ambitious. In a period of just six months the authorities had moved from a situation, in which the great bulk of imports were subject to quantitative restrictions, to the current situation, in which some 98 percent of imports could be imported freely. The government-planned civil service reform, which had not yet been implemented, would be a crucial topic of discussion with the authorities over the coming six months, including the mid-term review; that reform, too, was clearly ambitious. In addition, the privatization program was well under way. Further articulation of that program was expected in the next few months, with a view to eventually selling or winding up all but a few industrial and commercial enterprises--another clearly substantial reform.

As to whether the pace of reform could be stepped up, the staff did feel that the authorities should move to increase private participation in government banks, the staff representative from the Central Asia Department continued. The high level of reserves effectively had provided cover for the Government to move very ambitiously in its trade and exchange liberalization agenda; in that field, Nepal had moved very fast and very far in a short period. It might have been possible to move to complete the abolition of the import license auction in July 1992, instead of cutting the number of commodities covered from 43 to 12, but the staff understood the Government's desire to move in a phased way.

The staff representative from the Policy Development and Review Department recalled that the question had been raised why the staff was proposing in the draft decision that the Board approve the multiple currency practice up to April 30, 1993, even though the staff paper mentioned that the practice could continue up to 1994/1995. The date of April 30, 1993 linked the approval to the midterm review under the ESAF arrangement; accordingly, the continuation of the dual exchange rate would be looked at at the time of the midterm review and no later than April 30, 1993. Although the program did mention that the dual rate system could continue up to 1994/95, it also mentioned that the question of its continued application would be subject to review during the course of the program.

Mr. Ismael stated that Directors' support for the proposed ESAF arrangement for Nepal was most welcome. He appreciated Directors' wish to urge the authorities to undertake more ambitious and bolder concrete measures, but it was important to bear in mind the various constraints facing the authorities, which the staff had underscored during the present discussion. Nepal, of course, could not outpace or lag behind developments in India. It was also important to take into consideration the fact that the present Government was newly elected, had introduced many unpopular measures in a very short time, and therefore had to proceed cautiously to avoid moving beyond the public's limit of political tolerance. Another factor to bear in mind was the limited administrative capacity in Nepal, which meant that the authorities could not hope to tackle all the economic and financial problems at once. For instance, one should not expect the rate of inflation to fall at a time when prices had to be adjusted. There were other examples of factors that limited the possibilities for the authorities to move in line with the Board's expectations that bolder and more ambitious measures might be introduced. In that context, the main factor was the existence in Nepal of the political will to undertake all the necessary measures in due course. Technical assistance should be provided in order to enlarge the administrative capacity of the public service to undertake all the necessary adjustment measures.

With respect to the justification for the proposed ESAF arrangement, Mr. Abbott had made an important point in noting the catalytic role that approval of the arrangement would play vis-à-vis donor countries not only in 1992 but also in the medium term, Mr. Ismael said. It was true that the level of Nepal's reserves--five months of imports of goods and services--was comfortable at present. However, it was instructive to recall that, when the latest Article IV consultation with Nepal was concluded, the Director from the United Kingdom had criticized Nepal's high reserve level--nine months of import cover at that time--and had suggested that the reserves should be reduced to give a greater push to economic growth; several weeks thereafter, following a border incident with India, the reserves had rapidly been nearly depleted. Therefore, in terms of the reserve position, the proposed ESAF arrangement for Nepal was warranted.

Finally, he hoped that the issue of the circumstances in which ESAF financing was justified would be taken up in a separate review and not be part and parcel of the consideration of the present case of Nepal.

The Executive Board then approved the following decisions:

Enhanced Structural Adjustment Arrangement

1. The Government of Nepal has requested a three-year arrangement under the enhanced structural adjustment facility, and the first annual arrangement thereunder.

2. The Fund notes the updated policy framework paper for Nepal set forth in EBD/92/196.

3. The Fund approves the arrangements set forth in EBS/92/142, Supplement 1.

Decision No. 10145-(92/120), adopted
October 5, 1992

Exchange System

Nepal has introduced a multiple currency practice arising from the temporary establishment of a dual exchange rate system. The Fund grants approval for the retention of this multiple currency practice until April 30, 1993 or the time of the completion of the midterm review under the first annual arrangement under the enhanced structural adjustment facility, whichever is earlier.

Decision No. 10146-(92/120), adopted
October 5, 1992

Mr. Posthumus said that he had considered whether he might wish to abstain from approving the decision on the ESAF arrangement for Nepal. He had concluded that he would not abstain; he would support the arrangement as an exceptional situation and case. At the same time, he strongly protested the fact that his relatively simple procedural request to have the staff present the justification for the arrangement in a supplementary paper had not been accepted; after all, the staff had stated that in its view there was nothing unusual about the case that it had made, and he saw no reason why his request should have been refused.

2. PANAMA - 1992 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1992 Article IV consultation with Panama (SM/92/172, 9/2/92). They also had before them a staff paper on recent economic developments in Panama (SM/92/181, 9/17/92).

Mr. Quirós made the following statement:

Panama's economic performance during the first half of 1992 has been satisfactory, and the fiscal outturn during this period was better than expected. All performance criteria to end-June under the present stand-by arrangement were observed. Implementation of the Government's macroeconomic program and structural reforms has been supported by continued bilateral and multilateral financing. In September, the Inter-American Development Bank disbursed $50 million, as agreed in the original program.

Real GDP grew 4.6 percent in 1990, 9.3 percent in 1991, and a growth of 5.5 to 6.5 percent is estimated for 1992 and for the medium term. This is a remarkable turnaround from the substantially negative growth experienced in the two-year period 1988-89. Domestic investment is projected to be maintained at close to 20 percent of GDP. Inflation, on the other hand, has been less than 2 percent per annum, which is lower than the average inflation rate for major industrial countries. In February-March 1992, Panama made payments in the amount of $685.9 million ($253 million to the Fund, $220 million to the World Bank, $168 million to the IDB, $5 million to the International Fund for Agricultural Development, and $40 million to Paris Club creditors). This was the final stage of the clearing of arrears to the international financial institutions.

During the first half of 1992, the total external debt of the Republic of Panama was reduced by $305 million. Panama is engaged in periodic conversations with its commercial bank creditors and is developing mechanisms for a future formal negotiation.

