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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 92/119

10:00 a.m., September 16, 1992

R. D. Erb, Acting Chairman

Executive Directors	Alternate Executive Directors
	A. A. Al-Tuwaijri
	A. Raza, Temporary
	Wei B.
	Chen M., Temporary
	Deng H., Temporary
C. S. Clark	G. C. Noonan
T. C. Dawson	Q. M. Krosby
	J. M. Abbott, Temporary
	J. Prader
E. A. Evans	R. L. Knight
R. Filosa	
	A. F. Mohammed
	O. A. Himani, Temporary
I. Fridriksson	J. A. Solheim
H. Fukui	M. Nakagawa, Temporary
	S. Shimizu, Temporary
B. Goos	B. Esdar
J. E. Ismael	
	F. A. Quirós, Temporary
	P. Bonzom, Temporary
	O. Kabbaj
	H. Golriz, Temporary
L. B. Monyake	
D. Peretz	J. Dorrington
G. A. Posthumus	
	A. R. Ismael, Temporary
	M. Galán, Temporary
	L. E. Breuer, Temporary

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

Also Present

S. Kallas, President, Bank of Estonia. IBRD: J. M. Biderman, Europe and Central Asia Regional Office; D. Papageorgiou, Latin America and the Caribbean Regional Office. European II Department: J. Odling-Smee, Director; E. Brau, Deputy Director; E. Hernández-Catá, Deputy Director; L. Hansen, A. Knobl, A. K. Lahiri, T. O. Saavalainen, T. Shikado, B. B. Zavoico. External Relations Department: M. A. Seeger. Fiscal Affairs Department: A. G. A. Faria. Legal Department: F. P. Gianviti, General Counsel; W. E. Holder, Deputy General Counsel; R. H. Munzberg, Deputy General Counsel; P. De Boeck, H. Elizalde, R. B. Leckow. Monetary and Exchange Affairs Department: W. Coats, H. Cortes-Douglas, J. M. Jimenez. Policy Development and Review Department: J. T. Boorman, Director; J. Ferrán, Deputy Director; T. Leddy, Deputy Director; F. C. Adams, A. G. G. Bennett, J. Jaramillo-Vallejo, G. R. Kincaid, N. Kirmani, R. Morales, J. P. Pujol. Research Department: M. D. Knight. Secretary's Department: J. W. Lang, Deputy Secretary; R. S. Franklin, A. Jbili, A. Leipold, S. L. Yeager. Treasurer's Department: L. Aylward, W. J. Byrne, J. C. Corr, Z. Farhadian-Lorie, O. Gronlie, K. M. Kenney, P. R. Mennon. Western Hemisphere Department: S. T. Beza, Counsellor and Director; C. M. Loser, Deputy Director; J.-P. Amselle, P. D. Brenner, S. Clavijo, L. H. Duran-Downing, F. Fernández, J. J. Fernández-Ansola, T. Gudac, M. E. Hardy, C. E. Piñerúa, T. M. Reichmann, J. Valdivia. Advisors to Executive Directors: C. D. Cuong, J. Jamnik, E. Martínez-Alas, R. Meron, B. Szombati, A. Törnqvist, S. von Stenglin. Assistants to Executive Directors: S. Al-Huseini, G. Bindley-Taylor, B. Bossone, J. H. Brits, S. B. Creane, M. Da Costa, B. Eggl, N. A. Espenilla, Jr., M. E. Hansen, K. M. Heinonen, J. Jonas, K. J. Langdon, W. Laux, J. Mafararikwa, G. J. Matthews, F. Moss, L. F. Ochoa, J. K. Orleans-Lindsay, E. H. Pedersen, D. Sparkes, Tin Win, T. P. Thomas, R. Thorne.

1. ESTONIA - STAND-BY ARRANGEMENT

The Executive Directors considered a staff paper on Estonia's request for a 12-month stand-by arrangement in an amount equivalent to SDR 27.9 million (EBS/92/132, 8/18/92; Sup. 1, 8/25/92; and Sup. 2, 9/15/92).

Mr. Siim Kallas, President of the Bank of Estonia, was also present.

The staff representative from the European II Department said that the Estonian Government's Incomes Policy Commission had recently made a number of recommendations. In particular, the Commission had recommended that the Government implement a tax-based incomes policy along the lines agreed in the Memorandum of Economic Policies, including setting an average wage increase guideline for state enterprises of 12 percent, effective September 15; limit average wage increases for government employees to about 3 percent, also effective September 15; and raise the minimum wage by 50 percent, namely, from EEK 200 a month to EEK 300 a month. The staff, through its resident representative, had advised strongly against the 50 percent minimum wage increase, largely because the staff's early estimates suggested that such an increase would result in a budget deficit for the second half of 1992--owing mainly to resultant increases in social benefits--but also because the July and August 1992 increases in the consumer price index contained substantial distortions, as was noted in Supplement 2 of the staff paper, which should not be passed through to wage and benefit increases.

In the event, the Government had on that day decided to re-evaluate the recommendations of the Incomes Policy Commission, taking account of the distortions in the price indices and the budgetary impact, the staff representative stated. In particular, in order to contain the impact on the budget, the Government intended to raise pensions, which was the largest component of social benefits, by no more than 30 percent and to delay the implementation of the increases from September 1 to October 1, 1992. The staff estimated that if that package was adopted, the budget for the second half of 1992 would remain roughly in balance, although it would mean the virtual full utilization of the prudential cushion built into the budget projections. In any case, the authorities had stated that, if necessary, offsetting measures would be taken to keep the budget in balance.

The staff would return to Tallinn in October to review the program and would focus particularly on the implementation of the incomes policy and its implications for the state budget, the staff representative from the European II Department concluded. If the staff were to conclude that a budget deficit for the second half of 1992 was still likely, the staff would insist on the immediate implementation of offsetting measures to restore balance. Finally, the staff would have preferred the decisions that he had described to have been taken only after closer consultation with the staff and in advance of the current Board meeting.

Mr. Fridriksson made the following statement:

The Estonians consider themselves as not particularly emotional or temperamental, but as a people who can move extremely rapidly and effectively when given an opportunity to do so. Along with the other two Baltic countries, Estonia broke away from the Soviet Union after the failed coup in August of last year. Quickly realizing the importance of joining the community of independent nations, Estonia was the first of the countries that had been incorporated into the Soviet Union to apply for membership in the Fund, which it did on September 9, 1991. The challenge that they faced was to effectively tackle the tremendous distortions and resource misallocation that had resulted from decades of Soviet-imposed economic policies.

The Estonians again demonstrated their decisiveness in being the first of these countries to introduce its own currency--the kroon--based on the currency board principle, and quickly thereafter completed negotiations with the Fund on a stand-by arrangement. The Fund staff participated actively in the preparations for the currency reform, thus assisting the authorities in ensuring its success. My Estonian authorities are very grateful, in particular to the Chief and the staff of the Baltic Division for their efforts and support, but also to other Fund staff who have participated in the technical assistance provided to Estonia. I have no hesitation in stating that the Fund has earned the highest respect of my Estonian authorities.

For internal political as well as economic reasons, the authorities felt they had little choice but to introduce the currency reform at the earliest possible opportunity. The pressure for a national currency was strong, and the continued use of the Russian ruble was increasingly felt to be an obstacle to effective reform, for example, the privatization plans of the Government. Moreover, the serious shortage of cash rubles, which developed primarily in the second quarter of the year, created further difficulties and fueled the support for an early introduction of the kroon.

In adopting the currency board model for the reform, the authorities realized fully that they were choosing a very disciplined course, which would require fiscal balance and rigorous credit policies. However, their choice was also motivated by their concern that, in the circumstances, the central bank might not have sufficient expertise or instruments at its disposal to ensure the conduct of an appropriately tight monetary policy.

The staff papers provide a clear and comprehensive analysis of the recent dramatic economic and financial changes in Estonia. The authorities recognize that their efforts to restructure and reform the economy in the face of adverse external circumstances require a strong stabilization program complemented by far-reaching and effective structural reforms.

By mid-1992, the Estonian economy had suffered a severe contraction, prompted partly by the need to adjust to substantial external shocks. These shocks included a sharp deterioration of the terms of trade arising from the move of energy prices to near-world market levels and continued trade dislocations. Furthermore, a serious drought developed during the summer, resulting in agricultural output significantly below normal levels. The depth of the contraction is borne out by the fact that, in comparative terms, the output decline in Estonia over the period 1990 to 1992 will be more severe than has been experienced in Eastern Europe or in Russia. Partly, the contraction is the result of the tight policies followed by the authorities over the past year, as reflected, inter alia, in the strict rein on the credit expansion.

Notwithstanding many obstacles, the Government has already laid a solid foundation for the pursuit of a strong stabilization and structural program. It has adopted a comprehensive economic program for the 12-month period July 1, 1992 to June 30, 1993, which represents a strong effort to transform the Estonian economy into a market economy. The program has the two principal objectives of macroeconomic stabilization and structural reform. The main elements as regards stabilization are a completion of the price reform process, restrictive fiscal policies, monetary discipline under the currency board arrangement, a strict incomes policy to contain excessive wage increases, and further liberalization of the exchange and trade system. With regard to structural reform, the main elements include an acceleration in the privatization process, substantial improvement of the social safety net aimed at protecting the most vulnerable segments of society, a restructuring or closure of nonviable enterprises and banks, and the establishment of a legal framework consistent with a market economy.

The economic program includes a number of prior actions in all the major macroeconomic policy areas, including economic administration, all of which have already been implemented. In particular, the price liberalization process was largely completed prior to the currency reform in June. Moreover, significant recent steps have entailed increases in domestic energy prices that involved the full pass-through of higher import prices to final consumers. Gasoline prices have risen seventyfold in less than a year, which is indicative of the tremendous distortion of the previous system as well as of the magnitude of the imbalances to be addressed. Improvement in the energy efficiency of the economy is expected over time. As the staff points out, per capita energy consumption in Estonia is about ten times that of Finland.

In the area of fiscal policy, important prior actions were measures aimed at securing a balanced budget for the second half of 1992. The package introduced in connection with currency reform included various tax measures. Overall, the package is expected to generate enough revenue to ensure a surplus in the budget in the second half of 1992 equal to about 1 percent of GDP. Thus, the overall general government budget, which was in surplus in 1991, is projected to remain so in 1992. As part of the package, the Government also announced a wage freeze for July, to be followed by the adoption of a tax-based incomes policy intended to prevent recent price shocks from spilling over into wage inflation.

Although progress in privatization has slowed down since late 1991, the Government is now about to undertake major initiatives across a broad front. The principal vehicle will be the formation of the Estonian Privatization Office (EPO) modeled on the German Treuhand. After a slow start in creating a legal framework compatible with a market economy, the Government will step up its efforts. Bankruptcy legislation took effect on September 1, 1992. Competition legislation, as well as mortgage and contract laws, are under preparation.

The authorities have designed a strong stabilization and reform program, and their firm commitment to rapidly reform the economy has generated international support for the initial phase of Estonia's transition to a market economy. The residual financing gap is now largely filled by G-24 commitments, for which my authorities are thankful. The full list of contributors is included in Correction 1 to Supplement 2 of EBS/92/31. In its adjustment endeavors, Estonia will continue to need external financing. Realizing the potentially important role of foreign direct investment, the authorities intend to create a favorable regulatory environment in order to attract private capital inflows.

Mr. Prader made the following statement:

The boldness with which the Estonian authorities have launched their economic reform program matches the seriousness of their economic problems. It provides a real life example of a principle widely supported during our recent discussion on a reform strategy for the former Soviet Union, namely, that a country with more serious economic troubles and more exposed to external shocks needs to adopt a more ambitious program. The Estonian authorities have taken precisely this path, which we strongly believe is the only possible way of reviving economic growth and simultaneously providing the conditions for medium-term stability.

A unique feature of Estonia's reform strategy is the establishment of a currency board immediately after the introduction of the new currency. Once fairly common, currency boards have become a rather unusual monetary and exchange rate policy arrangement, although, given the circumstances in Estonia, I think it is not only viable but also promises more than negligible benefits for the economy. The return of Estonia's gold reserves and the launching of its own currency have given the authorities a chance to establish a monetary policy framework that will aid them in bringing down inflationary expectations and inflation itself rather quickly.

However, the staff is right in pointing out that there is nothing resembling a one-to-one correspondence between the current account balance and monetary conditions under the currency board regime. Aside from capital inflows, which could turn out to be rather low in the short and medium term despite potential interest rate differentials, two additional factors could affect monetary conditions under the currency board regime, namely, changes in the ratios of reserves to deposits and of currency to deposits. The reserves/deposits ratio can change if banks are generally holding reserves in excess of the prescribed minimum. If lending conditions improve, the authorities might decide to lower this ratio and increase liquidity in accordance with the current account balance.

