NOT FOR PUBLIC USE

8404

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 93/139

10:00 a.m., October 4, 1993

R. D. Erb, Acting Chairman

Executive Directors	Alternate Executive Directors
	A. A. Al-Tuwaijri
M.-A. Autheman	M. Sirat
	G. A. Heinen, Temporary
I. Fridriksson	J. A. Solheim
	T. Oya, Temporary
K. P. Geethakrishnan	A. Raza, Temporary
	K.-T. Hetrakul
D. Kaeser	K. Link
	P. Rubianes, Temporary
	E. V. Kotova, Temporary
G. Lanciotti	E. Quattrociocche, Temporary
	J. M. Burdiel, Temporary
	M. J. Mojarrad, Temporary
	M. A. Hammoudi, Temporary
	Y. Patel, Temporary
	J. Dorrington
	O. Havrylyshyn
	T.-M. Kudiwu, Temporary
	E. Wagenhoefer
	W. Laux, Temporary
A. S. Shaalan	Y. Y. Mohammed
	G. F. Murphy
	J. M. Abbott, Temporary
E. L. Waterman	
	Wei B.
A. G. Zoccali	A. F. Jiménez de Lucio

L. Van Houtven, Secretary and Counsellor
S. L. Yeager, Assistant

Also Present

IBRD: D. Dollar, M. Ward, East Asia and Pacific Regional Office. Central Asia Department: B. B. Aghevli, Deputy Director; V. Arora, M. Bell, M. Braulke, J. Dodsworth, O. Evans, D. J. Goldsbrough, U. R. Gunjal, Y. Horiguchi, Y. Metzgen, C. Mulder, Y. Yokoyama. External Relations Department: J. Starrels. Fiscal Affairs Department: D. C. L. Nellor. Legal Department: F. M. Zeidan. Monetary and Exchange Affairs Department: J.-P. Gollé, E. Milne. Policy Development and Review Department: T. Leddy, Deputy Director; S. B. Creane, N. L. Happe, A. K. McGuirk, E. van der Mensbrugghe. Southeast Asia and Pacific Department: C. M. Browne. Treasurer's Department: D. Williams, Treasurer; K. Boese, W. J. Byrne, J. C. Corr, H. Flinch, D. Gupta, P. R. Menon, G. S. Tavlas, R. Thorne. Advisors to Executive Directors: S. K. Fayyad, N. Mancebo, R. Meron, J. W. van der Kaaij. Assistants to Executive Directors: C. D. Cuong, G. Z. El-Masry, A. Galicia, N. P. Hahnemann, S. Ishida, K. J. Langdon, S. C. McDougall, S. del C. Olgiati, R. K. W. Powell, S. K. Regmi, S. Rouai, A. Sighvatsson, J. B. Wire.

1. VIET NAM - ECONOMIC PROGRAM FOR 1993-94

The Executive Directors considered a staff paper on the 1993-94 economic program for Viet Nam (EBS/93/154, 9/15/93). They also had before them the following statement by the Managing Director:

> As Executive Directors are aware, the recent mission to Viet Nam reached understandings with the authorities on an economic program for 1993-94. The program, as reflected in the staff paper, aims, inter alia, to sustain economic growth at a rate of 7-8 percent per year, reduce inflation to 7 percent by the end of 1994, and significantly strengthen the international reserve position. The Vietnamese authorities have indicated that once their arrears to the Fund have been cleared, they intend to request Fund support for their program under a stand-by arrangement and a first purchase under the systemic transformation facility (STF).
>
> Under Fund policies, management will not submit a member's request for the use of Fund resources to the Executive Board as long as the member concerned has overdue obligations to the Fund. However, to facilitate the work of the Support Group for Viet Nam, which is mobilizing the resources for the clearance of Viet Nam's arrears to the Fund, and to give Executive Directors an early opportunity to study the authorities' program, I instructed the staff to circulate the paper describing the program.
>
> In the last several weeks, the Support Group for Viet Nam has made great progress in mobilizing the resources needed to clear Viet Nam's arrears to the Fund through pledges by donors and arrangements for bridge financing. It appears that sufficient resources will be available to clear Viet Nam's arrears on October 5, 1993. The Vietnamese authorities and the participants in the bridge financing operation wish to minimize the duration of the bridge loan. To assist in this matter, I propose that the Executive Board discuss Viet Nam's economic program today, but that the decisions on the lifting of ineligibility and the use of Fund resources be taken up on October 6, 1993 after the clearance of arrears. On October 6, 1993, Viet Nam is also expected to consent to and pay for its proposed quota increase under the Ninth General Review, following which its requests for the use of Fund resources under a stand-by arrangement and the STF would be submitted for Board consideration.
>
> The proposed course of action, which is similar to the exceptional procedure followed at the time of clearance of Peru's arrears, would be consistent with the policy of not submitting requests for the use of Fund resources by a member as long as it is in arrears to the Fund. At the same time, by limiting the duration of the bridge loan, this expedited procedure would assist

Viet Nam, which has a strong record of cooperation with the Fund, to clear its arrears to the Fund.

The staff representative from the Central Asia Department said that although the latest data received from Hanoi were fragmentary, there were indications of continued good economic performance. The rate of industrial output growth in the first half of 1993 exceeded 10 percent, while the rate of inflation through September, on a 12-month basis, remained at about 8 percent. On that basis, the end-1993 inflation rate might be less than 12 percent, the rate projected in the staff paper. On the external side, gross official reserves had increased during August in line with the program target.

The initial policy measures envisaged under the program were being implemented, the staff representative from the Central Asia Department remarked. Tax measures, including an increase in selected consumption taxes, had been introduced with effect from September 1. On the monetary side, credit from the State Bank to the banking system had declined in line with the program, while interest rates on refinancing had been unified and increased ahead of schedule. Interest rates on deposits had been reduced marginally during September, but still remained firmly positive in real terms.

Mrs. Hetrakul made the following statement:

On behalf of my Vietnamese authorities, I would like to express my profound gratitude for the continued support that the Fund has been providing in assisting the acceleration of the normalization of my authorities' relationship with the Fund and the World Bank. The valuable advice from the Fund over the past few years has guided Viet Nam along its long journey on the difficult road of transformation. With the implementation of stabilization and market-oriented structural reform measures, visible progress has been made in many areas, and step by step, the economy is being revitalized, despite the external shocks resulting from the termination of aid and trading arrangements with its former partners in the Council for Mutual Economic Assistance (CMEA) and among the states of the former Soviet Union.