The country has continued its path of reconstruction and development, despite its need to face up to and resolve political problems through a prolonged period of difficult and costly institutional and physical rebuilding. The Panamanian authorities are willing to make additional efforts to continue implementing their economic program. The need to obtain and retain a national consensus on the program requires a proper balance to be struck between approaching political and social issues and satisfying economic and financial requirements in order to consolidate the many gains achieved so far, as well as to maintain adequate guidelines for the required future development of the Panamanian society. This is precisely the reason why the President of the

Republic has designated Vice President Ford to coordinate the execution of "Panama's Economic Development Program" on a full-time basis.

In December 1991, the Legislative Assembly approved a tax reform law that was part of the agreed structural reform program. This law comprises the simplification and rationalization of the tax system, providing the necessary efficiency and equity and adequate incentives to generate additional job opportunities and improve the ratios of savings and investment to GDP. At the Board meeting on February 24, 1992, we noted that the tax reform as such would be revenue neutral, but that improvement in tax administration would yield additional revenue. The preliminary results of the tax reform have so far been excellent, even if one has to agree that an objective evaluation of any tax reform requires a longer period of observation. By end-June 1992, the Government had achieved a revenue performance that was better than expected in the amount of B 40 million (0.7 percent of GDP), and the increase over the previous estimate will be close to B 90 million (1.6 percent of GDP) by year's end.

On page 8, the staff report expresses certain concerns regarding a new law approved in August 1992, under which payments to the Social Security Agency for both public and private employees equivalent to one third of the thirteenth-month salary bonus (representing B 45 million this year and somewhat higher figures in the future) was discontinued. The Panamanian authorities understand that measures need to be taken in order to guarantee that the Social Security Agency receives the appropriate compensation for the net revenue loss that resulted from this legal action. Discussions are taking place to review different alternatives, in addition to the ones mentioned by the staff and already implemented. Also, beginning in January 1992, the Central Government began making cash payments to the Social Security Agency of B 2.1 million a month, or B 25 million a year, to cover the additional support that the Social Security Agency provides to the Integrated National Health System. This also improves the cash flow of the Caja de Seguro Social (CSS) in comparison with previous years.

Regarding structural reforms, a new law establishing and regulating the process of privatization of public enterprises was approved by the Legislative Assembly on June 29, 1992. It is expected that through this new law Panama will be in a position to develop and modernize the national economy by strengthening the market system. At the same time, the law reduces the Government's role in the direct management of economic activities while helping to reduce the fiscal deficit and recourse to Government borrowing. The preferred method of privatization--according to the new law--will be the conversion of public enterprises or entities into joint stock companies, followed by the sale of their shares to the public. Panama will also use the mechanism of conversion of public enterprises into "mixed economy companies," in which the Government will have a minority interest.

The privatization law allows between 5 percent and 20 percent of the total of shares of privatized companies to be set aside--for a period of up to 180 days--for purchase by employees of such companies, and for farm workers in the case of privatized agricultural enterprises. Another provision establishes that shares or stock certificates of such companies will have a nominal value that cannot exceed B 50, thereby providing share ownership accessibility to a wider number of Panamanians. The authorities' privatization program aims at the reduction of the size of the public sector by transferring to the private sector activities employing 10 percent of the public sector work force of 132,804 employees (as of end-1991). Several nonbasic services, as well as the expansion programs of various government enterprises, i.e., electricity, water and ports, are to pass into private hands. At the same time, a reform program for the enterprises that will remain under public ownership is already being implemented through an Inter-American Development Bank assistance program. As part of this overall program of privatization and reduction of the public sector wage bill, the Government has established a program of voluntary retirement and expects that the funds for its implementation will shortly be approved by the Legislative Assembly.

The staff report notes, with concern, a cabinet decree that was issued in early June 1992 providing for payment of entitlements owed to government employees (wage increases and other benefits). This cabinet decree, whose original authorization was for up to B 85 million, has been reduced by B 20 million (Cabinet Decree No. 40 of September 9, 1992). Payments would be made through the issue of special government bonds. At the same time, the new cabinet decree links these payments to the privatization program, as the government bonds could be redeemed ahead of maturity with the proceeds from the privatization of the institution in which the employee served.

The main concern of the Panamanian authorities continues to be the creation of job opportunities. The present rate of unemployment is 15 percent. Our authorities recognize that this critical problem can be safely dealt with only gradually through sustained noninflationary growth.

Future growth in Panama will depend on greater dynamism of the export sector fueled by private investment. But, for this to happen, a more favorable international environment is required. The world economy seems to be under severe stress owing to low growth performance in many countries, including major industrial ones. The deceleration of world growth and the associated likely deceleration in the growth of world trade could have serious consequences for a large number of developing countries that are now engaged in implementing programs of structural reforms and trade liberalization. The process of adjustment to a more dynamic economy could become far more painful, thereby eroding popular support for basic structural reform. It is a collective responsibility to exercise all our efforts to reverse this trend in favor of economic growth and social progress.

The Panamanian authorities will continue working on the fiscal and structural front in order to be able to satisfy, on a timely basis, all future requirements of the present program.

Mr. Dawson made the following statement:

Panama's economic performance over the past three years on the whole has been positive, with enviable outcomes of strong growth, low inflation, and a narrowing current account deficit. The one soft spot in the economic picture is the persistently high levels of unemployment. But overall, the outlook is bright and should get better as Panama implements the structural reforms outlined in the stand-by program. For the first six months since the stand-by was approved and arrears were cleared with the Fund and the other international institutions, Panama has successfully met the program's quarterly performance targets.

Unfortunately, the economy is now on the verge of veering off its intended course, precisely because of less than programmed efforts on structural reforms. Policy measures taken over the summer threaten both the short-term economic outcome--with potential for missing the next two quarterly targets under the stand-by--as well as the medium-term outcome of sustained economic growth, by foot-dragging and back-tracking on necessary reforms.

On net, a good outturn is expected for the public sector in 1992, continuing the steep improvement in fiscal accounts since the late 1980s. Due to stronger than projected economic growth and improved tax administration and collection, better than expected revenue results for both the Central Government as well as public enterprises should offset larger than anticipated current expenditures for the public sector as a whole.

But on the expenditure side of the fiscal accounts, several issues raise concerns. First, we note that the full thirteenth-month bonus was returned to employees in August. Passage of the original December 1991 legislation dedicating a part of the bonus to social security finances was one of the long-awaited actions behind multilateral approval of the current stand-by arrangement and participation in the clearance of Panama's arrears. That it has been reversed six months later is disappointing. Although the authorities have taken remedial action, the alternative measures substitute unstable revenue sources for a permanent one, which does not add up to sufficient revenue to completely close the new gap.