More important in Estonia's case would be a change in the currency/deposits ratio. The staff briefly notes that changing the currency/deposits ratio requires changing the money multiplier. Estonia's banking system is, however, far from modern at present. There is much room for financial innovations, which could be introduced fairly quickly. Practical experience shows that financial innovations usually permit significant savings in terms of cash. Other things being equal, financial innovations should produce monetary easing. The automatic regulation of monetary conditions by a currency board system could, in case of changes in the underlying currency/deposits and reserves/deposits ratios, give rise to sizable changes in monetary conditions.

However, this situation differs in one important respect from the change in monetary policy induced by simply printing money. The printing of money has no natural limits, but both financial innovation and the reduction of reserves have limits. For this reason, under a currency board regime, monetary policy cannot permanently increase the money supply and raise price levels.

The question, however, is whether the exchange rate of the Estonian kroon could not have been fixed at a much less ambitious ratio vis-à-vis the deutsche mark. Pegging the kroon to the deutsche mark at a rate of 8:1 is reminiscent of the unfortunate 7:1 ratio between the Yugoslav dinar and the deutsche mark in 1991, which was also impossible to maintain. If even the Scandinavian currencies cannot maintain their deutsche mark peg, how can we expect the Estonian kroon to have better luck?

In other respects, Estonia's economic program resembles that adopted by the Latvian authorities. Estonia's commitment to respond to shocks with stronger adjustment efforts was clearly visible in the budgetary measures introduced during the first half of 1992. At present, the most serious threat to the commitment to balance the budget is a possible decline of output. The authorities must, therefore, be prepared for "any additional measures that may become necessary," to quote their letter of intent.

Strong efforts will still be needed to establish a systemic framework. The continued absence of appropriate legislation on the question of restitution and ownership rights can only jeopardize the privatization process and delay other reforms.

The Estonian authorities have shown their determination to pursue a comprehensive economic reform program. They have fully earned the financial support of the Fund. Therefore, I support the request for a stand-by arrangement and wish the authorities every success with their imaginative approach to reforming their economy.

Mr. Ismael made the following statement:

I am pleased to note the Estonian authorities' determination in transforming their economy into a full-fledged market economy and in steering out of the present difficult situation. This determination is evidenced by the forceful prior actions that have been taken, to be accompanied by a strong adjustment program in the form of the proposed stand-by arrangement. Estonia's adjustment and reform efforts, therefore, warrant the Fund's support, and I can endorse the proposed decision with the following observations.

First, the main task confronting the authorities is to bring inflation down to a manageable level. I am heartened by the authorities' intention to have inflation reduced from an average monthly rate of 30 percent during the first half of 1992 to a monthly rate of less than 0.5 percent by mid-1993. In view of the continued price liberalization and worsening terms of trade, as well as the implementation of currency reform, I wonder whether this target is not too ambitious.

Second, in order to achieve the inflation target and limit the decline in output simultaneously, emphasis should be placed on institutional and structural measures to stabilize the economy and enhance appropriate supply responses. In this connection, a faster implementation of measures, such as ownership transformation, financial sector reform, promotion of small- and medium-sized enterprises, and promotion of foreign investment, would expedite the adjustment process. The recently introduced restrictive tax-based incomes policy should also help reduce inflation expectations. In the wake of rising unemployment and deteriorating real wages, the social safety net should be reviewed to maintain the momentum of public support necessary to carry out adjustment efforts to their successful end.

Third, the authorities' intention to balance the budget is to be commended. The prudent fiscal policy should be continued, as the effectiveness of monetary policy is limited by the fixed exchange rate regime and the problem of convertibility of the kroon. While I welcome the recent tax reform package, I feel that consideration should be given to broadening the tax base with the ultimate aim of lowering rates later on. Tax administration should be strengthened further. Equally important are effective public expenditure controls, especially with respect to wage bills and reduction of subsidies. I would like to stress, however, that nominal wage controls should not be more than a temporary substitute for the introduction of more market-oriented wage-determination procedures. As privatization of large public enterprises is an ongoing process, in the short term, hard budget constraints should be established through commercialization. This would be more effective in solving the problem of interenterprise arrears.

Fourth, I welcome the intention to continue the cautious monetary policy stance through the currency board. The liberalization of interest rates of the specialized banks would help promote savings and improve the efficiency of resource use. Under the policy of convertibility, it is even more important for the authorities to maintain domestic interest rates at internationally competitive levels. Nevertheless, the improvement of prudential regulations and supervisory controls should be accorded high priority in order to preempt a crisis in the financial system and to pave the way for effective financing of private investment in the future.

Fifth, while I welcome the measures already taken to liberalize the exchange and trade system, as well as the other measures that are being contemplated under the proposed stand-by arrangement, I feel that, in view of the fragile nature of the external situation, higher priority should be accorded to domestic market reforms. In the longer term, the strength of the balance of payments hinges on the ability to diversify products and markets. Therefore, I welcome the authorities' attempts to work out various trade-promoting schemes, and I feel that at this crucial stage industrial countries could be of great help by opening up their markets to Estonian exports. The exchange rate policy appears to serve Estonia well as a nominal anchor against inflation, contributes greatly to the rationalization of foreign transactions, and provides the framework for foreign investment inflows. As for the foreign exchange surrender requirement for export earnings, I think such a measure can be useful in the present situation, although, in the long run, this requirement should be phased out. In addition, it is in the interest of all member countries of the ruble area to improve the clearing system for interrepublican payments.

Finally, the program is not without risks, as the success of its implementation depends on the required financial support of the international financial community. In this regard, I would like to urge the authorities to stand ready to take additional measures if necessary.

Mr. Goos made the following statement:

Much, if not all, of what I said at the Board discussion on Latvia (EBM/92/118, 9/14/92) appears to be valid in the case before us. This applies, undoubtedly, to the critical need to pursue vigorously macroeconomic adjustment and structural reforms on all policy fronts. So far, the authorities have demonstrated a remarkable degree of commitment to the task of transforming their economy--a commitment that also flows most impressively from the program before us, which no doubt deserves the Fund's financial support.

At the same time, I am concerned about the exceptionally strong contraction of domestic output and demand to the point where the low level of real incomes seems to hamper the effectiveness of supply-side initiatives. Combined with the need to maintain particularly tight financial policies as dictated by the currency board arrangement, there is a risk that the economy might go into a contractionary tailspin. In these circumstances, it is absolutely essential to preserve Estonia's external competitiveness, which points particularly to the need to contain domestic cost and price pressures, including wages, and to remove all obstacles to exports. Against this background, the authorities would be well advised if they dismantled the remaining export quotas--and export taxation--without delay. At the same time, however, I have considerable sympathy for the authorities' view that further price liberalization should take into account the degree of competition achieved in the industries and enterprises to be liberalized. This should, of course, not be taken as a pretext to maintain or reintroduce subsidies, nor to unduly compress profit margins. As an aside, recent experience in Estonia clearly shows that inflating more rapidly than in neighboring countries can offer only a short-term respite and certainly no fundamental, lasting solution to the country's problems.

Let me add my concern to those expressed by the staff representative about the recent increase in minimum wages. While I welcome the corrective measures taken in the area of pensions, which might help to keep the budget on track, they are most unfortunate in the sense that they threaten to undermine competitiveness at a most critical stage of the adjustment process. To conclude on this issue, I would urge the authorities to consult the staff in the future in a more timely manner on unexpected changes to agreed policies. Needless to say, I welcome the new initiatives of not only maintaining the competitiveness but also strengthening the efficiency of the domestic economy.

I also welcome the new initiatives of the authorities to accelerate the pace of privatization. Judging from the Treuhand's experience in eastern Germany, which, I understand, serves as a model in the next stage of privatization, I should caution against overly optimistic expectations about the size of likely privatization proceeds. There is, of course, a clear trade-off between sales prices that can be achieved and the objective of gaining commitments from investors to increase investment and maintain or expand employment. So far, the Treuhand's privatization operations have produced quite staggering losses.

Finally, I should like to specifically endorse the staff's advice that the domestic foreign currency accounts should not be closed for the time being and also add my advice that the social security system should be reviewed without delay, as the benefits seem to be much more generous than in industrial countries.

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

Mr. Bonzom made the following statement:

I am in full agreement with the thrust of the staff paper. I will thus be brief and will focus on the original instrument the Estonian authorities have chosen as the linchpin of their strategy aimed at meeting what are, as stressed by the staff--and, indeed, by any standard--"enormous challenges."

It is very welcome that the monetary reform undertaken in Estonia and the establishment of the currency board have been prepared, as described in the paper before us, in close cooperation with the staff. The risks of the currency board system are well known. In the case of an increase in the demand for foreign currency that would not be offset by an equivalent increase in foreign capital inflows, the system has a built-in deflationary impact, even though it also includes, at least in theory, built-in mechanisms for a return to equilibrium. Taking this deflationary risk into consideration seems especially relevant in a country where the GDP decline is projected at 30 percent this year, and perhaps slightly more if the latest trends in industrial production are any guide. In addition, I would appreciate comments from the staff on the consequences of the system on the range of solutions available to the problem of interenterprise arrears, which currently amount to about 9 percent of GDP.

As is also well known, however, currency boards can be very useful instruments for conducting monetary policy in economies that are relatively small and in countries that lack technical expertise. Above all, currency boards tend to enhance the credibility of the authorities' fight against hyperinflation and provide all economic agents with a useful nominal anchor. All those elements are especially relevant in Estonia's situation, and, on balance, the system should serve Estonia well.

The instrument may look original, but, in fact, its general implications for the conduct of economic policies are not. In Estonia, as in any other country, success will hinge heavily on the authorities' ability to generate positive responses from domestic as well as foreign economic agents. In the case of Estonia, these positive responses would translate into the foreign currency resources, which, under the currency board system, will themselves allow for sustainable credit expansion and activity growth. In this regard, let me just say in passing that among those foreign currency resources, official assistance will, at least in the short term, play a major role and, that a balanced burden sharing would be most welcome.

In any case, the authorities are to be commended for having drawn the consequences of this choice and for having accompanied their currency reform by the necessary financial and structural measures. As far as budgetary policy is concerned, the authorities have repeatedly shown that their commitment to a balanced budget--which is almost a prerequisite under the currency board system--was supported not only by words but also by deeds. They have eliminated most subsidies and have taken additional and offsetting actions at least twice already, once in May and again in August in the context of the adoption of the budget for the second half of 1992. We welcome the intention to take such offsetting steps again, as reported by the staff representative. Let me add that such a stance will have to be pursued with a medium-term perspective if the authorities want to make enough room for the social safety net that will be necessary in order to smooth the impact of the restructuring of the economy. In this regard, we look forward to better targeting, which should be part of the review of the social security system to be carried out before the end of the year, in the context of the necessary containment of the extrabudgetary funds deficit.

As far as wage trends are concerned, the authorities have shown similar restraint so far. It is appropriate, especially in view of the most recent developments described by the staff representative, that the program includes a review of the outcome of the current wage negotiations, and the staff is right in pointing to the need for this outcome to be consistent with the steady reduction of price differentials that is required under the currency board system.

Finally, the determined stance taken by the authorities on stabilization should be accompanied by no less determined action in the structural area. It is thus most welcome that the program incorporates an acceleration of the pace of reforms, especially as far as public enterprises are concerned. The forthcoming plan for privatization builds on recent well-taken measures and will certainly constitute a major step in the right direction. It is crucial that, at the same time, the authorities compensate for what the staff calls their "slow start in creating the legal framework compatible with the market economy." This includes the recent bankruptcy law, the forthcoming accounting law, and, last but not least, the determined action on what the staff describes as "the monopolistic structure of the Estonian economy." Indeed, and as stressed by the staff, the ongoing effort at demonopolization will make the rationale for the last remaining price controls gradually disappear. Mr. Goos also stressed this point. In addition, restructuring and commercialization of public firms would help for those firms that will remain public during the two years before the scheduled completion of the privatization process. There should have been more emphasis on this point in the paper on Estonia, as well as that on Latvia.

Let me conclude by saying that my authorities are very favorably impressed by the strong and credible commitment contained in the program to be supported by the requested stand-by arrangement. Therefore, we fully support the proposed decision.

Mr. Dorrington made the following statement:

To paraphrase Mr. Fridriksson's opening statement, like the Estonians, the British consider themselves as not particularly emotional or temperamental, but we are both peoples who can move extremely rapidly and, I hope, effectively given the opportunity and the need to do so. There can be no doubt that Estonia has a great need and was not found wanting when the opportunity arose. I support the proposed stand-by arrangement. It seems even stronger than the arrangement for Latvia that we approved earlier this week: notwithstanding the recent increase in the minimum wage, the real wage adjustment to the terms-of-trade shock is greater, the inflation objective is more ambitious, the fiscal position appears more secure, and the use of import tariffs has been avoided.