My authorities would also like to convey their sincere appreciation to the members of the Support Group for Viet Nam, particularly the Governments of France and Japan, who head the Group. Without their support this clearing of arrears would not be possible. Special thanks go to countries donating grants--namely, Austria, Australia, Belgium, Canada, Finland, France, Japan, Sweden, and Switzerland--as well as to the Banque Française du Commerce Extérieur (BFCE) and the Export-Import (EXIM) Bank of Japan, which arranged syndicated bridge financing so that sufficient resources will be available to clear Viet Nam's arrears. Last, but not least, the recent breakthrough in this endeavor could not have taken place without the close cooperation of the United States in removing some of the obstacles to the normalization process.

The clearing of arrears will permit Viet Nam to begin its full integration into the world financial community so that the country's development potential can be fully realized.

Despite limited international support, the Vietnamese economy has been progressing well. Gross domestic product rose at the rate of about 7.5 percent during the first half of 1993, while inflation remained on a downward trend, reaching an annual rate of 8 percent by July 1993. However, the intensified development efforts have led to an acceleration of domestic credit expansion and, consequently, strong pressure on the balance of payments. In the fiscal area, expenditures increased sharply owing to the legislative decision to adjust civil service wages and the increase in the capital budget to finance infrastructural projects. At an average monthly rate of about $25, the wage adjustment for civil servants was necessary to maintain a high morale in the civil service so as to ensure the success of the reform program. Investment in electricity generation and distribution was also essential in the face of rapidly growing energy demand for industrialization, particularly in the southern part of the country.

Progress in privatization has been slow owing to the lack of consensus on the speed and the modalities of the process. However, a new constitution was promulgated in 1992, which institutionalized the transition toward a free market economy. In the summer of 1993, important new laws were legislated to provide farmers with all the benefits of land ownership as well as to improve the climate of foreign investment.

On policy issues, my authorities are committed to, and will make their utmost effort in, implementing the economic program as elucidated in their letter of intent. The authorities will ensure a sustained output of 7 percent in 1993 and 8 percent in 1994, while the inflation rate will be reduced to 10 percent and 8.5 percent, respectively, during the corresponding periods. In the meantime, my authorities will pursue cautious macroeconomic policies to avoid an overheating of the economy and to prevent a resurgence of inflation. They plan to tighten credit policy, restrain current budget expenditures, expand the tax base, and improve administrative capacity for revenue collection. My authorities intend to continue their flexible exchange rate policy under which the rate will be determined by market forces and limited foreign exchange intervention will be used only to smooth short-term fluctuations.

In addition, my authorities will accelerate the implementation of the structural reforms required to move to a market-oriented system. During 1993-94, steps will be taken toward fiscal reform, restructuring state-owned enterprises, financial sector reform, and exchange and trade liberalization. Efforts will be made to regularize Viet Nam's relations with creditors, with the aim of containing the debt-service burden and maintaining it at sustainable levels.

My authorities are committed to implementing the policies described in the economic program to the fullest extent, and they would like to reassure the Board that they stand ready to take additional measures, as necessary, to ensure that the overall objectives of the program are achieved. In this connection, my authorities would like to reiterate their confidence in the Fund's experience and expertise in designing programs for their country. They would also like to express their enthusiasm for the Managing Director's April 20, 1993 manifestation of his concern for "the human suffering caused by the prolongation of the transition." In this respect, they are encouraged by the Fund's growing emphasis in its deliberations on conditionality on equity and the social impact of each Fund-supported program.

Mr. Autheman made the following statement:

Today's meeting marks the end of a difficult process and, we hope, the beginning of a new period for Viet Nam. We have come to the end of a process of normalizing Viet Nam's relations with the international financial community. On Tuesday evening, Viet Nam will have eliminated its arrears vis-à-vis the Fund. My authorities are extremely pleased with this outcome, which was made possible thanks to the efforts of the international community and the determination of the Vietnamese authorities.

As you recall, as early as 1991, France launched a series of informal meetings of the friends of Viet Nam devoted to that result. Last week, France and Japan chaired a formal meeting of the Support Group for Viet Nam that paved the way for today's Board discussion by finalizing the settlement of Viet Nam's arrears.

Viet Nam's arrears will be cleared through bilateral grants totaling $55 million, from nine countries, including France, and a bridge loan, syndicated by the BFCE, in close cooperation with Japan's EXIM Bank, which will be disbursed tomorrow. On behalf of my authorities, I would like to thank all the countries that have participated in this effort. I would also like to warmly thank the staff which, once again, has demonstrated its readiness and efficiency. It is now time for the Fund to further exert its influence in order to foster stability, reform, and strong growth in Viet Nam.

I would like to commend the Fund staff for the speed with which it has devised and agreed an economic program with the Vietnamese authorities. The results of Viet Nam's adjustment efforts are already impressive, even more so in light of the adverse environment that this country has faced in recent years. These are not small achievements, but there is still some room for progress. I refer here not only to structural reform, but also to slippages in the policy mix in the first half of 1993.

I fully share the staff's appraisal regarding Viet Nam's present situation and the definition of an appropriate economic program.

As regards fiscal policy, the slippages that occurred in the first half of 1993 were clearly linked to the implementation of the civil service wage reform, which seems to have been ill-advised. Whereas the objective of this reform is to put into place a clearer wage bill that would allow for better pay for fewer civil servants is fully appropriate, the implementation has raised concerns and needs to be improved. Moreover, the savings expected from the reform have not yet materialized; rather, the monetization of benefits has led to increases in public spending.

Strengthening the role of the private sector in the economy is of key importance considering Viet Nam's assets, particularly its labor force and natural resources. Moreover, this would have a dramatic impact on how Viet Nam is perceived by international markets and investors. It could lead to a notable increase in foreign direct investment, which is currently at a very low level. Thus, the timely clarification of the legal status of the domestic private sector is of crucial importance.

As to the Fund's involvement in Viet Nam, today's discussion should be only a first step, as access to Fund resources should certainly aim at preparing for a program to be supported under the ESAF successor. This seems indispensable in the medium term in view of Viet Nam's low per capita income and the need for structural reform. I would appreciate some indications from the staff regarding a possible time schedule for an ESAF program for Viet Nam.