In February, we were also impressed with Panama's intentions to make sharp but necessary cuts in public employment by over 10,000 in 1992. Given its public sensitivity, we read this action as a sign of the authorities' strong commitment to the program. Unfortunately, to date the reduction in public employment totals only 2,000 workers, and most of this was achieved through attrition. Given that the fourth and last quarter of this year is now upon us, we hope to hear today or shortly that budget authorization has been agreed for the severance payment that will allow additional cuts in public employment. Even so, we must note that the new targeted amount of a total 8,000 reduction is substantially short of the original target and will still leave a wage bill of significant dimensions.

Finally, the June cabinet decree authorizing payment for previously suspended wages and benefits creates yet another hole in this year's fiscal accounts. Mr. Quirós's statement notes that the total payment has since been lopped off by B 20 million, but this decrease does not yet seem to equal the "marked" narrowing of the payment as promised by the authorities in the staff report.

We note that the authorities broadly understand how these steps create uncertainties for the future of the program, and that, as a result, discussions on remedial steps are under way. We hope that any measures contemplated will be bold. It would be unfortunate for Panama's medium-term prospects if the original structural changes in the fiscal accounts were to be replaced by a collection of less permanent and more stopgap measures.

Regarding the outturn on public enterprises' accounts, we note the expenditure overruns linked to fuel costs and the wage bill. Some flexibility in tariff pricing might have helped avoid cost pressures by responding on a temporary basis to the effects of the drought. However, we also note that technical difficulties, presumably not quite so temporary in nature, were also responsible for the higher costs. A faster pace on privatization --one closer to that originally planned--would have prevented the other expenditure overrun, that on the wage bill. We have strong hopes that the enabling law on privatization finally passed by Parliament in June will speed up the process that until now seems to have proceeded in fits and starts. Many public companies long slated for privatization are still not there, such as the agricultural company Chiriqui or the National Port Authority. A good indicator of the importance the authorities attach to privatization will be the quick conclusion of the INTEL privatization, including the passage of necessary legislation.

Unfortunately there are also other areas where structural reforms have either slowed, stagnated, or backtracked. One is progress on trade reform, where Panama continues to lag far behind its neighbors. Many measures that were to have been completed by mid-1992 are still undone. The authorities are strongly encouraged to move ahead on trade liberalization plans as well as on parallel price decontrol. Not only is further disbursement of loans from international financial institutions tied to these reforms, but so are medium-term export and economic growth prospects, as noted in the staff's outlook projections.

We also remain concerned that unemployment is still stubbornly high, despite very strong economic growth--a sure sign of labor market rigidities. The authorities are strongly encouraged to complete their study and take action to reduce rigidities, including the requirement for prior legal approval for any dismissals. The continued existence of these rigidities is a disincentive to investment, and thus dampens the potential for improving the economy's growth capacity.

Notwithstanding the narrowing of the current account deficit, Panama's external accounts are still a concern. Although a decrease in stock of domestic arrears has been a successful part of the program, the continued accumulation of arrears to foreign commercial creditors continues, notwithstanding the settling of accounts with official creditors, to darken Panama's external creditworthiness and investment potential. We look forward to hearing positive results from the upcoming meeting with commercial creditors.

In summary, Panama has made impressive strides over the past few years. It is for that reason that we are disappointed to see the potential for reversing the gains achieved to date. The backtracking and slow pace in many reform areas does not bode well for release of future tranches of World Bank and IDB loans. Delays in these disbursements, along with missed fiscal targets, for reasons already mentioned, raise questions regarding Panama's ability to meet fiscal and credit targets for remainder of the program. But given Mr. Quirós's assurances, we are hopeful that Panama will quickly take the necessary measures to complete the first general review under the stand-by arrangement.

Mr. Goos made the following statement:

Let me start by saying I am quite impressed with the favorable economic performance of Panama's program so far. This applies in particular to the significant improvement in national savings, notably the public sector, and the better than expected performance in domestic investment. I found it quite remarkable, if not surprising, that the authorities have been able to basically maintain their excellent record of inflation under conditions of very strong growth, such as in 1991 as well as in this year. Maybe the staff could comment on this success story on the inflation front, as Panama's inflation rate has been well below the U.S. inflation rate.

While I found all this most encouraging, it is quite worrisome to note that the balance of payments gap remains to be closed, and that further substantial arrears are being accumulated to external creditors. We already expressed considerable reservations about the lack of financial flows. Those reservations have been heightened by the delay in the program review and its likely adverse effect on the country's credit standing and confidence of domestic and foreign investors. This is not an academic concern, as is indicated by the threat that IBRD disbursements might be postponed. It is obvious that the policy slippages responsible for the delays in the program review are anything but helpful in reaching early agreement with the country's commercial creditors.

Against this background and in order to reserve the Fund's ability to maintain its financial support, I would join the staff and others in urging the authorities to implement without delay the corrective measures recommended by the staff. In this context, I wonder whether, in the light of more recent steps the authorities might possibly have taken, the staff could provide us with their current assessments of the likelihood that the program will be brought on track as assumed in the paper before us. The complexity and political sensitivity of the issues facing the authorities, notably in the fiscal policy area--that is, the reduction of public employment and social security reform--lead me to wonder whether the staff is not overly optimistic in its expectations.

To conclude with two further points, I should like first to invite the staff to comment on the adequacy of monetary policy. I am concerned that the recent measures reported in the report aimed at curtailing the strong liquidity position of the banks might be insufficient to maintain monetary discipline.

Finally, while welcoming the authorities' intention to transfer monthly payments to a trust fund against Panama's current interest obligations to commercial banks, I found the amounts to be transferred unimpressive in relation to both the size of the actual interest obligations and the size of Panama's foreign exchange holdings. I wonder whether a more significant effort, if not direct payments to the banks, could not contribute to an early conclusion of the debt negotiations.

Mr. Kanada made the following statement:

At the outset, I welcome the satisfactory performance of the Panamanian economy from 1991 through the first half of 1992 and the observance of the end-June performance criteria under the stand-by arrangement approved in February. Since I am in broad agreement with the staff appraisal, I would like to make a few comments on some areas that might be adversely affected by some measures taken in the first half of 1992.

First, in the area of structural reform, it is regrettable that the program of public employment reduction was delayed because of the exclusion of appropriations for severance payments in the 1992 budget and lingering on of the discussions to secure budgetary authorization.

Second, with respect to revenue policy, although it is welcome that the revenue performance in 1991 and the first half of 1992 has been satisfactory owing to the steady tax income, I believe it will be necessary to take additional measures to compensate for the revenue loss of the Social Security Agency.