Given the commitment to a sound macroeconomic framework, the key to success, as in Latvia, will be the pace of structural reform in enterprise and financial sectors. Could the staff please comment on why the only World Bank lending expected during the course of the program is a single $30 million rehabilitation loan? It is absolutely essential that Estonia rapidly establish a close working relationship with the Bank and that operations are brought forward that will underpin the longer-term structural reforms required.

I have a number of questions about the program. Anti-inflationary policy seems to depend heavily on the discipline of the currency board and the credibility of the exchange rate peg against the deutsche mark. This arrangement brings its own uncertainties and concerns, however, particularly with regard to real interest rates. If the peg had 100 percent credibility with those involved in foreign exchange transactions, then, in the absence of exchange controls, interest rates in Estonia would be similar to those in Germany. The fact that they are much higher in Estonia must imply far from complete credibility of the peg. Nevertheless, we must ask whether interest rates are high enough. They are certainly lower than a backward-looking measure of inflation. This would not necessarily be of concern if wage and price setters in Estonia were convinced of the credibility of the peg and if all product and factor markets were fully flexible. In these extreme circumstances, expected inflation in Estonia would be similar to that in Germany. These assumptions are clearly not valid, however, and there is considerable uncertainty over the extent to which the peg will constrain inflation in the traded goods sector, and even more so in the nontraded goods sector, which constitutes the vast majority of the Estonian economy.

Only in the happy coincidence that the degree of credibility and flexibility in the domestic goods and factor markets is more or less equal to that in the foreign exchange market will the level of real interest rates be broadly appropriate. I have no reason to suppose that is currently the case, or will be in the foreseeable future. I would very much welcome the views of the staff on this, and the wisdom, or otherwise, of instituting a currency board together with a fixed exchange rate at such an early stage in the adjustment process. If the policy works, it will be a great achievement; but if it fails, it could undermine the credibility of similar commitments for a considerable time to come. On a related point, interest rate spreads seem very wide, presumably at least in part reflecting the quality of banks' balance sheets, and I wonder whether there is a case for temporary controls on these spreads until banks' portfolios have been cleared of nonperforming assets.

I also welcome the liberalization of trade but was unclear why export taxes and quotas still exist for some products. Could the staff please explain the rationale for these? I was also puzzled why there is a 100 percent surrender requirement for export proceeds.

I welcome the authorities' decision to restrict price controls to those commodities that are produced by monopolies. These controls will have to kept under very careful review to ensure that they do not inhibit the emergence of private sector competition or implicit subsidies. Wherever possible, privatization should be accompanied by measures to stimulate competition in what were monopoly-dominated sectors.

Finally, let me echo the remarks that were made about financing at the Latvian discussion (EBM/92/118, 9/14/92). The authorities must be under no illusion that exceptional assistance on the scale provided this year will be available in future. Every effort must be made to attract private capital flows, as well as finance from the development institutions. Needless to say, the industrial countries must play their part by opening up their markets to exports from the Baltic states.

With these remarks, I can support the proposed decision.

The staff representative from the European II Department said that the exchange rate of the kroon, which had been fixed at the rate of 8:1 against the deutsche mark, had been based on the then prevailing market rate for the ruble, which, given the conversion rate between the kroon and the ruble, had been expected to provide a fairly strong competitive rate.

In considering the issue of interenterprise arrears, the staff representative continued, it was important to distinguish between domestic arrears and interstate arrears. Estonia's interstate arrears with Russia were particularly large and had, until the kroon was introduced, their counterpart in Estonia's ruble correspondent account deficit with Russia. The Estonian authorities hoped that through negotiations with the Russian authorities, some agreement could be reached to offset interstate arrears with the settlement of balances held in correspondent accounts. In the interim, the Bank of Estonia was evaluating the situation in order to assess the dimensions of the problem and to study the options. One option, of course, would be to cancel both domestic and interstate arrears; another option might be to allow enterprises to enter bankruptcy, as had been the case in some of the other states of the former Soviet Union. One option that the authorities had no intention of pursuing was an expansion of central bank credit to settle arrears; in the view of the Estonian authorities, the recent experience of other states in that respect had been less than satisfactory.

As Directors were aware, project lending by the World Bank was by its very nature a somewhat lengthy process, the staff representative commented. Disbursement of funds under the $30 million World Bank financial sector rehabilitation loan, to which Mr. Dorrington had referred, was expected shortly after approval of the requested stand-by arrangement for Estonia.

One feature of the currency board system in Estonia, as Mr. Dorrington had observed, was the early establishment of a fixed exchange rate, rather than a floating rate as had been done in Latvia, the staff representative remarked. In reaching their decision to introduce the new currency fairly quickly, the authorities had understood that the necessary institution building of the central bank had not yet been completed. In that context, the currency board approach offered an attractive alternative; in that respect, several speakers had noted that the resulting monetary regime was quite strict.

The 100 percent surrender requirement for foreign exchange was, in practice, a repatriation requirement, the staff representative from the European II Department considered. As long as the possibility of holding foreign currency deposits in the banking system was maintained, which the staff had encouraged the authorities to do, it was hoped that, over time, the surrender requirement could be dropped. With respect to the continuation of export quotas and taxes, both had been reduced sharply in 1992 and the remaining amounts involved were small.

Mr. Dorrington said that the currency board obviously severely limited the degree of freedom on interest rates. He wondered whether the staff felt that, from a domestic viewpoint, interest rates were too high, too low, or about right.

The staff representative from the European II Department noted that in a currency board arrangement with a fixed exchange rate against the deutsche mark, German interest rates were clearly very important. Nominal interest rates in Estonia were about 10 percentage points higher than in Germany, which was well below the current inflation differential between the two countries. The expectation was that inflation in Estonia would slow down; if it did not, of course, the recession could well be much deeper. If inflationary expectations were correct, then interest rates in Estonia were probably not too low. In that regard, it was noteworthy that interest rates in Estonia had fallen in August, which suggested that confidence in the kroon had been rising rather than falling recently.

Mr. Filosa considered that real, rather than nominal, interest rates were the relevant indicator of the credibility of Estonia's exchange rate peg, as there was a considerable difference in the credibility of German and Estonian monetary policies. Furthermore, in adopting an exchange rate peg, it was important to establish an institutional mechanism that would allow the peg to be defended, as had recently become apparent in the case of the Finnish markka.

The staff representative from the European II Department said that the recent fall in nominal interest rates in Estonia, including in relation to German interest rates, was an indication that, over a certain period, confidence had increased. That observation did not, of course, have any implications for the level of confidence over the long term, which remained to be tested.

Mr. Filosa remarked that the definition of long run that was used in such assessments was crucial, as the credibility of the peg could very well be in jeopardy only a few months into the implementation of the program. That prospect underscored the importance of measuring interest rates in Estonia against those in Germany in real terms, which was necessary in order to allow for different inflationary expectations and exchange rate risks. The recent decline in nominal interest rates, while encouraging, was not a sound basis on which to measure the credibility of the kroon peg to the deutsche mark.

The staff representative from the European II Department said that he agreed with Mr. Filosa's analysis that nominal interest rates were only a short-term indicator of the credibility of the exchange rate peg.

Mr. Abbott made the following statement:

> Estonia has developed a very strong economic program, and we are pleased to support today's request for a stand-by arrangement. I agree with almost all of the staff paper and with what other speakers today have said, so I will just highlight a few points.
>
> The currency board approach to monetary policy that the Estonian authorities have adopted is very unforgiving of policy slippages. That is its strength and its vulnerability. By holding out the prospect of a rapid transition to price stability at an economically rational structure of relative prices, it creates the opportunity for Estonia to deal with its transformation toward

a capitalist market system in a more focused fashion. The confusion and policy distractions of inflation can be minimized.

Closing off the option of central bank financing of the public sector, as the currency board arrangement requires, mandates very firm budgetary control. Estonia's achievements in this area are already very impressive. Maintaining a government sector surplus this year in the face of the precipitous drop in both the terms of trade and output, as well as in the face of the crosswinds of ruble inflation, has been quite an achievement. Maintaining this budgetary balance over the course of the program is likely to face new tests as unemployment comes to the fore. The staff paper makes it clear that a lot of potential budgetary problems have been bottled up within the public sector corporations. Output has fallen and real wages have been slashed, but there have been few redundancies. Interindustry arrears have cushioned the shakeout that would have been expected, but continuing this will become increasingly difficult under the currency board regime.

Reports that tax arrears are emerging are an indication that budgetary revenue projections may be hard to achieve. We are not sure that "advance profit distributions" from selected state enterprises is the appropriate response, since it would tend to continue arbitrary taxation of profitable and successful enterprises.

A new stage in Estonia's economic transformation is now getting under way, with major structural reform legislation now being implemented or about to be approved. This includes bankruptcy legislation, formation of the Estonian Privatization Office, housing privatization, and land restitution. This legislation appears to be well considered, and we look forward to its early implementation. Like others, we would encourage the authorities not to let land restitution issues delay or frustrate privatization plans. The absence of a meaningful accounting framework is a gaping hole that needs to be filled in quickly.

The currency reforms introduced in June appear to be off to a very good start, with inflation decelerating sharply. While systematic convergence toward German inflation rates is expected to be achieved by mid-1993, we are somewhat concerned by the cumulative inflation anticipated over the course of the program. Consistent with the deutsche mark anchor, there is scope for the prices of nontraded goods to adjust more than the prices of traded goods, and this is expected to occur as some price liberalization is completed. There is also scope for some continuing escalation in the nominal prices of traded goods, since the starting point of the currency reforms was one of substantial undervaluation of the kroon. These expansion joints allow some needed flexibility in the early bedding-down stage of the new regime. Nevertheless, there is a risk that this transitional adjustment may delay full adjustment of inflation expectations to the requirements of the currency board regime. This morning's report by the staff representative about the 50 percent increase in minimum wages is worrying.

Smooth functioning of the currency board arrangement requires continuous arbitrage between the kroon and its reserve currency, the deutsche mark. We would be interested in some further comments by the staff on how this will operate. Some of the statements regarding residual capital controls and limits on banks' net foreign currency positions suggest equilibration may be frustrated by these restrictions. Fully effective banking competition will be necessary to make the system work, and the reports of complaints of inadequate prices paid on foreign exchange surrender indicate more needs to be done in the area of banking competition. Active operation of international banks with unquestioned access to the reserve currency would play a large part in making the system function smoothly.

Experience under other currency board arrangements indicates that bank reserves and bank liquidity can be very smoothly managed if the banks have ready access to the money markets of the metropolitan currency. Transactions in these money markets may escape our notice, since they tend to be submerged within the short-term balance of payments accounts; that is, short-term borrowing from abroad may be offset by short-term deposit placements abroad. Even if these transactions get netted out in the figures we see in the balance of payments accounts, the effect on short-term borrowing and short-term placements is to accomplish a maturity transformation that allows the banking system to borrow the exchange reserves needed to maintain bank liquidity. Thus, the monetary base of the economy need not be as much at the mercy of current account and long-term capital trends as some other speakers have suggested. The requirement, however, is full capital liberalization and the unquestioned credibility of the currency board arrangement.

Mr. Filosa made the following statement:

I am pleased to support, on behalf of this chair, the stand-by arrangement requested by Estonia. As the staff recognizes, the Estonian authorities realize that the challenge for the economic strategy they purport to undertake is "enormous." Nonetheless, they seem to be showing great determination and courage in pursuing their commitment to stabilization and reform, and what they have been able to do so far in terms of policy action, in spite of the strong deterioration of the economic situation, is clear evidence of those strengths. What is remarkable in this respect--and I think this can be attributed fully to the authorities--is that, if we go back and look at the recent pre-membership economic review of Estonia (EBM/92/40, 3/31/92), many of the recommendations made at that time by the staff and the Board on the need to expedite some crucial steps in the country's transition to a market economy have been followed closely.

We are rather displeased, however, with the recent developments on the incomes policy front, as reported by the staff representative. It is regrettable that the authorities have taken measures in this crucial area without prior consultation with the staff. We hope that such developments are not a prelude to a lowering of the guard on the part of the authorities, precisely at the time when they need to establish their full credibility, domestically and internationally, for the success of their program.

At this stage, I would like to raise only a few specific points. First, in the fiscal area, the staff paper on the pre-membership economic review of Estonia (SM/92/48, 3/6/92) illustrated clearly the three-tier structure of the Estonian budget, indicating that although almost half of budgetary revenues were collected at the state level, the largest share of general government expenditures was accounted for by extrabudgetary fund expenditures, followed by local spending and state spending. Accordingly, in the course EBM/92/40, this chair stressed the importance, among other things, of reducing extrabudgetary allocations to the maximum possible extent, so as to enhance the transparency of the budget, and of defining clear rules governing the financial relationships between the central and local authorities. I would be interested to know whether concrete steps in this field are being considered by the authorities.