France fully supports Viet Nam's eligibility for use of the STF. As is clearly explained in the staff paper, Viet Nam has suffered a major systemic shock with the collapse of its trade with other CMEA members.

I strongly hope that an arrangement with the Fund will trigger substantial financial assistance by other multilateral institutions as well as the much-needed debt alleviation within the framework of the Paris Club. I might add that France, as one of Viet Nam's largest creditors, will support Viet Nam's access to generous concessional treatment of its obligations to Paris Club creditors.

Mr. Oya made the following statement:

I would like first to express to Mr. Geethakrishnan and his authorities the heartfelt sympathy of my authorities, as well as my own, for the tragic loss of life caused by the recent earthquake in India.

Tomorrow, after much effort, Viet Nam's arrears to the Fund, which have been accumulating for almost ten years, will be cleared. I would like to welcome Viet Nam's return to the international financial community. This can be regarded as a historical event brought about by international coordination.

On behalf of my authorities, who co-chaired the Support Group meeting on September 27, I would like to thank the donor countries that participated in that meeting. As many as 9 of the 15 participating countries pledged grant contributions for the clearance of Viet Nam's arrears, and most participants expressed their readiness to contribute balance of payments financing for Viet Nam. It has been confirmed that the arrears will be covered by grant contributions, and we have been assured that the estimated financing gap for 1994 will be closed.

I commend the authorities for having embarked on the transition to a market economy as early as 1986 and for having decisively implemented a number of economic reform measures, which have resulted in good economic performance. I commend the authorities also for reaching an agreement with the Fund on a program in support of their request for a stand-by arrangement in combination with the use of the STF. I believe that these decisive efforts encouraged donor countries and led to positive support at the recent Support Group meeting.

I also would like to express my appreciation to the staff and management for negotiating an economic reform program with Viet Nam in a short period of time with limited staff resources. I recognize the considerable demands placed on the Central Asia Department, which was simultaneously involved in negotiations with Cambodia.

The staff also did an excellent job of constructing and working out the details of the scheme for clearing arrears, especially the bridge loan. Arranging a bridge loan was difficult because the loan is to be operated by France and Japan, neither of which is accustomed to operations in the United States. The staff gave helpful advice and made the necessary arrangements to enable the operation to be completed in only two days. I also would like to thank the U.S. authorities for their consideration for the operation of the bridge loan.

For our part, Japan announced at the Support Group meeting that it stood ready to provide Viet Nam with a grant of $15.1 million from the Trust Fund set up in the Fund and, for balance of payments financing, to provide an amount equal to the combined contributions of the World Bank and the Asian Development Bank.

The clearance of arrears is scheduled for tomorrow, and Viet Nam will return to the international financial community with a request for a stand-by arrangement and a purchase under the STF. This means that economic reforms in Viet Nam have been accorded international support. I would emphasize that it is crucial for Viet Nam to make every effort to reach an agreement on an arrangement under the ESAF successor by implementing all the measures incorporated in the program to be supported by the stand-by arrangement.

In concluding, I would call on donor countries to participate in the international effort to support Viet Nam so as to assure that the momentum shown in the clearance of its arrears will continue in the period ahead.

Mr. Waterman made the following statement:

I thank the Managing Director and the staff for their efforts, which have allowed early consideration of this proposed economic program for Viet Nam. The normalization of Viet Nam's relations with the Fund has involved a great deal of hard work and effort. The staff has combined its usual professionalism with a sense of urgency and a great deal of common sense. We also owe much to the work and leadership of the Governments of France and Japan in their role as co-chairs of the Support Group for Viet Nam. The work undertaken by their representatives on the Board has been particularly important. The United States has also played an important facilitating role.

We were happy to have been able to play a role in the clearance of Viet Nam's arrears to the Fund, and it will be my pleasure to lend my support to Viet Nam's request for the use of Fund resources this coming Wednesday. Continued financial and technical support will be of critical importance as Viet Nam enters into a new era of reform, and I would urge existing and potential donors to support the country in its efforts.

We all recognize that the clearance of arrears is only the first step toward a better future for Viet Nam. Viet Nam's recent economic performance has been impressive, especially taking into account the impediments that the country has faced over the past 30 years or so. Growth is strong, inflation is considerably lower, and export activity is picking up. Yet, significant improvements in economic management are needed. The program under consideration pinpoints many of these areas and sets important steps in motion toward achieving long-term sustainable growth and development in Viet Nam.

Naturally, the proposed program to be supported by a stand-by arrangement has a shorter-term perspective. The emphasis on controlling spending, improving revenue, and better monetary management are, however, appropriate, especially in view of the slippages in these areas in the first part of 1993. I join the staff in urging fiscal restraint and a slowdown in the expansion of domestic credit. This is necessary not only to ensure a successful first review under the proposed stand-by arrangement but, more important, for the stability of the Vietnamese economy.

The intended request for a purchase under the STF underscores the need for an economic strategy with a longer-term focus and greater emphasis on structural change. I agree with the authorities' wish, which is supported by staff, to move toward negotiating a medium-term program that might be supported by an arrangement under the ESAF successor. While recent growth in Viet Nam has been high, substantial structural adjustment as well as improvements in financial management will be required if Viet Nam is to replicate the performance of other dynamic Asian economies while achieving control over inflationary pressures.

In her statement, Mrs. Hetrakul has underlined her authorities' strong support for the program and their readiness to take additional measures, if necessary, to ensure that its overall objectives are achieved. As I am in broad agreement with the staff appraisal and welcome the program that has been developed, I have no hesitation in supporting it.

Mrs. Wagenhoefer observed that among all of the countries with overdue obligations to the Fund, Viet Nam had one of the best records in meeting its current obligations and in cooperating with the Fund on economic policies. It was therefore gratifying that conditions would soon be met for Viet Nam to fulfill its financial obligations and to normalize its relations with the Fund.

She welcomed the authorities' economic program for 1993-94, Mrs. Wagenhoefer continued. The program was particularly important at a time when the financial situation was showing signs of a rapid and even dramatic deterioration owing to the substantial loosening of financial policies in the first half of the year, which had led to a significant deterioration in the external current account balance. The staff and the Board had repeatedly pointed out the risks involved in such a policy stance, and it was regrettable that the authorities had not taken earlier steps to tackle the emerging problems. She hoped that that was not an indication of a setback in the history of close policy cooperation with the Fund at the very moment when that cooperation was bearing fruit. In that connection, she noted that the loss in net international reserves in the first half of 1993 subsequent to the loosening of financial policies amounted to about $320 million, or more than twice the amount needed to settle Viet Nam's overdue obligations to the Fund.