It is regrettable that the cabinet decree issued in June, authorizing payments to public sector employees for certain past wage increases that had been suspended since 1988, will cause an expansion of expenditure after the last half of 1992. I am afraid that this policy is inconsistent with the overall policy of reducing expenditure by public employment reduction.

Third, I would like to urge the Panamanian Authorities to try to get legislation passed as soon as possible on the privatization of INTEL and the introduction of the public sector employment reduction, as these are conditions for the release of the second tranche of the IBRD and IDB structural loans, which are key to the accomplishment of the performance criteria in the last half of 1992.

Mr. Torres made the following statement:

The adjustment program implemented by the Panamanian authorities has contributed to Panama's economic recovery since mid-1990 in a context of low inflation. In addition, Panama's external position has improved with the settlement of arrears to multilateral institutions and the Paris Club, and the reduction of the debt-service ratios. Performance under the stand-by arrangement with the Fund has been satisfactory, and all the performance criteria for end-March and end-June 1992 have been observed. It is regrettable, however, that some developments in the fiscal sector have caused a delay in the completion of the first general review of the stand-by arrangement. We understand the difficulties in gathering the necessary domestic consensus to approve the required reforms, and we are pleased to know from Mr. Quirós that the authorities will make every effort to continue implementing the program and to consolidate the gains achieved so far. It is crucial that the authorities act promptly in this regard in order to avoid the risk of future slippage.

As I am in broad agreement with the main thrust of the staff appraisal, I will only make a few comments. First, the economic recovery has yet to translate into higher employment in the labor force. The unemployment rate has declined somewhat in 1992, but it is still excessively high. It is assumed that if output growth continues, it will tend to decrease further. However, in the absence of strong and prompt action to eliminate the existing distortions in the labor market, particularly those contained in the present labor code, it is unlikely to expect a significant reduction of unemployment.

In this regard, the work of the Tripartite Commission provides an excellent opportunity to address the structural problems in the labor market in Panama in a comprehensive manner, and I hope that the Commission will be able to issue its recommendations by the end of this year, as expected.

In this regard also, I wonder whether the staff has any information on the impact on employment creation of the liberalization measures introduced at the end of 1990, particularly in the export-processing zones.

Second, in our last statement we stressed the need to strongly address the difficult financial situation of the Social Security Agency. We urged the authorities to strengthen their efforts to correct that problem on a permanent basis. As the staff points out, despite having high contribution rates, the social security system has some structural problems that work against reaching a balanced position. The legislation approved last December will contribute to solving that problem, but it will not be enough, in particular after the modifications introduced last August. Further reform of the system is required in order to improve revenues as well as to reduce costs, including administrative costs.

Third, important steps have been taken in the area of structural reform of the public sector, but it is necessary to accelerate the pace of that reform, in particular with respect to public sector employment and privatization. This would contribute to fiscal consolidation and would also allow the resumption of financial assistance from the IBRD and the IADB.

Fourth, we agree with the staff that further measures are needed in the area of trade liberalization and labor market flexibility. As the staff indicates, they are crucial to improving resource allocation and external competitiveness.

Finally, Panama is gradually normalizing relations with the international financial community. We hope that the authorities may very soon be able to reach an agreement with commercial banks and non-Paris Club official creditors, and that conditions for the completion of the review under the stand-by program may be fulfilled promptly. The authorities have made strong efforts and deserve our support.

Mrs. Martel made the following statement:

Panama seems on the right track to economic recovery and re-establishing international financial viability. All performance criteria under the stand-by arrangement concluded early this year have thus far been observed. The budget, in particular, has significantly benefited in terms of revenues of the stronger than expected economic growth.

However, the potential for future slippages appears real, which might jeopardize progress already accomplished and put the future of the program in danger. First, following a cabinet decree in June--although the magnitude of the payment in question has been reduced, as Mr. Quirós mentioned--there is a prospect of significant and excessive increases in public wages. These could be particularly detrimental to the overall fiscal balance, as the program for reduction of public employment is lagging behind schedule.

Second, successive packages of measures regarding social security have had, as a consequence, the appearance of a significant financing gap, the financing of which might be problematic.

Third, there have been delays in implementing the privatization program, owing mainly to late processing of the parliamentary bills.

Finally, some critical aspects of the trade reform have been postponed, namely, the phasing out of quantitative restrictions and the conversion of specific into ad valorem tariffs.

We thus certainly support the staff's intention to make the review under the stand-by arrangement conditional on the correction of the potential deviations in the program. We also hope that negotiations on commercial debt reduction, under a phased approach, could take place as soon as possible, so as to clarify the financial environment in which Panama's growth is expected to take place in the future.

This being said, one should not underestimate the achievements of the Panamanians during the past 18 months. Let me reiterate our appreciation for the progress made and our hope that, under very favorable circumstances as far as growth and inflation are concerned, undue relaxation of present policy will not lead to new difficulties.

The staff representative from the Western Hemisphere Department said that, with respect to the prospects for completing the review, the staff had highlighted actions in three policy areas in its discussions with the authorities: the prompt implementation of the public employment reduction, which was a key feature of the economic program in 1992 and 1993; the restoration of the financial position of the Social Security Agency, where revenue prospects were recently affected adversely by a measure approved by the National Assembly; and the tightening of wages and other benefit payments, which had been recently authorized through a cabinet decree.

The authorities had recently requested the National Assembly to authorize funding to initiate the public employment reduction program, the staff representative commented. The decision on the final authorization rested with the budgetary commission of the Assembly, and, according to the authorities, approval by the whole Assembly would not be required--which should speed up the process. Financing of the employment reduction program had been contemplated in the projections of the economic program, but the funding authorization by the Assembly was a legal requirement.

As regards the Social Security Agency, in discussions with the staff during the Annual Meetings, the authorities had indicated that they were still considering several options on possible revenue and expenditure measures to restore the Agency's financial position, the staff representative said. Any action on revenue or expenditure might need to be taken up by the National Assembly. However, the authorities had noted that, owing to higher than projected revenue in 1992, the financial situation of the Agency might prove to be stronger than anticipated. In the coming few weeks, the authorities intended to assess anew the type of measures that would be appropriate.