Second, with a currency board in place, which effectively limits the provision of new liquidity to the banks to the excess reserves made available through the external sector, it is extremely important that an interbank market be established soon so as to allow an efficient use of the liquidity available in the system by providing an adequate channel between the units in surplus of liquidity and those in deficit.

Third, and equally important, especially in light of the cessation of monetary financing of the government deficit, is the establishment of a market for government securities, which would enhance the role of the Government at a stage of development of the country in which the mobilization of public resources for investment in social infrastructure is essential.

My fourth and final point is rather general and concerns the crucial role and effects of the currency board in a country like Estonia. Certainly, the currency board provides a powerful instrument to guarantee price stability, especially in a country with no experience with central banking and, more generally, with monetary management. However, significant risks are inherent in the adoption of a currency board, in particular for a country like Estonia that for some time will be bound to suffer from a structurally weak external sector. Such risks basically relate to the potential inadequacy of the currency board in providing enough liquidity to the economy, especially when the economy is undertaking a dramatic process of economic restructuring.

The currency board provides the domestic monetary authorities with a strong rule of conduct that prevents them from giving way to inflationary pressures. This, of course, is highly desirable, especially in a country where it is necessary to restore orderly monetary conditions quickly. The currency board system presents some significant problems as well, however, which might cause considerable medium-term costs for the economy. One such problem is that it precludes the monetary authorities from accommodating changes in the demand for liquidity owing to temporary factors or to permanent changes in real activity that should best be accommodated through adequate adjustment in the supply of liquidity. In fact, given the exclusive dependence of the domestic supply of liquidity on the external sector, increases in the demand for liquidity linked to "physiological" reasons--for example, changes owing to the seasonal patterns of payments--in the absence of a parallel increase of external financial resources, could be satisfied only by raising domestic interest rates vis-à-vis world rates to stimulate capital inflows from abroad. Alternatively, the increase in the demand for liquidity would result in higher interest rates and/or would force import compression--two less-than-desirable options, indeed. Finally, the full backing of the domestic currency requires the locking up of foreign exchange reserves and, therefore, represents quite an expensive system of monetary control.

All in all, the effect of a currency board system, especially the one that has been adopted in Estonia, is that of radically eliminating any room for flexibility in the conduct of monetary policy. If, on the one hand, this is certainly a way to avert irresponsible policy decisions, on the other hand, it precludes the necessary degree of adaptation of monetary policy to the liquidity needs of the economy. In the case of an economy such as Estonia, for which the medium-term prospects for external capital inflows are less than certain, the risk would be that of imposing upon the economy a deflationary bias at a time when it needs to grow rapidly and steadily.

I do not intend to go into further detail regarding the currency board system. My comments should, however, point to the need for careful reflection on the costs and benefits of such a system of monetary control, in particular when its adoption might receive consideration by other countries. To this end, I believe it would be very useful if the Board could have an opportunity to discuss this delicate technical issue with the staff, perhaps in the form of a seminar. Certainly, the subsequent reviews of the Estonian case will offer useful material for further, periodic reassessments of this important matter.

To conclude, let me reiterate this chair's strong support for the Estonian authorities' request.

Mr. Al-Tuwaijri made the following statement:

I am in broad agreement with the staff's appraisal and shall make only a few remarks for emphasis.

First, like previous speakers, I commend the authorities on their introduction of a historic and comprehensive economic program aimed at transforming Estonia toward a full-fledged market economy. In this regard, the significant headway made with respect to price and trade liberalization is highly welcome.

Second, the authorities have courageously decided to implement a dramatic stabilization program, which should ensure the early reduction of inflation to international levels. Key to this is the currency reform implemented in June 1992, which included the full backing and convertibility of the kroon, coupled with a highly restrictive fiscal stance. In regard to the latter, I welcome the authorities' fiscal measures, which should ensure that general government balance is attained. Here, I share the staff's view that the authorities should stand ready to implement compensatory measures if revenue shortfalls or social security expenditure overruns occur.

Third, the highly restrictive stance of financial policies requires the rapid implementation of structural reforms and the provision of adequate external financing to avoid a marked and protracted decline in output.

Finally, it is imperative that the privatization process be reinvigorated. Here, I note that the Estonian Privatization Office will give preference to buyers that undertake to invest new capital and provide for the maintenance and expansion of employment levels. However, I hope that this strategy will not be rigidly applied, since it may lead to significant delays in the privatization process. Furthermore, if the authorities' privatization program is to succeed, it is imperative to introduce as soon as possible a meaningful accounting framework and a legal framework consistent with a market economy, as well as to implement effective bankruptcy laws.

With these remarks, I support the proposed decision.

Mr. Golriz made the following statement:

At the outset, I would like to support Estonia's request for a stand-by arrangement. Given their firm commitment to structural and macroeconomic reforms, the authorities deserve our support. The authorities should be assisted in coping with the problems they face, especially in bringing inflation under control so as to protect the purchasing power of the population.

We are in broad agreement with the thrust of the staff's appraisal, but we have a few comments. First, we take note of the authorities' commitment to financial discipline, which we believe is a step in the right direction. In this connection, budgetary management procedures should be put in place in order to streamline expenditures. In addition, a modern tax system should be initiated with the introduction of income, corporate, and consumption taxes.

Second, we are pleased with the measure taken by the authorities in establishing an independent institution for policymaking in the monetary domain. Hopefully, credit to commercial banks and enterprises will be kept under strict control so as to avoid any slippages that could fuel inflation and undermine the value of the currency.

Third, a comprehensive incomes policy should be devised in order to contain wage increases, such as those witnessed in some of the other former Soviet republics. However, it is of utmost importance that a social safety net be put in place to assist the vulnerable segments of the population and to prevent emergence of social tensions in this sensitive phase of implementation of bold reforms.

Fourth, given the difficulties encountered in their relations with the neighboring as well as other markets, the authorities are to be commended for the liberal trade and exchange policies already implemented. Hopefully, their implementation would bear fruit as soon as the adjustment measures have paved the way for sustainable growth. In this context, once commercialization and privatization are fully implemented, the structural reforms could play a major role, especially in the public enterprises. It is, however, necessary for the international financial community to assist Estonia if the strong stabilization and reform program it has embarked upon is to succeed.

Finally, we wish the authorities well in their stabilization and adjustment effort.

Mr. Chen made the following statement:

Once again, I welcome Estonia's recent membership into the Fund and its first request for a stand-by arrangement. I observe with great interest the accomplishments that the Estonian authorities and people have made since their independence. However, I also note with concern the severe economic difficulties now confronting this newly independent country.

Nevertheless, the Estonian authorities are to be commended for their courage and determination in meeting these new challenges and for their strenuous efforts to stabilize, as well as to restructure, the economy. Estonia should be proud of being one of the first states of the former Soviet Union to be able to use Fund resources, because what they have accomplished in the monetary and fiscal areas within a short period of time is obviously a credit to the authorities, as well as the Fund.

The authorities have a well-prepared and comprehensive program to implement. I broadly agree with the staff appraisal and support the main thrust of the reform measures and policy actions. However, I am still skeptical about the extent to which the authorities can accomplish their tax objectives in the present circumstances, given that production continues to contract, large-scale enterprise reform and tax reform have not yet started, and, moreover, no fundamental improvement has so far been seen in efficiency.

In this context, unless the staff considers that the majority of tax rates are too low, I believe that too much action on the tax side can be counterproductive and may, therefore, not contribute realistically to fiscal consolidation. Therefore, it is indeed pragmatic that, for the time being, efforts should be focused more on the expenditure side and on improvement of tax administration. In the meantime, action on the tax side should be brought down to a realistic level so that possible shortfalls in tax revenues would be reduced or the tax target achieved with increased certainty, thereby increasing responsiveness from the supply side of the economy.

With these brief observations, I support the proposed decision and wish the authorities success in the implementation of their reform program.

Mr. Posthumus made the following statement:

It is hardly a special compliment to the Estonian program to say that it is bold and strong, because this description has become somewhat too familiar in the proceedings of the Board. The bold and strong part of the program is, in this case, not only the series of measures that have been taken, but also the self-imposed financial discipline that comes with the currency board monetary system that has been chosen. The system imposes monetary discipline. If the discipline weakens, whether on the fiscal side or the credit side, reserves flow out, the monetary base shrinks, and financial shortages force adjustment. For small countries, however, the currency board system is a recognition that independent financial policies have strict limitations. It is interesting that a country that has not managed its own economy for 50 years seems to realize better than many market economies how important maintaining financial balance is. However, the siren songs of easy credit, monetary and fiscal stimulation, and so on are very attractive, and many policymakers have succumbed to them. In reaction to Mr. Filosa's statement, I cannot understand that there is a systematic deflationary bias in this system, which he seemed to imply. There may, however, be problems in the present adjustment phase.

Of course, the national currency could have been introduced later, after a larger part of the price and wage adjustment had taken place. The risks that many speakers have pointed out would have been less. I can only hope that the authorities realize that an overhasty run to a national currency will make their life very difficult, indeed, because in the short term there are no ways out.

The problems of interenterprise arrears and bad bank loans are common to all former centrally planned economies. The staff pays little attention to these problems. The currency board arrangement rules out a bailout through an extension of credit. However, this might not immediately change the behavior of enterprises, as they can assume a bailout by the Government, or the use of the "emergency clause" in the currency board arrangement. Perhaps the staff has already had some indications about the recent developments of these arrears. The close link between state enterprises and commercial banks promotes an inefficient allocation of credit. Banks may tend to issue credit to nonviable state enterprises, rather than to the private sector. According to the letter of intent, plans will be developed by November 1992 to address these problems. I assume that at least an outline of these plans will be available at the time of the first review of the program, which is also scheduled for November.

Mr. Noonan said that his chair shared the view expressed by other speakers that the efforts and commitment of the authorities should be supported by the Fund with a stand-by arrangement. As his main concerns had already been addressed by previous speakers or in the discussion on Latvia's request for a stand-by arrangement (EBM/92/118, 9/14/92), he could be very brief. He would, however, like to record that his chair also shared the concern expressed by others that incomes and other policies must be consistent with the maintenance of the fixed exchange rate with the deutsche mark, if a contraction of Estonia's economy was to be avoided.

On the issue of privatization, Mr. Al-Tuwaijri had pointed out that under the German Treuhand model for privatization adopted by Estonia, preference was given, inter alia, to buyers who undertook to maintain employment levels, Mr. Noonan commented. It was not clear to him that such a policy was an optimal approach that would lead to an efficient allocation of resources in Estonia. As Mr. Goos had noted, the Treuhand was expected to incur very substantial losses. It was difficult to envision that Estonia had the resources to bear the corresponding cost without compromising the fiscal position.

Mr. Himani recalled that Lenin had said that debauching the currency was the most effective way to destroy capitalism. Given the nature of its currency reform, it was tempting to suggest that of all the former Soviet republics, Estonia had moved furthest ahead in restoring capitalism. While he shared much of what Mr. Abbott had said about currency boards, it should be stressed that the full benefit of a currency board system could be reaped only with full capital and current account convertibility, which was not the case in Estonia. He would be interested to know why full capital account convertibility had not been introduced at the outset of the program and when it would be introduced.

Mr. Filosa observed that the issue of the currency board had raised genuine interest among speakers, particularly Mr. Abbott, Mr. Bonzom, Mr. Posthumus, Mr. Dorrington, and himself. With respect to his own views, he wished to stress that, in the short run, the establishment of a currency board might be counterproductive, because it could not provide the framework in which needed monetary discipline could operate. His remarks at previous discussions should leave no room for doubt that monetary contraction was absolutely essential in all of the states of the former Soviet Union. In essence, however, his concerns centered around the issue of fluctuations in the demand for liquidity based on "physiological" factors, by which he meant factors that were inherent in the dynamic working of the economy. A currency board provided an obstacle to the provision of adequate monetary responses to physiological changes in the demand for liquidity, inasmuch as its operation would lead to interest rates that were either too high or too low or to import compression. Of course, that characteristic of the currency board system was only a problem in the short term, and he did mean to imply that at any moment of time there should be a strict correspondence between the liquidity provided through external sources and the liquidity that the economy needed for physiological reasons.