She hoped that the agreed program would reverse the current tendencies, Mrs. Wagenhoefer stated. Without the change of policies foreseen under the program, much of the progress that Viet Nam had achieved so far in financial stabilization would be reversed; that would not be in the interest of the country. The envisaged tightening of the fiscal stance under the program was therefore both welcome and necessary. It was also important that the authorities succeed in retiring the major part of Viet Nam's concessional refinancing, which had significantly increased in the first part of 1993, and that monetary aggregates be kept under close control. The successful implementation of the program would also establish a track record following the policy deviations in the first half of the year and provide the basis for a successor program with a medium-term orientation.

The Vietnamese economy had displayed remarkable growth rates in past years, Mrs. Wagenhoefer observed. At the same time, much remained to be done in order to enable Viet Nam to achieve the ambitious growth targets underlying the staff's medium-term scenario. Attaining growth rates of 7-8 percent required a substantial increase in investment over the medium term. The staff's medium-term scenario assumed an increase in the investment/GDP ratio to about 20 percent by 1998. While that was a substantial increase compared with the current rate of 12 percent, it remained to be seen whether it would be sufficient to generate such high growth rates. It should be kept in mind that the average investment/GDP ratio for fast-growing developing countries in the late 1980s and early 1990s was about 26 percent. For Asia, the average investment/GDP ratio was about 30 percent--substantially more than the level assumed sufficient in the case of Viet Nam. She would be interested to hear the staff's comment on that point.

An essential prerequisite for achieving higher investment levels was a considerable increase in domestic saving, Mrs. Wagenhoefer commented. It therefore appeared that in the medium term, a stronger reduction in the fiscal deficit than envisaged in the program might be needed. In that context, she noted that Viet Nam had achieved considerable success in mobilizing additional revenues, as underlined by the fact that the revenue/GDP ratio had risen by several percentage points since 1991. However, the increase in revenue had been outpaced by a much larger increase in the expenditure/GDP ratio. Current expenditure in 1993, for example, was programmed to be 8 percentage points higher than two years earlier. Capital expenditure would be about 4 percentage points higher than in 1991. It was also interesting to note that the program relied to a large extent on additional revenue measures to achieve the intended improvement in the fiscal deficit, while efforts to reduce current expenditure were basically limited to restraining the fiscal effects of the ongoing wage reform for the civil service.

The staff pointed out that the tax system was still weak and that there was substantial room for improvement, Mrs. Wagenhoefer recalled. Nevertheless, she wondered whether more attention should be given to reducing expenditures. A determined effort to accelerate the envisaged retrenchment of the civil service should, therefore, be given the highest priority. She also understood from the staff paper that the authorities planned to reduce nonwage current expenditure by 0.5 percentage point in 1994. However, it appeared that the discussion on the concrete measures to be taken was still at a preliminary stage. As the rapid expansion of government expenditure was the main source of the increase in the budget deficit, she believed that further attempts to reduce the deficit had to focus more on government spending.

The other prerequisite for strengthening savings was reform of the financial system, Mrs. Wagenhoefer considered. She agreed with the staff that banking reform would be a critical element in any strategy to secure the basis for growth in Viet Nam. She also agreed with the staff on the need for a general overhaul of the restrictive external trade regime. Both elements should be included in any medium-term program.

Viet Nam was a country of great potential, and it would be most welcome if Viet Nam would proceed on the path of structural reform in order to free up that potential and if the Fund could assist in that process, Mrs. Wagenhoefer stated. She believed that the authorities' program deserved the Fund's support.

Mrs. Kotova made the following statement:

> To facilitate the restoration of Viet Nam's access to international financial assistance, the Board is turning to an exceptional procedure, as was pointed out in the Managing Director's statement. However, I would focus instead on the exceptional circumstances and challenges that the country faces at present. Viet Nam confronts problems typical of countries in transition from a centrally planned to a market economy; it also has a full spectrum of problems typical of a low-income country. Moreover, the country is experiencing problems rooted in the termination of aid and trading arrangements with traditional partners and has to completely rebuild its external strategy. We welcome the fact that nontraditional approaches were found to deal with such an exceptional situation.

Despite these challenges, the Vietnamese economy has been progressing reasonably well. It is most impressive that the authorities have managed both to maintain conditions for economic growth and to reduce inflation from an annual level of 300 percent to 30 percent. It is noteworthy that, despite external debt difficulties, Viet Nam steadily demonstrates good cooperation with the international financial community, and the Fund in particular. We hope that the provision of the stand-by arrangement and the purchase under the STF, once arrears to the Fund are cleared and the requirements for the increase of the country's quota are met, will facilitate new steps down this road.

At the same time, precisely because the country has numerous problems of different origin and at this particular stage of its reintegration into the world financial community, it is indispensable to establish clear policy priorities that can be adhered to not only under the present program, but also under follow-up programs in the medium term. From this standpoint the program has certain room for improvement.

Of the envisaged measures, administrative and institutional improvements might be given immediate priority. It is worrisome that the country still lacks a range of market-based policy instruments. I sense that the authorities are constantly balancing between the objectives of growth and stabilization, and the recent easing of financial policies means sacrificing stabilization and systemic efforts to the objectives of maintaining growth and external viability. This is not a viable strategy in the long run, and points to the need to develop institutional capacity for market-based economic management. Among the problems that can be addressed reasonably quickly are the streamlining of the tax system, which is currently weak and overcomplicated; revision of the priorities of monetary policy; revision of the excessively ambitious civil sector salary reform; development of the regulatory framework for enterprise reform; and the revision of trade regulations. I would put special emphasis on the completion of the legal reform and, more generally, on the legal aspects of the above-mentioned systemic efforts.

As to the specific features of the program, it is commendable that the increase in the overall wage bill of the civil service sector has been revised. However, even the present, more modest increase puts considerable pressure on the budget and calls for further consideration. The envisaged increase in the total wage bill might not be indispensable if the monetization of all in-kind benefits is fully completed, and especially if the authorities find ways to reduce public service employment in general. The opening up of new job opportunities in the emerging private sector might be an appropriate solution. In any event, the country does not seem to be able to afford the luxury of an increase in the wage bill next year that is equivalent to more than one half of its total requirements for concessional assistance in the same year.