As to the recent cabinet decree authorizing increases for past wages and benefits, the staff representative continued, the authorities had recently indicated that, while the coverage of the decree had been defined by setting a ceiling of about B 65 million on the overall payments--full payment of which would likely exceed the targets for the deficit of the public sector--they anticipated that the actual payments would be smaller--perhaps around B 40-45 million. In addition, actual payments on account of the cabinet decree might be made in stages rather than in a lump sum during the remainder of 1992 and in 1993, so as to limit the payments to within the program ceilings. The staff estimated that public sector revenue would be some B 10-15 million above the latest projections, and thus any payments of additional wages benefits in 1992 above that extra revenue would necessitate compensating measures.

Panama did not have either an independent exchange rate policy or an independent monetary policy, the staff representative noted. The country did not have a central bank, and it used the U.S. dollar as its own currency. The strong increase in liquidity observed in the banking system since 1990 corresponded to continued substantial capital inflows as well as to generally cautious lending by the public and private commercial banks. Panama had a very open economy, and the observed increase in liquidity had been essentially demand determined, and thus would not be expected to have an adverse consequence for inflation.

Over the past few years, Panama had a lower inflation rate than that of its trading partners--when measured in U.S. dollar terms--owing in part to the low rate of increase in wages, which had been due in turn to the high levels of unemployment, the staff representative remarked. In the early 1980s, the inflation rate in Panama was roughly equivalent to that of its trading partners--in U.S. dollar terms--but in the second half of the decade, particularly in the past few years, the rate of increase of domestic prices slowed and had been lower than the rate in the trading partners. The developments in wages in Panama--which had stagnated or even declined in this period--had undoubtedly played a role in that outcome. The structural reforms contemplated in the authorities' program, and particularly the trade liberalization, should have a positive impact on the employment situation. Agriculture and agroindustry had had sluggish growth for a number of years, in part because of the excessive protection. The trade reform contemplated in the program was in any event just an initial step that would need to be followed up by further steps later on.

The authorities had acknowledged that the rigidities in the labor code had been a factor in the high level of unemployment in Panama, the staff representative from the Western Hemisphere Department said. However, as speakers had noted, the rate of unemployment had decreased and was currently at about 15 percent, much lower than the 20-25 percent rate that had prevailed in early 1990.

Mr. Torres said that he wondered whether there was any evidence that the elimination of portions of the restrictions of the labor code had had a beneficial impact on employment. For example, the export processing zones had been eliminated in 1990. What happened when the restrictions affecting only part of the market were eliminated? The high rate of unemployment strongly suggested that the unemployment had a significant structural component.

The staff representative from the Western Hemisphere Department responded that labor code rigidities had been eased in 1990 by allowing the extension of wage contracts negotiated during 1988-89 for a period of four years. The significance of the contract extensions was that economic activity had fallen off substantially in 1988-89, and the contracts during that period had emphasized the maintenance of employment rather than wage increases. In addition, certain provisions of the labor code for newly created export processing zones had been eliminated, although the effects on employment did not appear to be significant yet. In any event, the decline in the unemployment since 1990 was due to a combination of factors, including the economic recovery as well as the changes in the labor code.

There were still some elements of the labor code that made it difficult to achieve a further decline in unemployment, the staff representative from the Western Hemisphere Department continued. Certain provisions of the code, including compensation benefits, were very costly to small businesses. Although wages in Panama had been rising slowly, they were still much higher than those in neighboring countries. The current rate of unemployment of about 15 percent was about the rate observed in the early and mid-1980s, before the recent economic difficulties experienced by Panama. The main challenge in that connection was to find the proper approach for continuing modifications in the labor code, which would encourage further decline in unemployment in the coming period.

Mr. Végh said that the low inflation rate in Panama was due not so much to the wage policy and the high rate of unemployment as to the fact that Panama did not have its own currency; as a result, Panama's rate of inflation was tied to the inflation in the country whose currency has been adopted, namely, the United States. The staff paper showed that, as a percentage of GDP, the fiscal deficit in Panama had been smaller than the fiscal deficit in the United States, with the exception of the unusual situation in 1989.

Mr. Dorrington made the following statement:

> At the time of the previous Board review of Panama, in February 1992, Directors emphasized quite appropriately the considerable progress that has been made by the Panamanian authorities. Indeed, these remain major achievements. However, more recently, progress in deepening and strengthening this adjustment has suffered a number of setbacks. Medium-term viability is far from assured, and significant financing gaps are expected until 1995, even under the debt-reduction scenario. This clearly points to the need for greater financial strengthening, rather than a

weakening of some of the fiscal policy measures as has been the case. I would particularly emphasize, as others have, the need to rationalize further the social security system, avoid further slippages in the public sector work force, and restrain wage and benefit outlays. I will not dwell on these issues; they have been explored already by previous speakers.

I was also disappointed to see less progress than planned on trade reform and delays in replacing highly distorting restrictions by more uniform ad valorem taxes. Panama remains a highly protected economy. Further progress is important not just because of the benefits that these reforms would deliver in their own right, but as others have already said, equally importantly, because they are needed to trigger IDB and World Bank financing. Without this, the financial situation would inevitably worsen and arrears to the banks would increase, resulting in an atmosphere less conducive to an early debt-reduction agreement.

I should not pass from this topic without highlighting the statement on page 3 of the staff paper that the overall balance of payments in 1990/91 "was more than financed by the accumulation of the debt arrears to commercial banks and other creditors." This goes without comment in the staff paper as if it were a normal and accepted state of affairs. I presume that was not the intention.

It appears that Panama operates almost as three separate countries--the canal, the Canal Free Zone and the rest of the country. Could the staff please comment on the experience in the Canal Free Zone.

Two further points on structural reforms. First, I was surprised at the contrast between the public and private banks. I understand that the private banks have recovered well from the events of the late 1980s, although it is difficult to find any reference to this in the staff paper. Instead, the paper dwells on the problems of the public banks, which seem to have coped far less well. This reinforces the argument for rapid privatization of the public banks, or perhaps even a winding down of some of their functions, although there is probably a case for some central bank-type functions to remain in the public sector.

Second, there is a clear need both to reduce the high level of unemployment and to improve the efficiency of the economy as a whole by improving the functioning of the labor market. It is largely because of these structural rigidities that the benefits to Panama in terms of competitiveness through following the value of U.S. dollar have not been fully realized. I was also reassured to learn from the staff that appropriate procedures have now been put in place to avoid a repetition of short-term arrears that occurred for technical reasons in August 1992.

In conclusion, I commend the fact that all the performance criteria under the stand-by arrangement were observed. Some of the developments already mentioned give cause for concern. I would urge the authorities to pursue vigorously the various recommendations in the report.