The longer-term concern that he had raised was that Estonia's highly uncertain prospects for capital inflows suggested that there would be a deflationary bias in the currency board arrangement, Mr. Filosa stated. In all developing countries, current account developments were delinked from domestic monetary conditions as a fundamental element of the development process. Although temporary, Estonia's negative current account balance would be best accommodated through the application of prudent but flexible monetary policy. The currency board arrangement prevented such a response at a crucial stage in the adjustment process, and there was certainly no need to use the experience of the gold standard as the guiding principle for monetary policy in the states of the former Soviet Union. He was confident, however, that the Estonian authorities realized that a currency board was not a necessary condition for the implementation of sound financial policies. Moreover, even the staff did not appear to be overly enthusiastic about the introduction of the currency board, which it seemed to view as instrumental primarily in coping with the lack of expertise in monetary management.

Mr. Abbott remarked that the history of currency board arrangements suggested that there would be far more flexibility within the short-term capital account if financial integration between the local currency and the metropolitan currency could be achieved. Mr. Filosa had alluded to the operation of the gold standard. It seemed to him, however, that the smooth functioning of the gold standard had been based on the ability of countries to obtain the liquidity they needed, which had been made possible by the existence of a well-integrated, short-term international capital market based in London. The currency board system might not be the best for all countries, but it had potential. The Estonian currency board arrangement was an experiment, and it would be important to follow carefully developments under the program in order to learn more about the operation of the currency board system. He looked forward to further discussions on the subject.

The staff representative from the European II Department recalled that Mr. Abbott and Mr. Himani had raised some concerns about arbitrage and the smooth functioning of the currency board in the absence of full capital account convertibility. It was true, of course, that a full-fledged currency board required full capital account convertibility, which had not been introduced in the initial stage of Estonia's program. Nevertheless, arbitrage was still taking place, as, for example, nonresident capital flows were not restricted and Finnish banks were already taking advantage of the arbitrage possibilities; current account convertibility would also, to some extent at least, encourage arbitrage. Furthermore, some of the regulations on capital flows were not enforced in practice, as valid documents for current account transactions were rarely needed to exchange foreign currency into krooni and vice versa. The staff had encouraged the authorities to relax capital controls over time, and it was expected that they would do so in due course.

With respect to Mr. Filosa's questions concerning intergovernmental relations in Estonia, the staff representative continued, he would note that all but two extrabudgetary funds had been merged into the state budget, namely, the social security fund and the medical insurance fund. It was expected that, within the social security fund, all non-pension-related benefits would be transferred back into the budget and that the social security fund would deal primarily with pensions. The wider issues of intergovernmental relations, such as the sharing of the tax base between local governments and the state and the power of local authorities to borrow, were currently being considered by the authorities.

On balance, the staff as well as the authorities shared the view expressed by Mr. Chen that the tax burden was already high enough, the staff representative from the European II Department considered. In the future, fiscal restraint would have to be on the expenditure side. On the tax side, the main effort would be to reform the tax structure without raising the tax burden.

The Director of the Policy Development and Review Department said that Mr. Filosa's comments about the potential for deflationary bias in the currency board arrangement were interesting, although he would not use that phrase. There was certainly a need in Estonia for a very forceful anti-inflationary stance of policies at the present juncture, and the currency board arrangement provided the mechanism to achieve that goal. In addition, the currency board arrangement introduced an element of confidence into the economy, in an environment in which confidence was lacking in the initial stage of reform owing to the absence a track record and the institutions for discretionary monetary policy. To the extent that the arrangement contained a "deflationary bias," therefore, the process of reducing inflation and establishing meaningful relative prices would be accelerated, thereby allowing an early improvement in living standards, which was closely related to the staff's concerns about the authorities' wage policy. There was a chance, of course, that prices would decelerate even faster than planned in the program. Over the longer term, as some Directors and the staff representative had mentioned, the linkages between capital markets would provide the needed flexibility and would remove any "deflationary bias" from the system.

Mr. Filosa commented that while he agreed with much of what the Director of the Policy Development and Review Department had said, the question remained whether capital movements in Estonia could be expected to be as buoyant in the long run as they were in Hong Kong, for example. The fact that the financing for the currency board was provided through official intervention was a good indication that it was not realistic to expect the private sector to invest in Estonia before the proper functioning of a capital market was established in Estonia. If he was correct, the currency board arrangement might provide an obstacle to the necessary delinking of the balance of payments from the orderly development of the economy. If it was not possible to attract sufficient private funds over the long term, namely, in the next few years, there might be difficulties in strictly adhering to the requirements of the currency board. He supported the idea of introducing the currency board in the very short term; unless all the conditions were established to allow sufficient private capital inflows, however, the temporary delinking between developments in the balance of payments and developments in the domestic economy might be appropriate. The experience of other currency board arrangements, with the exception of that established in Hungary, demonstrated the difficulties of encouraging sufficient private capital inflows and the proper functioning of such an arrangement.

The Director of the Policy Development and Review Department remarked that while he agreed with Mr. Filosa's proposition, he would come to the opposite conclusion. For a small open economy, the most important factor in encouraging private capital flows was the confidence of investors in neighboring countries with similar monetary regimes that the stability of the economy would be preserved. If the Estonian experiment was successful, the authorities would be provided with an opportunity to create that confidence faster than would be possible through a process of institution building and convincing, discretionary monetary management.

Mr. Fridriksson made the following concluding remarks:

> At the outset, I would like to thank Executive Directors for the interest that they have shown in the situation of Estonia and the authorities' efforts to quickly reform the economy. The encouragement provided by the Board will be very important to my authorities, who will be duly informed about the views expressed by Directors in the Board today. I would also like to reiterate the appreciation of my authorities to the Chief and staff of the Baltic Division, as well as the other Fund staff who have provided technical assistance to Estonia, for their dedication and professionalism. Let me just quote a statement from a recent publication of the Bank of Estonia on the currency reform, in which the Governor of the Bank notes that "special thanks belong to the International Monetary Fund mission in Estonia which provided a great amount of advice in connection with the monetary reform."
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> I would like to add some comments on the currency reform, which provide, perhaps, a little further background to the thinking and sentiments in Estonia. In the publication that I referred to, the Governor of the Bank also states the following: "Ladies and gentlemen, I have the honor and pleasure to inform you that the monetary reform in Estonia has come true...The team preparing the monetary reform was confronted with a difficult choice for a long time. It was the choice of the ideology of the reform. Let us confess that our skills and knowledge do not enable us to work as perfectly as we wish. Therefore we have chosen a clearer and simpler way. The Estonian kroon is fully backed by the gold and foreign exchange resources of Eesti Pank. This principle was also fixed by the Estonian Supreme Council in the Currency Law of

the Republic of Estonia. Another important point that was put down in the legislative acts preparing the monetary reform is the fixed rate of the Estonian kroon to the German mark. This will enforce to our delight a very strict monetary policy." The experience of Estonia should become very interesting to monitor, and, given the planned quarterly reviews of the program, the Board will have ample opportunity to follow developments closely.

As mentioned, the program is expected to lead to a reduction in the rate of inflation during the program period to Western European levels. Such an achievement demands strict adherence to the policies outlined in the program, to which the authorities are fully committed. On the recent considerations in the incomes policy area, let me just emphasize that a formal decision has not been taken and that there will be ample opportunity to discuss the issue with the authorities over the next few days and particularly during the Annual Meetings.

In the structural area, developments are in many respects similar to those experienced in other countries in transition, but the Government has moved swiftly in this area and intends to further strengthen the effort. Until this year, there was not much of a private sector in Estonia, but private sector activity has seen rapid growth in recent months, particularly within the services and retail sectors. Moreover, several joint ventures with foreign companies have either been agreed or are under discussion.

The residual external financing of the three Baltic countries was treated together within the G-24 framework, and the adjustment effort demonstrated in the contents of the programs that have been negotiated has secured virtually full coverage of the financing gap, with further commitments likely in the period ahead. My authorities are grateful to the countries that have committed external financial assistance. The support of these countries encourages my authorities to continue their determined adjustment efforts.

The Executive Board took the following decision:

1. The Government of Estonia has requested a stand-by arrangement for a 12-month period in an amount equivalent to SDR 27.9 million.

2. The Fund approves the stand-by arrangement set forth in EBS/92/132, Supplement 3.

Decision No. 10141-(92/119), adopted
September 16, 1992

2. PERU - ACCUMULATION OF RIGHTS - REVIEW; AND OVERDUE FINANCIAL OBLIGATIONS - REVIEW FOLLOWING DECLARATION OF INELIGIBILITY

The Executive Directors considered staff papers on the second review under the rights accumulation program for Peru endorsed on September 12, 1991 (EBS/92/148, 9/8/92; and Cor. 1, 9/9/92), and on the further review of Peru's overdue financial obligations to the Fund following the declaration of its ineligibility to use the general resources of the Fund, effective August 15, 1986 (EBS/92/151, 9/10/92).

Mr. Breuer made the following statement:

I would like to express the deep appreciation of the Peruvian authorities for the intense efforts undertaken by both management and staff in support of Peru, as well as to the members of the Board for having agreed to undertake the current review with such short notice.

At the previous review under Peru's rights accumulation program (EBM/92/58, 4/17/92), Mr. Végh highlighted the Peruvian authorities' commitment to their economic program under the rights approach. The events that have transpired since then provide clear testimony in this regard, as all the commitments made by the Government on that occasion have been implemented, despite extremely difficult internal and external conditions. This firm commitment has paid off. Inflation has been reduced dramatically, from 7,650 percent in 1990 to 139 percent in 1991, and it is now projected to be less that 50 percent by the end of 1992.

Concerning the evolution of the program itself, virtually all of the performance criteria have been met since December 1991, at times with considerable margins. Special mention should be made of the extremely tough fiscal adjustment that took place during the first half of 1992, which exceeded by about 4 percentage points of GDP the targets set in the program, and which kept the program on course despite a shortfall in external financing. In addition, profound structural reforms have been implemented, and even accelerated recently, as evidenced in the reforms of the public sector that include, inter alia, trimming of employment in government institutions, liquidation of insolvent financial institutions, and the privatization of state-owned enterprises.

Notwithstanding these achievements, it is clear that there are significant challenges ahead. Growth during the first half of 1992 has fallen short of expectations. Inflation, while clearly in a sharply declining path, remains above desired levels as a result of a series of supply shocks. There are also important issues that are being addressed that relate to the low tax ratio, which constrains public investment in much-needed physical and social infrastructure, the uncertainties associated with external financing, and the difficulties experienced by a limited number of financial institutions.

Nonetheless, as noted in the staff paper, the authorities are aware of these issues and have put in place a package of measures to deal with each one of them. Moreover, recent developments concerning the internal security of the country can only favor the environment for foreign and domestic investment, as will the increase in imports, including much-needed capital goods for the crucial energy sector. Both of these factors support the expectation that growth will be resumed toward the end of the 1992.

Turning to the issue of Peru's overdue obligations to the Fund, it is worth noting the considerable degree of continuity and perseverance in the Peruvian effort. Under the previous Administration, arrears to the Fund were frozen at the August 1989 level, and all obligations falling due to the Fund since then have been met. The current Administration implemented a very ambitious and courageous program of stabilization and structural reform starting in August 1990, which was formally endorsed by the Fund on September 12, 1991. One year later, the program is solidly on track, and, if the program continues on track, compliance with the end-September 1992 targets will ensure the accumulation of the full amount of rights under the rights accumulation program. That is, clearance of arrears to the Fund, amounting to over SDR 620 million, and to the World Bank could take place as early as the end of 1992, in which case this would be the last review of Peru's overdue obligations to this institution. Hence, we are close--very close, indeed--to the culmination of a significant and prolonged effort by both the Peruvian Government and the Fund's management and staff, and to a major success in the application of the strengthened arrears strategy.

The profound crisis affecting Peru has been reflected in many forms, some of which, hyperinflation, economic stagnation, overdue obligations, and so on, have been discussed in this Board on repeated occasions. It is evident that much progress in putting in place an economic policy regime to address these issues has been accomplished in the recent past. Moreover, the Peruvian authorities have assumed a number of difficult international commitments, which they have adhered to. Yet, they cannot continue this effort alone. The support of the international community is not only needed, but also essential if Peru is to overcome the current situation. Therefore, this chair urges members of the Board to send a strong message to both the Peruvian authorities and the outside world in this regard.

In closing, this chair is happy to announce that Peru has accepted the Third Amendment of the Articles of Agreement.

Mr. Quirós made the following statement:

We are in broad agreement with the thrust of the staff paper that reviews the accomplishments made by Peru under the rights accumulation program. Peru has been implementing a strong macroeconomic adjustment and structural reform program under extremely difficult circumstances. Economic performance was satisfactory during 1991 and in the first half of 1992, and all quantitative performance criteria were met, in some cases with significant margins. In 1992, GDP is expected to be lower than previously projected, as losses have been experienced in agricultural and manufacturing output owing to the severe drought and associated electricity shortages. This situation has also produced a supply reduction that, linked to certain increases in indirect taxes, has given support to renewed inflationary pressures.