On the policies related to the banking sector and, more generally, the monetary stance, the authorities are trying to restrict the growth of domestic lending in anticipation of a resurgence of inflation. At the same time, they are trying to increase private sector access to the formal banking system. For this purpose a number of special policies and refinancing schemes are being introduced. I am afraid that they only further complicate the existing procedures and might be harmful to sound banking practices and the efforts to control monetary aggregates. The authorities could instead consider phasing out all direct lending of the central bank to the state-owned enterprises and channeling financial resources to public companies entirely through domestic commercial banks. This would help to tighten fiscal and monetary stance as well as put the state-owned enterprises on an equal footing with the emerging private companies, thereby improving the competitive environment and making it more conducive to private sector development. It would also push forward somewhat the enterprise reform in the public sector. The experience of many other transitional economies shows that unless the state-owned enterprises are subject to tough financial constraints, it is difficult to accelerate either the privatization or the restructuring of the state enterprise sector.

On external sector developments, certainly, Viet Nam will need access to financial assistance in the near future. With the implementation of the authorities' commitments on the systemic front, the country will enter into the next phase of reform, which will be, at least, no less costly than the present one. It is important now to achieve the maximum possible normalization of relations with creditors and to obtain realistic rescheduling schemes for the accumulated debts and arrears. This is another immediate priority for the country. My authorities are fully aware of the scope and the nature of Viet Nam's requirements for assistance and rescheduling and are giving them the most serious consideration. In this respect, I note from the footnote on page 19 that Viet Nam has initiated negotiations to restructure its debt to the Russian Federation, but that "there is yet no agreement between the Vietnamese authorities and creditors on the appropriate exchange rate for the conversion of transferable rubles into convertible currencies." Could the staff elaborate on what other creditors hold claims on Viet Nam in transferrable rubles and why the exchange rate for the conversion could not be established according to the Fund's recommendation to my authorities at the time of the unification of the ruble exchange rate.

With these remarks, I endorse the proposed program.

Mr. Fridriksson made the following statement:

I am pleased to note that Viet Nam's arrears with the Fund are in the process of being cleared, and that Viet Nam continues to cooperate with the Fund. With a high economic growth rate and a significant decline in inflation, the performance of Viet Nam's economy has been impressive over the last few years, in spite of adverse effects owing to the loss of CMEA-trade and the cessation of assistance from the former Soviet Union and other CMEA countries. Nevertheless, the recent fiscal and monetary relaxation is cause for concern, and needs to be reversed promptly.

The progress that Viet Nam has achieved so far has been made without the benefit of an arrangement with the Fund, and with only limited access to external financing. In the period from 1989 to 1992, Viet Nam therefore financed its high economic growth rate and its balance of payments deficit, to an important extent, through the accumulation of arrears to external creditors.

In 1993 growth has continued to be buoyant, but the financing seems to have shifted to a drawdown of external reserves combined with domestic monetary easing. The relaxation of economic policies perhaps reflects to some extent the constraints on Viet Nam's access to external financing and underscores the pressing need to normalize relations with external creditors.

Viet Nam clearly stands to benefit from a Fund-supported program, as it will allow for a strengthening of stabilization and reform efforts and will open up other sources of external financing. In view of Viet Nam's previous satisfactory economic performance--with only minor external assistance--it is likely that it will perform well under an arrangement with the Fund.

Once the arrears with the Fund have been cleared, Viet Nam will be eligible for the use of Fund resources; and I will be ready to support a request to that effect. In view of Viet Nam's stage of development, however, external financing on nonconcessional terms should be kept to an absolute minimum. I agree therefore with Viet Nam's preference for an ESAF arrangement and hope that such an arrangement will be negotiated as a matter of high priority. In the interim, a stand-by arrangement with the Fund would permit a rescheduling under the Paris Club, which is very much needed.

The 1993-94 economic program appears to be relatively cautious with respect to structural reform and adjustment. Exchange and trade policies are to be liberalized, but important nontariff barriers and a multiple currency practice are to remain. One actually gets the impression that structural reform is stalling, which is unfortunate. It must be speeded up again in order to further the increase in investment that will be required to maintain a high rate of GDP growth. Comments from the staff on the structural reform program in general would be welcome as would comments on plans to corporatize profitable state enterprises. According to the paper, the authorities plan to introduce legislation on bankruptcy by December, but what are their plans with respect to property ownership legislation?

The slippages in macroeconomic policies during the current year originate in a significant increase in government expenditure, leading to an increase in the budget deficit and a deterioration in the current account of the balance of payments. The increase in current expenditure is partly due to the phased implementation of a wage reform. This reform seems to be a necessary and unavoidable step in order to promote efficiency in the state sector. I agree, therefore, that revenue-enhancing measures should be an important element in the 1993-94 economic program. However, even with these measures, the budget deficit remains at a high level, which is reflected in a significant balance of payments deficit. Further measures might therefore be called for. It is, in this respect, not completely clear why, at a later phase in the wage reform, the average salary level has to be increased by 50 percent. This is probably an effect of the planned widening of the dispersion of the pay scale, but perhaps a less ambitious approach might be advisable on this score, while still--as the staff suggests--accelerating the retrenchment of government employment.

Further measures to contain public expenditure are also called for, in view of the Government's investment in the north-south electricity transmission line. As Viet Nam is a low-income country with a relatively high debt-service ratio, I agree with the staff that borrowing on commercial terms for this project should not form part of Viet Nam's development strategy.

Viet Nam's capacity to service external debt has risen significantly in recent years, and the debt-service burden is projected to decline to a manageable level in the coming years owing to the continued buoyancy of economic activity and diminishing financial imbalances. In the present circumstances, it is important that private domestic saving and nonbank domestic financing of the budget through treasury bills are promoted. The banking system reform and the elimination of administered interest rates, which is part of the 1993-94 economic program, is crucial in this respect.

In conclusion, Viet Nam has demonstrated its intention to reform and stabilize the economy in difficult circumstances and has made impressive progress. As external financing becomes available, Viet Nam will be able to develop rapidly.