Mr. Knight made the following statement:

This chair was among those that expressed some misgivings as to Panama's ability to live up to commitments undertaken at the time of its request for a stand-by arrangement in February. To some extent, those concerns remain, especially on the medium-term outlook, which is essentially unchanged from the last discussion.

Nevertheless we are pleased to note that Panama met the first half-year performance criteria under the stand-by arrangement; and that real progress has been made towards the strengthening of public finances from the revenue side. Like others, we would like to think that this performance can be matched by equivalent restraint on the expenditure side. The staff has identified the critical areas requiring action, and we fully endorse its recommendations, particularly on the need for greater restraint in managing the public sector wage bill. For both public finance and efficiency reasons, the authorities cannot afford to treat this area of expenditure as a general purpose safety net.

There is very little scope for easing or delaying further fiscal action as long as substantial arrears remain outstanding. Moreover, as others have noted, the viability of the fiscal situation is very closely dependent on timely disbursements by the IBRD and the IDB, which in turn depend on the authorities' ability to implement agreed reform measures on public employment reduction, privatization, and trade reform.

In view of the importance of attaining the fiscal target, it is appropriate that the review of the stand-by arrangement has been linked to progress on key measures essential to securing the target.

Finally, we would join others in encouraging the authorities to engage Panama's commercial creditors in negotiations at the earliest opportunity to find a way to regularize the arrears obligations and thus work back towards creditworthiness. Panama's debt indicators remain at uncomfortably high levels and could certainly benefit from debt relief. Given the potential benefits, I wonder why progress in this area seems to have been so slow.

In closing, I would compliment the authorities on their progress so far and hope that they can continue the process.

Mr. Noonan made the following statement:

I would like to associate this chair with the compliments already extended to the authorities on their performance to date. My comments will focus more on the medium term, and I will return to the unemployment outlook.

Unemployment at 15 percent remains high. As Mr. Quirós says in his statement, the main concern of the authorities continues to be the creation of job opportunities. The large public service probably is a symptom of past misguided efforts to create jobs, because these were not necessarily self-sustaining. Indeed, the public service of 133,000 now seems so disproportionately large that I am curious to know what all these people are engaged in in a country with a population of only 2.5 million. I share the authorities' concern about job opportunities.

Having regard to the past growth of population at 2.2 percent a year, which will be reflected in the future labor force, and the expected growth in labor productivity, I doubt that projected growth of about 5 percent a year for the economy over the medium term will make much of an impression over current high unemployment rates.

The downsizing of the public sector will only contribute to a continuing high unemployment, although I nevertheless support the objective of a substantial reduction in the public sector. I would be more reassured about the employment outlook if the output of the economy were not so narrowly based on services, and geographically in the canal zone. This is a point Mr. Dorrington raised already. And if private sector investment were stabilizing at a higher rate than 16 percent and were growing rather than slightly declining this year, I do not see in the macroeconomic outlook the basis on which widely based growth in output and employment will take place.

In his statement Mr. Quirós rightly says that future growth in Panama will depend on greater dynamism of the export sector fueled by private investment. However, while a rising tide of international growth would contribute to this desirable outcome, that locomotive alone will not do much to close the gap in per capita in Panama and the developed countries. A much higher rate of private investment in Panama, both absolutely and relative to other countries, is also required.

In that context, I have to share the reservations of the earlier speakers that the conditions conducive to a desirably higher rate of private investment have not been adequately identified by the authorities and, consequently, are not being addressed with the urgency the unemployment outlook requires. For instance, the staff representative referred to labor costs as a problem. Indeed, how some of the structural changes on which the authorities are embarked will lead to increased output and employment remains unclear. The staff representative has said already that it is difficult to assign cause and effect. But until the conditions required for increased investment are clearly identified and put in place, the problem of unemployment will remain largely unresolved.

The staff representative from the Western Hemisphere Department said that Panama's economic structure had been skewed toward services, which included activities of the Panama Canal and the Colon Free Zone. The Colon Free Zone had registered a rapid increase in activity in the past two years. However, the size of the Free Zone was not very large and output was recovering from a very slow level. Also, there had been considerable trade movement with very low levels of value added.

Speakers had raised the issue of the uneven protection, which gave different status to the Colon Free Zone compared to the rest of the economy, the staff representative recalled. Indeed, agriculture and agroindustry had been highly protected for a number of years, and that situation had created a kind of dual economy, as there was very little or almost no protection for many other activities, including consumer goods and the activities of the Free Zone. The Government's trade reform program, which was supported by the World Bank's economic recovery loan, aimed precisely at reducing the high level of disparity in tariffs and eliminating quantitative restrictions in order to equalize protection throughout the economy. Reduction and equalization of protection would certainly have a positive impact on resource allocation, and the staff had raised with the authorities the question of completing that process more rapidly than planned. The authorities were obviously concerned about the immediate problem of job losses in the protected industries. However, trade reform would, over a period of years, be expected to have a positive impact on unemployment, through diversification of the structure of the economy. Elsewhere in Latin America, trade liberalization had clearly helped in the creation of the employment.

The level of public sector employment in Panama, at about 130,000, was clearly very high, the staff representative commented. The public sector wage bill was about 15 percent of GDP, which was substantial by Latin American standards. Public employment had grown significantly in the 1970s and 1980s, together with the increased protection in some sectors, characterized by the drive toward import substitution. When economic growth became less dynamic, employment growth became more concentrated in the public sector. The authorities' program with the support of the Fund, the World Bank, and the IDB, aimed at reducing the size of the public sector through privatization, attrition, and incentives for the voluntary retirement.

As to inflation, he agreed with Mr. Végh that the low rate in Panama was explained mainly by the fact that Panama did not have independent monetary and exchange rate policies, as it adopted the U.S. dollar as its own currency, the staff representative from the Western Hemisphere Department said. In his earlier remarks his intention had been to advance the reasons for the inflation rate in Panama having been even lower than inflation in the United States or in Panama's trading partners--when their inflation was measured in U.S. dollar terms. In that context, he had stressed the role of wage increases.

Mr. Quirós said that he wished to make several general comments. First, the authorities in Panama were fully aware of Panama's rights and responsibilities as a member of the international financial community. The flow of world trade and the work of the Fund were closely tied to the way in which all those responsibilities were observed. The success of an individual country making sacrifices and meeting its responsibilities depended to a significant extent on the efforts of the rest of the world. Second, it was difficult for many countries both to restart the process of democracy and be able to meet economic and financial goals undertaken in the recent past.