The fiscal effort is the cornerstone of the adjustment program. Efforts have been made to improve the tax system and to increase the efficiency and effectiveness of tax administration. We are pleased to note that the central government revenues were increased from 7.8 percent of GDP in the first half of 1991 to 8.2 percent of GDP in the first half of 1992. We urge the Peruvian authorities to adhere strictly to their commitments in the fiscal sphere, as achievement of the fiscal objectives remains a necessary condition for strengthening the sustainability and the credibility of the adjustment process.

The Peruvian authorities also need to persevere in their efforts to reinforce the financial sector. As noted in the staff paper, several banking institutions have been facing major difficulties, and there is a need to establish adequate and efficient supervision of the banking system and to ensure banking prudence in order to improve portfolio performance and liquidity and profitability ratios. Along these lines, the proposal for a new central bank charter, and the necessity of maintaining the independence, capacity, and integrity that are the basic requirements of these institutions, are of paramount importance.

We support the proposed decisions.

Mr. Dawson made the following statement:

Heading into the last stage of Peru's rights accumulation program, we can look back on an exceptional performance over the past two years, a result that provides a welcome justification of our intentions in designing the arrears strategy. Striking progress has been made in reorienting the economy along free-market principles, and hyperinflation has been stunted at the same time that the program's performance criteria were met, often with ample margins. The consistency of performance and perseverance to commitment under Peru's rights accumulation program has been exemplary. Unfortunately, however positive these results, at the same time the Peruvian economy has been in decline, the improvement in inflation was not as sharp as projected, and the external accounts are shakier than had been hoped.

The drought has had devastating effects on an already weakened economy following years of decline in the late 1980s. Both the agricultural and manufacturing sectors have been crippled this year. Not surprisingly, domestic debate in Peru has raised questions as to whether the rights accumulation program was too tight or whether measures to stimulate the economy should be taken. On balance, our view is to caution the authorities to stay the course, in expectation that the economy should bounce back in 1993 with a stronger economic base provided by strict adherence to the program. Nonetheless, we find it hard to see support for the optimistic expectation that there will be any growth this year, as currently projected, and we would be interested in the staff's views on growth prospects this year and next.

We strongly encourage the authorities to stick to the focus of the program--closely controlled fiscal policy, for which results have been admirable in the first half of the year. Therefore, we have some concerns regarding the higher expenditures and restructured spending priorities now planned for the remainder of 1992. The changed course may not be surprising, given that expenditures were kept tightly in check earlier this year, possibly contributing to escalating pressures to raise spending now. But we note that wages and salaries are the budget components registering the largest increase, while capital expenditure is now programmed to drop off. The Peruvian authorities are urged to continue their strong record of determining spending choices based on long-term needs of the economy rather than short-term exigencies.

Impressive improvements have been made in Peru's tax administration over the past year and a half. Reforms were slow to take off but are now on track and showing positive results. It is a testament to this effort that revenues are increasing, in part through enhanced tax compliance, despite the drop in economic activity. We look forward to the completion of the long, ongoing tax reform process by the end of this month as temporary decree measures are made permanent. These changes in revenue structure will be critical in ensuring that needed receipts are forthcoming in future budgets.

Regarding the restructuring of the overall public sector, one big accomplishment has been the reduction in size of public sector employment since early 1991 by 80,000. However, there is still substantial room for further cuts within the Central Government, as well as at the local and regional level. While efforts to privatize the public enterprise sector also got a slow start, movement now seems to be pushing ahead steadily. We hope that the recent resignation of the head of the Privatization Committee, reportedly a key factor in promoting the progress on privatization to date, will not slow the process. Overall, privatization efforts could yet be further intensified to match the structural reforms and liberalization already implemented elsewhere in the economy. Enabling regulations that are still needed so that these reforms can be fully effective should be quickly completed, particularly those that would encourage much-needed investment activity. All of these structural reforms will be important in preparing solid ground for stable economic recovery.

Keeping the fiscal deficit and domestic financing in check will continue to play the dominant role in permanently subduing inflation. But the central bank continues to walk a tightrope in managing monetary and exchange rate policy, given the Peruvian Government's concerns, as noted in the staff paper, regarding the potential negative effects of the exchange rate on competitiveness. We would be interested in learning the staff's views on how effective the monetary authorities' policy to date has been in pursuing real depreciation of the new sol without reawakening additional inflationary pressures.

Regarding weaknesses in the financial system that have emerged, we note that some consolidation of institutions actually could be healthy. This view, combined with our visceral reaction against excessive market intervention, however well intentioned, causes us to consider with caution the limited scheme described in the staff paper for budgetary support of the banking system. We are much more inclined to support the strengthening of prudential regulations and supervision, as suggested by the staff. In addition, we welcome the proposed new central bank charter, providing for more autonomy, which should assist the monetary authorities in carrying out their traditional central bank responsibilities.

Looking ahead to the time when clearance of arrears to the international institutions will take place, we have one question regarding the role of the World Bank. While noting that loans in an amount sufficient to clear Peru's arrears to the World Bank have already been approved, we would be interested in knowing whether additional loans from the World Bank are in the pipeline, so that much-needed net new money from the World Bank will be extended in 1993 to complement that potentially forthcoming from the Fund.

Peruvian authorities are clearly in need of congratulations for the performance under the rights accumulation program to date. Meeting the targets under the program will assist Peru in rejoining the international monetary system by building confidence in the authorities' commitment to economic reform and stabilization, as well as by building the framework for stable economic growth in the future. Even so, the negative economic outturn this year is disappointing and, notwithstanding recent successes in the anti-terrorism campaign, could build domestic pressures unfavorable to continuation of economic stabilization policies. We encourage the Peruvian authorities to withstand these challenges and not to deviate from their original goals as the closing stages of the rights accumulation program draw near.

Mr. Dorrington said that he could join Mr. Quirós and Mr. Dawson in commending the Peruvian authorities for persevering with their adjustment efforts in difficult circumstances. Progress seemed to have been at least satisfactory in most areas. Provided that Peru observed the end-September 1992 performance criteria and negotiated an appropriate new program with the Fund, it should be possible to clear--or, rather, refinance--its arrears to both the Fund and the World Bank by the end of the year, which would be a welcome achievement, given the size of Peru's arrears. He would be interested to learn more from the staff about the timing and modalities of the arrears clearance exercise, including arrears to all creditors, and the scope of the follow-up program.

Clearly, Peru still faced immense difficulties, Mr. Dorrington considered, not least its unsustainably high debt burden and very weak domestic revenue base. The needed radical improvement in tax administration and collection would take time, which underscored the need for tight control over public expenditure. It was also essential to re-establish confidence in the domestic banks, as lack of confidence was a major reason for the large differential between deposit and lending rates shown in Chart 1 of EBS/92/148. Moreover, real deposit rates were close to zero, which was particularly worrisome given that private sector savings as a percentage of GDP had been halved between 1989 and 1991.

He would also be interested to learn more from the staff about the external financing of the new program, particularly whether an increase in Fund exposure to Peru was contemplated beyond the existing very high level and how other external financing would be mobilized, Mr. Dorrington said. His impression was that, despite the hiatus caused by political developments earlier in the year, Peru's financial position during the rights accumulation program had been rather more comfortable than had been expected by the support group, owing largely to private capital inflows.

Finally, he would like to record his chair's disquiet at having to consider the very important issues before the Board without the usual period of notice, Mr. Dorrington stated. He hoped that Directors would be given the usual period of time to examine any future proposals before they were considered by the Board.

Mr. Bonzom made the following statement:

I would like to join other speakers in commending Peru for the impressive track record that has been established under the rights accumulation program, as all performance criteria at end-March and end-June were met with large margins. Most notably, despite adverse circumstances, fiscal policy, which is indeed the cornerstone of the program, was further tightened and the overall public sector deficit was brought down to 0.8 percent of GDP for the first half of 1992, compared with an initial target of 4.6 percent of GDP for the same period. Furthermore, considerable progress has been made on structural reforms to improve the overall competitiveness of the economy.

For the remainder of the year, I can concur with the staff that fiscal and monetary policies seem appropriately designed to achieve full compliance with performance criteria for end-September. Nevertheless, I would like to make two remarks regarding the measures envisaged by the authorities for the last part of 1992.

First, concerning the higher than projected inflation rate, I wonder whether private capital inflows have not compounded supply-side factors--namely, the drought situation--by placing additional pressures on prices. Given the level of those inflows and the fact that they do not appear to be temporary, the authorities should monitor developments in this area closely and be prepared, if necessary, to absorb the effects of such private capital inflows. I would appreciate the staff's comments on this issue and on recent developments in prices and private capital inflows.

Second, on fiscal policy, although the overall fiscal deficit target for 1992 is projected to be met with a margin of 1 percentage point of GDP, the structure of public spending is not the most desirable. As a matter of fact, higher than projected current expenditures, especially on the wage bill and military outlays, are projected to be accommodated by cuts in capital expenditures. I certainly hope that in the coming months the authorities will be able to step up programs designed to improve the most-needed economic and social infrastructure.

Notwithstanding these remarks, the impressive past economic performance of Peru amply justifies a favorable conclusion of this second review under the rights accumulation program. Looking ahead, I wonder whether the staff could give us more detailed information about the next steps that have to be taken by Peru toward the end of the year to bridge the financing gap. I would also appreciate some comments on the timing for a successor program, after the anticipated completion of the current program.

To conclude, the achievements of the Peruvian economy under the rights accumulation program, including the track record of payments to the Fund, bear witness to Peru's cooperation within the context of the intensive collaborative approach, and I can therefore approve the proposed decisions.

Mr. Galán made the following statement:

Since the Board's endorsement of the rights accumulation program, the Peruvian authorities have remained committed to the adjustment process and the structural reforms envisaged in the program, even under adverse circumstances. Indeed, after the satisfactory results achieved in 1991, unforeseen events have imposed a setback in output recovery, as well as in the control of inflation during the first half of 1992, in a context in which all performance criteria and most indicative targets under the program have been met with wide margins. We welcome the authorities' determination to continue with the process of transforming Peru's economy, and to normalize relations with the international financial community. Their efforts deserve our financial support.

As I am in broad agreement with the main thrust of the staff appraisal, I would like to add only a few comments. First, fiscal policy has been conducted well within the lines established in the program. The set of revenue measures approved by the Government in late 1991, and in early 1992, including efforts to improve tax collection, have compensated for the impact of administrative delays in the implementation of the value-added tax (VAT). In addition, public sector investment has not developed as planned owing to delays in external project financing, and current expenditures have been kept within targets. We welcome the authorities' announcement that the temporary tax measures will be made permanent, and that efforts will continue to increase efficiency in revenue collection. However, we have some concerns regarding the pace of investment. In a context in which supply difficulties have conditioned output growth and inflation still remains a major cause for concern, it could be dangerous to accelerate government spending, as it seems to be the case for the second half of 1992. We agree with the staff that extreme caution is needed to avoid excessive demand pressure that could jeopardize inflation and balance of payments objectives. We also concur with the staff's view that more efforts are needed to increase social programs oriented to the most needed segments of the population.

We welcome the authorities' efforts to introduce changes in the structure of the public sector and reduce its size. In this regard, important steps have been taken, namely, cuts in personnel in several public offices and the central bank and the restructuring and closing of official development banks. The privatization program has already advanced in the first part of 1992, and we are pleased to learn that it will continue in the remainder of the year.

Developments in the monetary accounts during 1992 have been broadly in line with the program, as the increase in net international reserves has been compensated for by lower net domestic assets of the central bank, and credit conditions have been tightened by commercial banks. In this regard, it is worth noting that private capital outflows that took place in April 1992 have been reversed. This was made possible by the high level of interest rates and the strong commitment to the adjustment process demonstrated by the authorities. We welcome the central bank's strategy of maintaining tight conditions for credit to commercial banks. However, we have some concerns with the policy actions that will take place in order to provide liquidity to the banking system, and how the authorities plan to accommodate credit expansion within money targets. In the first place, while we understand the need to alleviate problems in the banking sector, the possibility of having an easy solution for nonperforming assets could prevent banks from making further efforts to collect payments and relax their credit policies, creating efficiency problems.

Moreover, we have some doubts about the decision to increase remuneration of commercial bank deposits in foreign currency at the central bank merely for the purpose of increasing their liquidity. As we understood the issue at the previous Board discussion on Peru (EBM/92/58, 4/17/92), the reduction in that rate had the purpose of reducing the incentive to increase deposits denominated in foreign currency. We would like to have some further clarification from the staff regarding the rationality of those measures, their convenience, and how the authorities plan to compensate for deviations in money targets that could emerge from the implementation of that strategy. In our view, further efforts are needed in the area of banking supervision in order to reduce liquidity and solvency problems in the future. In that regard, the steps already taken by the authorities in that area represent positive developments.