Mr. Abbott made the following statement:

Since the Board will not be able to review the proposed decisions on Viet Nam's request for the use of Fund resources until tomorrow, I will limit my comments today to the economic situation in Viet Nam and the merits of the proposed program.

From the staff's assessment of the economic situation and the proposed program, it is now clear that the expansionary monetary and fiscal policies pursued by the authorities during the course of 1993 have resulted in a significant reversal of earlier progress toward macroeconomic stability. As a result, and in the context of continued strong growth in real GDP, the downward trend in inflation has been reversed, and Viet Nam is experiencing a significant deterioration in its external accounts.

We share the staff's view that without decisive corrective measures, a dangerous inflationary spiral could materialize and further balance of payments difficulties could develop. Furthermore, we are disappointed that there has been little progress this year on much-needed structural reforms critical to the development of a market-based economy, such as reform of the financial sector, restructuring and privatization of state-owned enterprises, and elimination of practices that distort the pricing and allocation of foreign exchange. Viet Nam clearly must redouble its efforts to ensure macroeconomic stabilization and adjustment, and do so in a fashion that will broaden the role of the private sector and the scope of market forces. This requires not only a substantial tightening of fiscal and monetary policies, but also a much more vigorous effort to implement structural reforms, particularly those that will enhance the development of the private sector.

We thus are encouraged by the array of measures in the proposed stand-by arrangement and agree fully with the staff's recommendations. Previous speakers have commented on these in detail, so I would just underscore some key issues.

The most important task for the authorities is to regain control over monetary aggregates and the fiscal deficit. Further erosion of price stability may be unavoidable this year, but a prompt tightening of both fiscal and monetary policy could go some distance toward reversing unsustainable trends and advancing the reform process.

On the fiscal side, the degree of erosion during 1993 is discouraging. The authorities must ensure that the planned increase in capital spending takes place as envisioned, within the parameters of an overall reduction of the fiscal deficit and their established practice of avoiding recourse to bank financing. Like the staff, we would also prefer that the authorities abandon any plans for nonconcessional borrowing. While increased foreign financing should provide some scope for increased public investment, it will also be important to boost revenues through new measures, rationalize existing tax measures, and move forward with an across-the-board improvement in tax administration. On the expenditure side, we agree with the staff that the planned wage reform plan would be overly stimulative and should be scaled back, and that it must be accompanied by accelerated efforts to reduce the public work force. As well, a real reduction in defense expenditures merits serious consideration.

As the Central Government's fiscal deficit is not being monetized, and interest rates are at positive real levels, monetary policy must focus on reduced credit to state enterprises. As well, control of monetary aggregates could be considerably improved through the adoption of more indirect tools. To do this, problems in the treasury bill market will need to be rectified, and a much simplified and market-determined system of interest rates will need to be adopted.

We welcome the scope of the structural and external measures planned to support a stand-by arrangement, as described in Table 9 of the staff paper. Of course, these measures will need to be extended and strengthened should Viet Nam be in a position to utilize resources under the ESAF successor. Three areas deserve immediate attention. Financial sector reform is required to improve the State Bank's ability to conduct monetary policy and to establish an efficient market-based financial infrastructure that will emphasize the role of private institutions, particularly in the banking sector. The scope for private sector activities needs to be widened as far as possible through the restructuring and privatization of state-owned enterprises and through the elimination of the present list of products and services reserved for the state sector. Finally, the numerous trade restrictions must be lifted, and the exchange rate system should be reformed to eliminate practices that distort the pricing and allocation of foreign exchange.

In conclusion, the actions envisioned under the proposed program should help reaccelerate the process of economic reform, increase the role of market forces in the economy, and permit continued strong economic growth and substantial capital investment that will increase economic opportunities for the people of Viet Nam. On Wednesday we will be prepared to take positions on the various decisions to be proposed by management tomorrow.

The staff representative from the Central Asia Department recalled that some concern had been expressed about the lack of adjustment in nonwage current government expenditure at a time when tax revenues were envisaged to rise to a high level. He tended to agree that more should be done in that respect in the coming period, but in the context of the proposed program the envisaged reduction of 1.5 percentage points of GNP in the current expenditure category in 1994 was perhaps all that could be achieved. Specific expenditure-reduction measures would be a matter for discussion in the context of the forthcoming Article IV consultation scheduled for mid-November.

It should be noted that in the past, the authorities had exhibited a tremendous ability to cut current expenditure when there was an absolute need to do so, the staff representative continued. For example, current expenditure had been reduced from 17.8 percent of GDP in 1989 to 12.5 percent in 1991. The recent reversal of that trend would be a critical issue for discussion with the authorities.

Concern had also been expressed that the projected rise in the investment/GDP ratio--to 20 percent under the staff's medium-term scenario--was somewhat modest compared with that of other Asian countries in the late 1980s and early 1990s, the staff representative recalled. It should be noted that an increase to 20 percent represented an increase of about 8 percentage points of GDP, which was substantial. Moreover, in the past, Viet Nam had repeatedly achieved a low incremental capital output ratio, possibly indicating the great efficiency of capital investment in generating additional output. At the same time, the low ratio might reflect measurement problems. Thus, when looking at past, current, and future levels of investment, the effect of possible measurement errors should be kept in mind. The Fund was supporting a number of technical assistance programs to strengthen Viet Nam's statistical capability, and with progress in those areas, measurement issues should be clarified.

The structural measures that the staff would recommend in the period immediately ahead were summarized in Table 9, and he had nothing to add in that respect, the staff representative stated. As to the reform of the legal system, as noted in the staff paper, the land use law had recently been promulgated and had entered into force. Two other major pieces of legislation would be put into place in the near future. The first was a labor law aimed at increased labor mobility and the other was the bankruptcy law. The staff was somewhat concerned, however, that the coverage of the latter might not extend to the state enterprise sector, where such a law was absolutely needed to harden the budget constraint. Many other areas of the legal system would be looked at in the context of the staff's work, in collaboration with the World Bank, on a policy framework paper and a possible program to be supported under the ESAF successor.

As regards public enterprise sector reform, the authorities had recently relicensed all enterprises that seemed to be viable, the staff representative continued. About 30-40 percent of existing enterprises had not been relicensed, and their future was unclear. The staff would be watching developments with respect to those enterprises in the coming period. As to equitization, progress in that area had, unfortunately, been slow. To date, there had been only one instance of equitization, but a number of cases were pending, and further progress could be expected in the near future.