Third, the authorities in Panama attached the greatest importance to the democratic process, Mr. Quirós continued. In that connection, it was important to bear in mind that Supreme Court decisions in Panama must be adhered to, whether or not the authorities liked the decisions. The Supreme Court had decided that the salary for the thirteenth month was a right of government workers, and that the Government could not attempt to create savings by eliminating that salary payment. That decision had involved $45 billion in additional expenditure, and the Government had immediately introduced taxation for social security on the thirteenth-month payment, which had resulted in additional revenue of $17 million. The authorities had also decided to raise an additional $20 million through social security bonds. For the first time in many years, the Government had decided to pay on a cash basis to the social security system about $1.2 million a month in order to compensate that system for the use of its resources to accommodate the national health care system.

The authorities were fully aware that the external debt posed a serious problem, Mr. Quirós said. Panama owed some $2.8 billion to commercial banks. In that connection, two points should be emphasized. First, the authorities, with the support of the international financial organizations, had agreed that those organizations should be repaid first. Second, some time was needed to replenish the Government's resources after having paid about $686 million to the international organizations; the banks needed to appreciate that fact. The banks had been able to benefit from Panama's facilities for commercial bank operations in the country, and the banks not only seemed to understand the problems facing the Panamanian economy, but also had found it easier to work in a country that did not have its own central bank. The authorities hoped that the next set of discussions with the banks would include final negotiations on how best to address the external debt. To that end, the authorities intended to create an escrow account to hold deposits of about $35 million that would be in place at the time of the negotiations with the banks. At the same time, the authorities intended to employ the new policies and facilities provided by institutions; in October 1992 Panama planned to open international bidding on legal and financial advice for the preparation of a sound proposal to present to the banking community. Thus far in 1992, Panama had reduced its total external debt by $315 million.

The Managing Director had recently made an important statement on the importance of including social elements in the development and implementation of adjustment programs, Mr. Quirós noted. His authorities attached considerable importance to that matter.

In Panama, as in many other countries, unemployment seemed to be the most important problem, Mr. Quirós said. The problem in Panama clearly was structural in nature. During the 1980s, the rate of unemployment was only about 6 percent. The rate had risen to 12-14 percent before the difficult embargo and political problems of 1988/89. Private enterprise in Panama had decided in the mid-1980s, and especially after 1982, to reduce its use of labor, partly because of the labor code, and partly because of the fact that, in a capitalistic economy, the wage bill had to be contained to the extent possible. Also, in the 1970s Panama had decided to promote its industrial capacity, and its capital-intensive operations in particular, by giving investment and other incentives to capital imports, rather than emphasize increased use of labor. At the same time, Panama faced the same unemployment problems that were facing most other countries; changes in technology and the composition of world trade and output meant that time was needed for countries like Panama to adjust in general, and to improve the positions of persons who were overtrained and undertrained in particular. Panama would definitely need public and private investment and a fair deal for its exports, including not only bananas but also other items. The processing zones in Panama had not yet gained the momentum that the authorities had expected, but those zones would probably be able to benefit Panama eventually.

The authorities fully intended to meet their commitments before the end of the year, Mr. Quirós stated. The fact that the Vice President had resigned as Minister of Planning to undertake the implementation of the adjustment program on a full-time basis reflected the authorities' commitment.

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

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/92/119 (9/16/92) and EBM/92/120 (10/5/92).

3. PERIOD FOR CONSENT TO INCREASES IN QUOTAS UNDER NINTH GENERAL REVIEW AND SUBSTITUTION OF ORDINARY FOR BORROWED RESOURCES UNDER ENLARGED ACCESS POLICY - EXTENSION

1. The Executive Board, considering that:

- it is a matter of great regret that some member countries have not yet consented to the quota increase under the Ninth Review or accepted the Third Amendment;

- it appears that both the quota increase and the Third Amendment will not become effective before the end of September 1992;

- early ratification of the general increase in members' quotas under the Ninth Review is imperative;

- the Fund's liquidity position is projected to decline rapidly during 1992-93, which increases the urgency of the quota increase coming into effect as early as possible,

urges those members that have not yet consented to their quota increases under the Ninth Review or accepted the Third Amendment to make every effort to complete the necessary procedures as soon as possible.

2. The Executive Board decides that Decision No. 9546-(90/145) on the substitution of ordinary for borrowed resources in financing purchases made under arrangements approved under the Policy on Enlarged Access shall continue to apply to arrangements approved not later than the date on which the requirement for the effectiveness of increases in quotas under the Ninth General Review of Quotas specified in paragraph 3 of the Resolution of the Board of Governors No. 45-2 has been fulfilled, or November 30, 1992, whichever is earlier.

3. Pursuant to paragraph 4 of the Resolution of the Board of Governors No. 45-2, "Increases in Quotas of Members - Ninth General Review," the Executive Board decides that notices in accordance with paragraph 2 of that Resolution must be received in the Fund before 6:00 p.m., Washington time, on November 30, 1992. (EBD/92/225, 9/24/92)

Decision No. 10147-(92/120), adopted
September 28, 1992

4. ARGENTINA - REVIEW UNDER EXTENDED ARRANGEMENT

1. Argentina has consulted with the Fund in accordance with paragraph 4(d) of the extended arrangement for Argentina (EBS/92/46, Sup. 1) and paragraph 4 of the letter of March 4, 1992 from the President of the Central Bank and the Minister of Economy and Public Works and Services of the Argentine Republic, in order to review progress in the implementation of Argentina's economic program and in negotiations with commercial banks.

2. The Fund decides that the second review contemplated in paragraph 4(d) of the extended arrangement for Argentina is completed. (EBS/92/144, 9/1/92; and Cor. 1, 9/1/92)

Decision No. 10148-(92/120), adopted
September 18, 1992

5. FRANCE, SEYCHELLES, AND SRI LANKA - ARTICLE IV CONSULTATIONS - POSTPONEMENT

Notwithstanding the period of three months specified in Procedure II of the document entitled "Surveillance over Exchange Rate Policies" attached to Decision No. 5392-(77/63), adopted April 29, 1977, as amended, the Executive Board extends the period for completing the next Article IV consultation with France, Seychelles, and Sri Lanka to the dates indicated in EBD/92/219 (9/19/92).