The outlook for the medium term still reflects the fragile external situation and the significant debt burden. However, the authorities' efforts to normalize Peru's relations with the international financial community, as well as the liberalization of trade and the opening of the economy to foreign investment, should contribute to further improvements in the future. It is crucial that the authorities remain firm in their commitment to the adjustment process and advance the structural reforms already initiated.

With these comments, we support the proposed decisions.

Mr. Nakagawa made the following statement:

At the outset, I would like to strongly support the completion of the second review under Peru's rights accumulation program. Since the completion of the previous review, all the quantitative performance criteria for March and June 1992 were met with wide margins. The authorities have successfully managed the country's economy in the face of the severe drought, the rise in terrorism, and substantial shortfalls in external disbursements. Measures were taken to strengthen fiscal revenues, and expenditures were contained below the program targets. Thus, the deficit of the combined public sector shrank to a level well below the program target in the first half of 1992. While developments in inflation and output fell short of the initial targets, the figures could have been much worse had the authorities failed to respond appropriately to the adverse economic and social situation in the first half of 1992.

For the second half of 1992, I generally endorse the staff's assessment. It is welcome that the authorities have maintained their commitment to reduce the monthly inflation rate to about 2 percent by the end of the year. The key to meeting this objective will be to maintain a cautious approach toward fiscal policy. In this connection, like Mr. Dawson, I feel uneasy about the authorities' decision to recover somewhat the pace of fiscal expenditure in the second half of 1992. Also, more weight will be put on fiscal outlays relating to wages and salaries, military expenditures, and pensions.

The costs of combating the insurgency, reforming the political process, as well as strengthening the financial sector are listed as the reasons for the increased appropriations. However, given the country's still precarious economic situation, I would urge a cautious and deliberate approach toward increasing the pace of expenditure. In this regard, I wonder whether any foreign assistance is expected relating to the elections for the constitutional congress. I also could not help wondering whether the recent arrest of the leader of the Shining Path guerrilla movement will have a positive effect on reducing military expenditure. I would appreciate the staff's comments on these points.

The recent turbulence in the banking system is another source of concern. I would be interested to learn what the impact on the government budget would be of the possible liquidation of the large Government-owned mortgage bank mentioned in the staff paper. In this regard, I welcome the fact that the authorities have already taken steps to strengthen prudential regulations and supervision of the banking system. However, a new provision by the Government to provide liquidity to the banking system, which will be financed through budgetary transfers, is a source of concern. The Peruvian authorities should be aware of the risks involved in budgetary support for turbulence in the financial system.

Finally, on the financing of the program, the substantial loss of external credit to the public sector is one of the uncertainties of the program. As noted in the staff paper, Japan disbursed $50 million at the end of July 1992 as the second tranche of its cofinancing for the Inter-American Development Bank's (IDB) trade sector loan. The third and final tranche from Japan, which is also $50 million, is expected to be disbursed once the conditions for the third tranche of the IDB loan are met. In addition, Japan has already pledged another $100 million in the form of cofinancing for the IDB's financial sector loan. Once the loan agreement between the IDB and the authorities has been completed, it is planned that an exchange of notes will take place in due course regarding the cofinancing from Japan.

In closing, I hope the authorities will continue to manage the economy appropriately and prepare a firm basis for the successor program to the rights accumulation program. My authorities greatly welcome the fact that Peru is very close to clearing its arrears to the Fund, and they highly commend the authorities' efforts so far. With these comments, I support the proposed decisions.

The staff representative from the Western Hemisphere Department recalled that a number of questions had been raised on fiscal policy, particularly the increased pace of expenditures that was envisaged under the program for the second half of 1992. As illustrated in Table 3 of EBS/92/148, a substantial shortfall in expenditures under the program had been recorded in the first half of 1992, owing in part to difficulties in meeting the investment targets under the program. Accordingly, for the second half of 1992, the authorities intended to bring the pace and structure of expenditures into line with the targets in the program for the year as a whole primarily through a substantial acceleration in the rate of investment, from about 1.4 percent of GDP in the first half of 1992 to about 3 percent of GDP at the end of the year. Another factor underlying the planned increase in the pace of expenditures was the acceleration in social spending, following a number of administrative problems that had occurred in the first half of the year. A series of nonrecurrent expenditures was also planned in the second half of the year associated with the drought, financial support of domestic banks, and increased military outlays related primarily to wages and salaries. Even with the adjustment in the pace of expenditure, however, expenditures would fall short of the targets under the program for 1992, although they would be higher than the outturn for 1991.

According to the information available to the staff, the difficulties faced by a number of domestic banks did not appear to be a widespread problem, the staff representative said. The problem, which was fairly recent, stemmed from the economy's transition from hyperinflation to stability and the associated reduction in the size of the banking system in real terms. The banks' difficulties had been exacerbated by the coincidence of lower economic activity and higher interest rates in the first half of 1992. In response to the Government's request for technical assistance from the Fund, a group of experts was currently in Lima helping the Government and the superintendency of banks to assess the banks' portfolios with a view to designing a program that would lead to increased capitalization of the banking system, if necessary, and strengthened prudential regulations. With respect to the situation of the mortgage bank, the estimated $50 million in financial support for the bank's operations would be absorbed through the budget in the form of a deposit insurance scheme. In addition, the intention was to undertake a net lending operation by the Government to provide liquidity to the banking system to lend to the private sector.

The central bank had been intervening in the exchange market for a number of months, which had resulted in a depreciation of the exchange rate that had more than reversed the appreciation that had occurred in the first quarter of 1992, the staff representative commented. The depreciation had been effected without departing from the monetary targets in the program, however, because the intervention had been offset by the strengthening of the fiscal situation and by placing small amounts of Government paper in the market.

As explained in the staff paper, the projection for growth in 1992 as a whole was influenced by the 2 percent decrease in activity in the first half of the year, related mainly to the effect of the drought on agriculture and the rationing of electricity, the staff representative from the Western Hemisphere Department said. The authorities expected that economic activity would pick up in the second half of the year, although that would depend in part on the continuation of the drought and the electricity shortages. With that in mind, the projection for the year as a whole of 1 percent seemed reasonable. For 1993, the authorities expected a normalization of growth in the range of about 3.5-4 percent, as had originally been envisaged for 1992.

The staff representative from the Policy Development and Review Department noted that, as reported in the staff paper, Peru's rights accumulation program had been proceeding well in terms of the results achieved so far. The expectation was that satisfactory progress would continue in the period immediately ahead. During the recent past, Peru had kept current on its payments to the Fund and the World Bank. The strategy was to continue the current approach until the completion of the rights accumulation program toward the end of 1992. In the meantime, a mission was expected to return to Peru later in the year to work with the authorities on the preparation of a follow-up program, which would be set in a medium-term context. Once the policies under that program had been better defined and the order of magnitude of the financing had been better established, an approach would be made to possible donors to obtain the necessary financing.

The staff representative from the World Bank said that the Bank was operating under the assumption that Peru would be able to clear its arrears to the Bank and the Fund by the end of 1992. On that basis, the Bank staff was preparing a series of investment loans for critical sectors of the economy, such as education, health, energy, highways, and urban development. It was expected that those loans would be disbursed within 5-7 years. If circumstances allowed, the staff would also prepare a loan of about $250 million to help finance the adjustment cost of the privatization process. A technical assistance loan of about $30 million to help the authorities with the privatization process was also under preparation. In sum, the Bank's Board would probably approve about $300-500 million for Peru in 1993, the bulk of which would come from the main privatization loan.

Mr. Prader made the following statement:

Given Peru's adverse circumstances, it is encouraging to see that the Peruvian authorities remain committed to the policies agreed under the rights accumulation program. We are also pleased to learn that virtually all of the performance criteria have been met with much room to spare. The Peruvian authorities have not only maintained the pace of their reform process but have also even succeeded in accelerating the pace.

Unlike some countries that have been reluctant to restructure the public sector for fear of adding to unemployment, Peru has taken bold steps to streamline its public institutions, including a reorganization of the Government-owned banks. This reorganization is being complemented by a comprehensive privatization program, which is expected to cover a large number of companies by the end of the year. We would simply point out to the authorities that to succeed, these promising measures must be supported by a functioning social safety net to alleviate the hardships they will necessarily impose on the population. We found the treatment of the social safety net issue, both in the staff paper and in the authorities' letter of intent, to be somewhat perfunctory in view of its importance. We hope adequate provisions have been made to address the grave social problems that may emerge during the reform process. Could the staff give us a more detailed account of the planned social measures?

The authorities plan to take a further step toward fiscal consolidation by improving the efficiency of the tax system. We note with satisfaction that the tax system reforms already implemented have increased government revenues to 8.2 percent of GDP during the first half of 1992.

For Peru's international reserves position, the present large inflows of capital may turn out to be a mixed blessing. Private capital inflows can be seen as a measure of foreign investor confidence, and as evidence that the credible reforms being implemented are starting to pay off. But there are also negative aspects. One of these is the appreciation of the currency in real terms, which has already begun to erode Peru's export competitiveness. Another negative aspect is that capital inflows of the "hot money" type can suddenly reverse themselves, as shown in a recent IMF Working Paper on capital inflows and real exchange rate appreciation in Latin America (WP/92/62, August 1992). The staff paper on Peru does not provide enough information on the sources of the present inflows to make an adequate assessment of this risk for Peru. Could the staff give us more details about the composition of these flows and the implications for this risk?

Let me turn to the aspects of the staff paper that we find extremely worrisome. First and most important is the fragility of Peru's recovery, shown by a GDP for the first half of 1992 that is 2 percent below that recorded in the same period last year. Viewed on a month-to-month basis, the figures are even more dramatic: according to The Economist of July 11, 1992, Peru's April 1992 GDP was 7.5 percent below that recorded in 1991 and its May 1992 GDP was 8.5 percent below that recorded in 1991. While we admit that the reasons for this decline are largely exogenous, we find it difficult to accept the staff's unchanged medium-term assumption that real GDP growth rate will gradually rise to about 5 percent a year by 1995. We would be interested to know the basis for the staff's optimistic view. For the time being, however, we tend to share Mr. Dawson's skepticism.

It is also troubling that the economic slowdown is accompanied by a persistently high inflation rate of 33 percent for the first half of 1992, instead of the program's assumed rate of 24 percent. The stubbornness of the inflation rate may reflect more than supply shortages caused by drought and a higher than expected indirect tax increase. Inflation has been a serious problem for Peru, which only two years ago was experiencing hyperinflation, and great vigilance is therefore needed to detect the first signs of a resurgence.

I will end with a general issue in the form of the argument we presented at the 1991 review of Peru's overdue financial obligations (EBM/91/121, 9/12/91) concerning Peru's obligations to commercial creditors. This issue is passed over very lightly in the authorities' letter to the Fund detailing their policy intentions, which implies that Peru's creditors are still maintaining their "wait and see" attitude. As this attitude forces the Fund and other official creditors to bear the brunt of Peru's burden, we would certainly hope the commercial creditors will take a more active role. We would be interested to know of any new developments in this area. Has the staff any news on this front?

We are hopeful that the firm commitment of the Peruvian authorities to the rights accumulation procedure will suffice as a clear signal of the permanence of their adjustment efforts. We, therefore, urge the Peruvian authorities to maintain their commitment to reform, and we support the proposed decisions.

Mr. Esdar made the following statement:

Like other speakers, I welcome the overall satisfactory performance of Peru and the progress achieved so far under the current rights accumulation program in overcoming the arrears problems. I can endorse the staff's policy recommendations, and could associate myself very much with the remarks of Mr. Dawson. Therefore, I have only a few points on which I would like to comment.

First, inflation for 1992 is now expected to exceed the originally envisaged target by a substantial margin. I understand that the overshooting of the inflation rate is, to some extent, caused by higher indirect taxes and drought-related shortages. However, against the background of Peru's inflation history, it is of the utmost importance that these one-time price effects should not be translated into a permanent higher rate of inflation. Therefore, I share the remarks of Mr. Prader on this issue.

Second, while the overall fiscal stance in the first half of 1992 was within the program targets, this should not lead to an expansionary policy in the second half of the year. This point was made by other speakers as well. In addition, I share the concerns of Mr. Bonzom with regard to the shift in the structure of public spending in favor of unproductive spending, such as wages, pensions, and military expenditure. This trend has to be reversed as soon as possible.

On the revenue side, I noted that the Government has implemented a large number of tax measures. However, I had the slight impression that tax measures were sometimes introduced very much on an ad hoc basis without a clear and well-defined blueprint for tax reform. The same observation may hold true for administrative reform, under which some ministries were eliminated, others were established, and responsibilities were shifted in one way or the other. Perhaps the staff could address the question of whether this impression is right, and whether there might be some room for more technical advice in this area.