Ownership in the banking sector was an important but politically sensitive issue, which the authorities were keeping under close review, the staff representative commented. As the staff continued its work with the authorities toward an ESAF-type program, it should be in a better position to say more about bank ownership as well as the general question of ownership.

As to the timetable for a possible ESAF-successor program, the staff would hold its Article IV consultation discussions with Viet Nam in mid-November, at which time it hoped to agree with the authorities on a draft policy framework paper, the staff representative remarked. On the basis of that paper, the staff would like to begin negotiations on an ESAF-type arrangement, perhaps in the context of the first review under the stand-by arrangement, which was currently scheduled for late February 1994. If the policy discussions with the authorities went smoothly, it might be possible to bring a request under the ESAF successor to the Board before mid-1994.

The footnote on page 19 referred to the staff's understanding regarding negotiations between the Vietnamese authorities and creditors holding claims in transferrable rubles, the staff representative from the Central Asia Department explained. Other CMEA creditors were Poland, Bulgaria, and Hungary. As the issue was highly technical, the staff would propose to take up the questions that had been raised in that regard on a bilateral basis.

Mr. Quattrociocche made the following statement:

> A substantial step forward in the process of reintegrating Viet Nam into the world financial community is being accomplished. The clearance of arrears to the Fund, which is expected to take place tomorrow, will give this Board the opportunity to consider Viet Nam's use of Fund resources. This chair stands ready to support Viet Nam's request for a stand-by arrangement and for access to the STF, in the light of the authorities' economic program for 1993-94 and the good prospects for debt relief and additional bilateral support.
>
> The key policy issue in the accomplishment of Viet Nam's economic stabilization is how to pursue the appropriate degree of demand restraint--with a view to containing inflationary pressures--without hampering growth prospects. The staff rightly suggests a restrained stance of financial policies, and we agree that the containment of inflation should be the primary goal.
>
> Monetary policy has a key role to play in this endeavor. Credit policy is to be set to secure a steady accumulation of

external reserves and a lower rate of monetary expansion. The envisaged growth of broad money seems to be consistent with growth and inflation targets, but the authorities should stand ready to review the appropriateness of the monetary and credit targets, taking into account developments in macroeconomic indicators. Bank lending to the public sector should be kept at low levels, so as to enable banks to extend credit to the private sector to support growth without compromising financial stability. Financial sector reform should also be given absolute priority, with a view to improving monetary control and promoting financial discipline in the banking system, as well as making interest rates market determined. Indeed, even though interest rates are substantially positive in real terms, their prompt and complete liberalization would give considerably more effectiveness to the instruments of monetary policy at the authorities' disposal.

On the fiscal side, the effort to enhance government revenues and contain budget expenditures is a key part of the adjustment process. Strict discipline in the execution of the budget is vital for achieving the public investment and monetary targets. We welcome the authorities' commitment to current expenditure restraint, but we share the staff's concerns about the speed, or lack of it, with which the retrenchment of government employment is being carried on. Much also remains to be done to streamline and rationalize the tax system. Although tax measures are more far reaching than in the past, additional refinement would be required to significantly raise the tax/GDP ratio. In this connection, I would appreciate staff comment on why the value-added tax--which would certainly help broaden the tax base--has not yet been adopted.

Structural policies should aim at restructuring the public enterprise sector, reducing production costs, and stimulating diversification of the economy. In this connection, it is regrettable that public enterprise reform is not keeping pace with expectations. This should become a more central element of the adjustment program so as to enhance the operational efficiency and budgetary contributions of the enterprises themselves. Besides, a less gradual approach to the opening up of certain economic activities to the private sector would be warranted. At the same time, the economic and business climate would greatly benefit from a much clearer definition of property rights than the halfway solutions considered up to now. Failure to promptly address this delicate issue could undermine investors' confidence at a stage when confidence is most needed and could constitute a stumbling block to Viet Nam's development.

The staff's baseline scenario suggests that Viet Nam can expect to enjoy a sustainable growth rate of about 7-8 percent a year over the medium term, if current inflationary pressures can be reduced. This would be an extremely favorable outcome. However, its realization will depend to a large extent on the continued pursuit of supply-enhancing and market-opening measures designed to strengthen both the confidence and the efficiency of Viet Nam's private sector. Viet Nam's medium-term prospects underline the need for caution in the framing of macroeconomic policy, and boldness in the pursuit of further liberalization and reform. So far, the authorities have proven to be up to their task, and I have no doubts that they will be able to drive their economy onto a sustainable, low-inflation, high-growth path that will allow for an increase in living standards and the achievement of their social objectives.

Mr. Wei made the following statement:

At the outset, I would like to express appreciation to the donor countries for their contribution in helping Viet Nam clear its arrears to the Fund. I also commend the staff for its diligence and efficiency in designing the program. Viet Nam's economic performance has been remarkable over the past few years owing in large part to the authorities' prudent macroeconomic policies and systemic reform measures. In view of the resurgence of excess demand pressures during the first half of 1993, I am convinced that the economic policies envisaged in the 1993-94 program are in the right direction to achieve sustained economic growth and deepen reforms. Since I am in broad agreement with the staff appraisal, I will make some brief remarks on some aspects of the program.

On fiscal policy, as one of three revenue-raising measures, receipts from imports are expected to increase following the replacement of import prohibitions on 13 products with tariffs as well as increased duties for steel and other products. However, both the volume and value of imports might be constrained by tighter financial policies. In this context, I wonder whether revenue targets will be achieved if import receipts fall short. I would appreciate the staff's comments on this point.

We welcome the authorities' intention to take measures in the envisaged program and in the medium term to move toward indirect monetary controls. However, the necessary foundation for indirect monetary management should be laid before completely relinquishing the old tools so as to avoid the emergence of a vacuum between the dismantling of the old system and the setting up of the new one.

The use of indirect instruments such as reserve requirements, rediscount windows, and open market operations requires a well-functioning debt instrument market in addition to an institutional setup. In this context, it is encouraging that the authorities have indicated that during the program period they will make efforts to develop domestic currency and debt instrument markets. In this connection, the central bank's issuance of short-term notes for open market purposes is welcome in the absence of a mature short-term treasury market. However, the accumulation of an excessive amount of such debt will handicap the central bank's ability to adjust the stance of monetary policy to changing economic situations, either domestic or external. Therefore, once circumstances permit, the use of central bank debt notes should be reduced.