Decision No. 10149-(92/120), adopted
September 23, 1992

6. REPUBLIC OF GEORGIA - REPRESENTATIVE RATE FOR RUSSIAN RUBLE AS CURRENCY OF GEORGIA

The Fund finds, after consultation with the authorities of the Republic of Georgia, that the representative rate under Rule 0-2(b)(i) for the Russian ruble (as currency of Georgia) against the U.S. dollar is the midpoint between buying and selling rates for the Russian ruble against the U.S. dollar in the interbank market, as ascertained by the Central Bank of Russia. (EBD/92/229, 9/28/92)

Decision No. 10150-(92/120) G/S, adopted
September 30, 1992

7. REPUBLIC OF KYRGYZSTAN - REPRESENTATIVE RATE FOR RUSSIAN RUBLE AS CURRENCY OF KYRGYZSTAN

The Fund finds, after consultation with the authorities of the Republic of Kyrgyzstan, that the representative rate under

Rule 0-2(b)(i) for the Russian ruble (as currency of the Republic of Kyrgyzstan) against the U.S. dollar is the midpoint between buying and selling rates for the Russian ruble against the U.S. dollar in the interbank market, as ascertained by the Central Bank of Russia. (EBD/92/223, 9/24/92)

Decision No. 10151-(92/120) G/S, adopted
September 29, 1992

8. MALAWI - ENHANCED STRUCTURAL ADJUSTMENT ARRANGEMENT - EXTENSION OF COMMITMENT PERIOD

The commitment period of the additional arrangement for Malawi under the enhanced structural adjustment facility (EBS/92/153, Sup. 1) is extended to May 31, 1993. (EBS/92/155, 9/24/92)

Decision No. 10152-(92/120), adopted
September 29, 1992

9. REPUBLIC OF MOLDOVA - REPRESENTATIVE RATE FOR RUSSIAN RUBLE AS CURRENCY OF MOLDOVA

The Fund finds, after consultation with the authorities of the Republic of Moldova, that the representative rate under Rule 0-2(b)(i) for the Russian ruble (as currency of the Republic of Moldova) against the U.S. dollar is the midpoint between buying and selling rates for the Russian ruble against the U.S dollar in the interbank market, as ascertained by the Central Bank of Russia. (EBD/92/230, 9/30/92)

Decision No. 10153-(92/120) G/S, adopted
October 2, 1992

10. SIERRA LEONE - OVERDUE FINANCIAL OBLIGATIONS - REVIEW FOLLOWING DECLARATION OF INELIGIBILITY - POSTPONEMENT

Paragraph 4 of Decision No. 9970-(92/45), adopted April 3, 1992, shall be amended by substituting "not later than October 31, 1992" for "within six months of the date of this decision." (EBS/92/156, 9/25/92)

Decision No. 10154-(92/120), adopted
September 30, 1992

11. SWITZERLAND - ACCEPTANCE OF OBLIGATIONS OF ARTICLE VIII, SECTIONS 2, 3, AND 4

The Fund notes with satisfaction that, with effect from May 29, 1992, Switzerland has accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement. (EBD/92/226, 9/25/92)

Decision No. 10155-(92/120), adopted
September 30, 1992

12. SYRIAN ARAB REPUBLIC - 1992 INTERIM ARTICLE IV CONSULTATION

The Fund notes the staff report for the 1992 interim Article IV consultation with the Syrian Arab Republic (SM/92/177) and declares the consultation completed.

Decision No. 10156-(92/120), adopted
September 24, 1992

SYRIAN ARAB REPUBLIC - DECISION CONCLUDING 1992 ARTICLE XIV CONSULTATION

1. The Fund takes this decision relating to the Syrian Arab Republic's exchange measures subject to Article VIII, Sections 2(a) and 3, and in concluding the 1992 Article XIV consultation with the Syrian Arab Republic, in the light of the 1992 interim Article IV consultation with the Syrian Arab Republic conducted under Decision No. 5392-(77/63), adopted April 29, 1977, as amended (Surveillance over Exchange Rate Policies).

2. The Syrian Arab Republic continues to maintain restrictions, as described in SM/92/177, on payments and transfers for current international transactions in accordance with Article XIV, Section 2, except that the multiple currency practices and exchange restrictions, described in SM/92/177, including those evidenced by external payments arrears, are subject to Fund approval under Article VIII, Sections 2(a) and 3. The Fund encourages the authorities to take the necessary steps for the elimination of arrears on current payments and transfers, to unify the exchange rates, and to liberalize other exchange restrictions on current payments and transfers. The Fund urges that the restrictive features of bilateral agreements with Fund members be eliminated as soon as possible.

Decision No. 10157-(92/120), adopted
September 24, 1992

13. RELATIONS WITH GATT - CONSULTATION WITH CONTRACTING PARTIES - FUND GUIDANCE

The Executive Board approves the recommendation by the Committee on Liaison with the CONTRACTING PARTIES to the GATT with regard to the guidance statement for the Fund representative attending the GATT consultation with Egypt and Tunisia, as set forth in EBD/92/228 (9/28/92).

Decision No. 10158-(92/120), adopted
September 30, 1992

14. TRANSITION ISSUES IN CENTRALLY PLANNED ECONOMIES - PUBLICATION

The Executive Board approves the proposal to publish together, in the Occasional Paper series, two papers on transition issues in previously centrally planned economies (SM/92/30 and SM/92/45) as set forth in EBD/92/222 (9/22/92).

Adopted September 29, 1992

15. EXECUTIVE DIRECTORS' OFFICES - STAFFING

The Executive Board approves, with one objection, the recommendations of the Committee on Executive Board Administrative Matters concerning the staffing of Executive Directors' offices as set forth in EBAM/92/82 (9/21/92).

Adopted September 28, 1992

16. STAFF MEMBER - LEAVE WITHOUT PAY

The Executive Board approves the proposal set forth in EBAP/92/141 (9/17/92) concerning the extension of leave without pay for a staff member.

Adopted September 22, 1992

17. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAM/92/80 (9/15/92), EBAM/92/81 (9/18/92) and Supplement 1 (9/29/92), EBAM/92/83 (9/22/92), EBAM/92/84 (9/23/92), EBAM/92/86 (9/28/92), EBAM/92/87 (9/30/92), by Advisors to Executive Directors as set forth in EBAM/92/81 (9/18/92) and EBAM/92/86 (9/28/92), and by an Assistant to Executive Director as set forth in EBAM/92/85 (9/24/92) is approved.

18. TRAVEL BY MANAGING DIRECTOR

Travel by the Managing Director as set forth in EBAP/92/142 (9/22/92) is approved.

19. TRAVEL BY ACTING MANAGING DIRECTOR

Travel by the Acting Managing Director as set forth in EBAP/92/144 (9/30/92) is approved.

APPROVED: April 16, 1993

JOSEPH W. LANG
Acting Secretary