Finally, I strongly urge the authorities to make all efforts to meet the necessary preconditions so that external financial support can be provided in a timely manner.

Mr. Al-Tuwaijri said that he wished to join previous speakers in commending the authorities for the progress achieved so far, and for their strong commitment to continue the strategy being pursued under the rights accumulation program. He supported the proposed decisions.

Mr. Solheim made the following statement:

As I broadly agree with the staff's assessments in the paper on the second review under Peru's rights accumulation program, I will only comment on a few points.

The political as well as the economic situation in Peru remains fragile, and the authorities will face many difficult challenges in the time ahead. I am pleased to note, however, that Peru has made considerable progress in a number of areas under its rights accumulation program. Nevertheless, problems remain in some areas. Even though the rate of inflation has declined markedly, the targeted level of 2 percent a month by end-1992 is not likely to be achieved. Improved inflationary performance should, therefore, remain a main objective of the program.

Despite a number of appropriate measures taken recently by the authorities, the reform of the tax system and of the tax code remains a weak point. As also stressed by other speakers, it is important that the authorities step up the implementation of the planned reforms in the tax area. I also note with concern the serious difficulties experienced by the banking system. I agree with the comments of previous speakers concerning the importance of strengthening the supervisory system and in showing extreme caution in the choice of possible supportive measures for the banking system. I understand from the staff's comments that an important reason for these problems may be classified as portfolio adjustments due to a lower inflationary environment, and that fraud, speculative actions, and so on are not the main reasons.

Private capital inflows have recently rebounded and exceed projected levels. I would appreciate some comments from the staff on the extent to which the capital inflows reflect the fact that Peru is regaining the confidence of creditors, and whether the inflows are mainly of a short-term nature, thus representing a potentially destabilizing factor?

All in all, Peru has maintained a satisfactory payments record to the Fund and has continued its adjustment and reform efforts. Consequently, Peru is cooperating with the Fund in accordance with the formal criteria under the enhanced collaborative approach. In addition, external financing for the rest of the program period has been identified. I can, against this background, support the proposed decisions.

Mr. Deng made the following statement:

Peru has made remarkable progress with the support of the rights accumulation program. Inflation has been sharply reduced and structural reforms widely implemented. Considerable progress has been made in strengthening the balance of payments position and in normalizing relations with external creditors. The economic program is firmly on track, with all program targets being met--some even with significant margins.

We commend the Peruvian authorities for these achievements and encourage them to make extra efforts to address the major problems that still face the economy. Inflation performance should be further strengthened by maintaining a tight fiscal and monetary policy stance. Structural reforms should be further enhanced in order to reduce the vulnerability of the economy to external shocks and to create conditions for a sustained economic recovery. We, therefore, fully endorse the various policy undertakings that have been pursued so far and encourage the authorities to stay firmly on the program course, and to take any additional measures necessary to minimize any possible shortfalls.

Turning to the issue of overdue financial obligations to the Fund, we are particularly encouraged by the authorities' determination to settle fully their overdue financial obligations to the Fund in the immediate period ahead. Like the staff and other speakers, we sincerely hope that this will be the last review of this subject for Peru.

We support the proposed decisions.

The staff representative from the Western Hemisphere Department said that the Government was making its best efforts to increase the social investment and current spending component of the budget. In the revised budget, the amount of such spending was about 1.5 percentage points of GDP, which was very close to what had been included in the original program and double the amount recorded in 1991.

There had been indications that inflation was continuing to decrease and was moving into line with the rate envisioned in the program, the staff representative remarked. The rate of increase in prices during August was estimated at 2.8 percent, which was lower than had been programmed, and there had been a substantial reduction in the average rate of price increases over the past three or four months to 3-3.5 percent.

The tax measures that the authorities planned to implement in 1992 were part of a concerted effort, with the technical assistance of the Fund and other international institutions, to launch a comprehensive tax reform, the staff representative stated. Some measures had to be taken on a temporary basis, owing to difficulties in obtaining congressional approval of the necessary legislation. The authorities were committed to implementing a comprehensive reform of the basic tax structure, including VAT, the income tax, and the wealth tax.

With respect to the effects on prices of the increase in private capital inflows, the staff did not have any indication that the increased flows were putting pressure on prices, the staff representative from the Western Hemisphere Department said. The central bank was maintaining a tight monetary stance, coupled with the Government's tight fiscal stance. As in the case of other countries, private capital inflows largely reflected private sector transactions and were primarily demand determined. As to their composition, some private capital inflows were short term in nature and were reflected as an increase in deposits of the banking system. More recently, there had also been a substantial increase in longer-term capital inflows, which were financing a pickup in investment.

The staff representative from the Policy Development and Review Department remarked that the general strategy with respect to Peru's obligations to commercial creditors was to first try to address the issue of arrears to international institutions and bilateral official creditors. Although there had been some contacts with the commercial banks, especially in recent months, there was not much progress to report in that area. The Peruvian authorities had taken some steps to reduce restrictions on the repayment of short-term working capital loans, as reported in the letter of intent, and had authorized some limited debt-equity swap operations.

Mr. Breuer commented that the impact on Peru's program of recent developments in the internal security of the country was obviously difficult to predict. It was the belief of the Peruvian authorities, however, that the impact could only be positive in terms of promoting a better environment for foreign and domestic investment. As he had noted in his opening statement, there was a very strong sense of euphoria in Lima and other cities, which would presumably lead to a sharp increase in the popularity of the Government, which, in turn, would increase support for the program. A program of the nature being implemented in Peru clearly involved tremendous social costs. If recent developments had contributed to an increase in the popular support of the program, therefore, the prospects for the further implementation of the program would be improved.

The issue of the increase in government spending in the second half of 1992 was covered well by the staff representative from the Western Hemisphere Department, Mr. Breuer considered. He would only stress that no one was more interested in stabilizing the Peruvian economy than the Peruvian authorities. The Peruvian authorities had proven their flexibility and commitment to ensure that stability was ensured. As noted by the staff, nonrecurrent factors played an important role in the planned increase in government spending.

The Executive Board took the following decisions:

Accumulation of Rights - Review

1. Peru has consulted with the Fund in accordance with paragraph 4(b) of the decision on accumulation of rights for Peru (EBS/91/141, Sup. 2) and paragraph 18 of the letter dated March 26, 1992 from the Minister of Economy and Finance and the President of the Central Reserve Bank of Peru, in order to review implementation of Peru's rights accumulation program and establish performance criteria for end-September 1992.

2. The letter, with annexed tables, dated September 8, 1992 from the Minister of Economy and Finance and the President of the Central Reserve Bank of Peru shall be attached to the decision on accumulation of rights for Peru, and the letters of August 21, 1991 and March 26, 1992, as amended, with their respective annexes, shall be read as supplemented by the letter, and annexed tables, dated September 8, 1992.

3. Accordingly, paragraph 4(a) of the decision on accumulation of rights for Peru shall comprise references to Tables 1, 2, 3, 4, 5, and 6 annexed to the letter dated September 8, 1992.

4. The Fund determines that the review contemplated in paragraph 4(b) of the decision on accumulation of rights for Peru and paragraph 18 of the letter of March 26, 1992 has been completed.

Decision No. 10142-(92/119), adopted
September 16, 1992

Overdue Financial Obligations - Review Following Declaration of Ineligibility

1. The Fund has reviewed the matter of Peru's overdue financial obligations to the Fund in light of the facts and developments described in EBS/92/151 (9/10/92).

2. The Fund welcomes the progress made by Peru in the context of the rights accumulation program. The Fund calls on

Peru to preserve the conditions necessary to enable external donors and creditors to continue flows of grants and nonconcessional lending in support of Peru's adjustment efforts on a timely basis.

3. The Fund notes the recent payments made by Peru and Peru's intention to continue settling financial obligations to the Fund as they fall due, pending full settlement of its arrears. Nevertheless, the Fund regrets the continued existence of Peru's overdue financial obligations to the Fund and stresses that full and prompt settlement of these arrears should be given the highest priority, and notes that efforts toward their settlement are under way.

4. Unless Peru has settled its overdue financial obligations to the Fund in the meantime, the Fund will review the matter of Peru's overdue financial obligations to the Fund again within six months.

Decision No. 10143-(92/119), adopted
September 16, 1992

3. HAITI - ANNUAL MEETING CREDENTIALS

Mr. Dawson recalled that it had been the practice of the Fund since its first Annual Meeting to require credentials of member country delegations. It was his understanding that, in the case of Haiti, the Fund and the Bank had received indications that more than one delegation from that country might seek to present credentials for the forthcoming Annual Meetings. Specifically, it was his understanding that President Aristide of Haiti had communicated to both the Fund and the Bank his desire to have a delegation of his Government seated at the Annual Meetings, and that there were some indications that a separate delegation would be sent by the Government that had succeeded President Aristide. It was the strong view of his authorities, and of the authorities of most countries represented in the Executive Board, that the Aristide Government was, indeed, the legitimate Government of Haiti.

With respect to the procedures of the Fund for dealing with such cases, Mr. Dawson continued, it was his understanding that when there was a challenge to a participant's credentials, the dispute was referred to the Chairman of the Board of Governors. He would like to know whether the staff agreed that the situation he had described was accurate and whether, under the circumstances, the staff would withhold accepting the credentials of any delegation from Haiti until the Chairman of the Board of Governors had reached a conclusion on the matter. In that regard, it was also his understanding that the Chairman of the Board of Governors would normally refer the matter to the Joint Procedures Committee for advice, and that any decision he subsequently made could be contested before the Board of Governors.

The General Counsel stated that the staff had, indeed, received notifications from both the Aristide Government and the Government that was in place in Port-au-Prince; both notifications contained designations for the Governor and Alternate Governor of the Fund and the Bank for the Annual Meetings. In the absence of any support for the other notification, the staff would act in accordance with the practice of the Fund, namely, to give preference to credentials received from the Government exercising effective control over the country, which in Haiti's case would be the Government in Port-au-Prince. He understood, however, that some Fund members supported the view that the Aristide Government should, perhaps, be given preference, or at least it was their view that the issue was serious enough to be referred to the Chairman of the Board of Governors. In that case, the issue would in fact be referred to the Chairman of the Board of Governors for his decision. It was the usual practice, but was not required, for the Chairman of the Board of Governors to refer such matters to the Joint Procedures Committee before coming to a decision. In any case, such a decision could be challenged before the Board of Governors.

Mr. Dawson asked what the staff intended to do with regard to credentials pending a decision by the Chairman of the Board of Governors on the matter.

The General Counsel replied that, for the time being, no credentials would be accepted from either delegation.

Mr. Dawson wondered whether the General Counsel could confirm that, on the basis of the present discussion or informal consultations, the matter would definitely be referred to the Chairman of the Board of Governors for a decision.

The General Counsel said that he could confirm Mr. Dawson's understanding.

Mr. Quirós noted that Mr. Kafka, who was currently in Curaçao attending the annual meeting of Governors of Latin America, Spain, and the Philippines, would return to Washington on September 17, and would then be available for any further discussion related to Haiti.

Mr. Evans wondered whether the Secretary could indicate when the Joint Procedures Committee might be convened to discuss the matter.

The Secretary observed that the Chairman of the Board of Governors would arrive in Washington on the evening of September 17, at which time the staff would meet with him. In principle, the Joint Procedures Committee was at the disposal of the Chairman, who could decide to call a meeting of the Committee at any time. In doing so, however, the Chairman would want to take into account the dates of arrival in Washington of the members of the Committee.

The Acting Chairman, noting a number of affirmations from Executive Directors, concluded that there appeared to be wide support among Directors for the staff's intention to refer to the Chairman of the Board of Governors the issue of the credentials of the Haitian delegation to the 1992 Annual Meeting.

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/92/118 (9/14/92) and EBM/92/119 (9/16/92).

4. JAMAICA - STAND-BY ARRANGEMENT - WAIVER OF PERFORMANCE CRITERION

1. Jamaica has consulted with the Fund pursuant to paragraph 4 of the stand-by arrangement for Jamaica (EBS/92/96, Sup. 3, as amended), in order to reach understandings regarding the circumstances in which purchases under the arrangement can be resumed.

2. The Fund decides that notwithstanding the nonobservance of the performance criterion on the cumulative increase in the net domestic assets of the Bank of Jamaica, no further understandings are needed for Jamaica to resume purchases under the stand-by arrangement. (EBS/92/147, 9/8/92)

Decision No. 10144-(92/119), adopted
September 14, 1992

APPROVED: April 16, 1993

JOSEPH W. LANG
Acting Secretary