Following Viet Nam's normalization of financial relations with the international community--including the Fund--and the clearance of overdue external debt obligations, increasing amounts of capital inflows will be forthcoming. Even though domestic credits are to be tightened further, increased capital flows might lead to an increase in net foreign assets, and thus exert pressure on the money supply. In this connection, I advise the monetary authorities to remain vigilant with regard to the timely adjustment of their monetary stance by taking into account the expansionary effects of possible large capital inflows on the growth of monetary aggregates. We are pleased to note Mrs. Hetrakul's statement that the authorities stand ready to take additional measures, as necessary, to ensure that the overall objectives of the program are achieved.

In conclusion, we stand ready to support Viet Nam's request for a stand-by arrangement and a purchase under the STF.

Mr. Heinen made the following statement:

With the country on the point of clearing its arrears to the Fund, today's Board discussion on Viet Nam's medium-term economic program is especially important. The staff is to be commended for producing an excellent paper from a statistical data base that is still less than ideal, even though the authorities have begun to improve their statistical capacity with the aid of technical assistance from the Fund. The authorities are also to be commended for the good economic track record they have been able to establish without having received much direct foreign assistance. Real GDP growth is now steady at about 7 percent a year, inflation has dramatically decreased from its 1988 levels, and the exchange rate is stable vis-à-vis the U.S. dollar following a 15 percent appreciation in 1992.

Even though this track record has been marred since early 1993 by a marked relaxation of fiscal and monetary policies, it should be noted that most of the relaxation probably resulted from anticipation of a rapid resumption of external assistance, which at the beginning of the year seemed realistic. It is thus fair to assume that following tomorrow's settlement of arrears, concessional aid flows will solve some of the balance of payments problems caused by premature spending on crucial infrastructure. In this connection, it is timely that the World Bank is planning priority assistance to Viet Nam in three crucial areas, namely, primary education, highway rehabilitation, and agricultural credit and extension services.

The authorities' 1993-94 program, which has been worked out in collaboration with the staff, appropriately emphasizes stabilizing the overall macroeconomic framework and moving ahead with systemic reforms. We would therefore stress only two points in this discussion.

The wage reform just getting under way is a courageous step away from the bloated and inefficient bureaucracy common to countries with a history of central planning. According to the staff, a 20 percent reduction in the civil service is planned to offset the planned dispersion of the pay scale while increasing the average salary level by 50 percent. I would appreciate some elaboration on what social safety nets are in place and how many layoffs are actually involved.

We support the staff's recommendations on further reducing trade barriers so as to promote allocative efficiency. Here, the planned rationalization of the tariff system and the liberalization of the import permit and licensing systems will be most useful. However, we would exclude any nontariff barriers--for example, the import quota on cigarettes--as long as they represent deliberate public policy measures on the part of the authorities. Such measures would have to be accompanied by corresponding disincentives--for instance, high consumption taxes--against domestic production. Does the staff know to what extent the authorities are limiting the importation of certain commodities for public policy reasons or for other reasons, such as protection?

We would like to congratulate the French and Japanese co-chairs of the Support Group for Viet Nam for fostering a broad participation of donors to arrange the grants and bridging loans to help Viet Nam clear its arrears. This chair is looking forward to the Board's discussion of Viet Nam's requests for the use of Fund resources.

Mr. Dorrington made the following statement:

My authorities welcome this discussion and the circumstances surrounding it. Although the United Kingdom was not able to contribute directly to the arrears clearance operation, we have recently established a substantial program of grant-financed technical assistance to Viet Nam, much of which is to help with macroeconomic management issues that are relevant to this program.

We welcome the commitment of the authorities to narrowing the fiscal deficit. My main continuing concern on the fiscal side is that large public sector pay increases are scheduled to continue into 1994. Moreover, while several tax measures have been taken to raise revenue and improve tax coverage, the system remains weak and, in many ways, overcomplicated. I would therefore strongly urge the authorities to take full advantage of the Fund's technical assistance in this area, including in establishing effective methods of monitoring and controlling expenditure.

As to monetary policy, inflation has been brought down substantially. But, more recently, the indicators show that credit policy has again been relaxed, albeit to increase the private sector's access to credit. It is most important that the authorities implement their plans to tighten credit.

Taking the numbers at face value, the medium-term prospects for the balance of payments appear to be quite good. The staff's figures show an immediate cash flow problem, which will certainly require an extensive rescheduling from official bilateral creditors. But the projections show debt ratios apparently falling quickly to relatively comfortable levels. Of course, there is a substantial amount of uncertainty over the size of the external debt stock, and the issue will have to be dealt with in the Paris Club. But without prejudicing those discussions, my advice to the authorities would be to think seriously before giving the impression of having an insurmountable insolvency problem that can only be solved by debt or debt-service reduction in the Paris Club. I am not saying that we would wish to stand in the way of that route, but from the perspective of Viet Nam's best interest, the judgment might prove to be a finely balanced one. I would be interested to hear the staff's thoughts on this.

In the end, if Viet Nam were able to protect its creditworthiness and, hence, its image in the international financial community, it could enhance its access to new financial flows, as well as encourage greater flows of foreign direct investment.

Viet Nam is well positioned to become the next Asian Tiger economy. Great steps forward have already been made. But there is a long way to go, and full implementation of this program represents an important next step.

An STF arrangement has the advantage over a stand-by arrangement of a longer repayment period. The Paris Club, however, will probably insist on an upper credit tranche arrangement, which points to a stand-by arrangement. The staff view is clearly that

Viet Nam is eligible for the STF, and I do not disagree. Indeed, I look forward to agreeing to Viet Nam's requests. I would, however, be interested to know what the thinking is behind the precise mix of resources that is being proposed.

Mr. Kaeser made the following statement:

In previous Board and Support Group meetings this chair has always called for, and acted on, a normalization of relations between the international community and Viet Nam. On those occasions, we commended the progress achieved by the Vietnamese authorities in reforming their economy according to market-oriented principles.

Today, we are glad to see that Viet Nam is on the verge of reintegrating completely into the international community by clearing its arrears to the Fund and normalizing its relations with creditors. In the short run, Viet Nam will gain access to Fund resources in the framework of a stand-by arrangement and a purchase under the STF, to be followed by a program to be supported under the ESAF successor. We endorse this strategy, which will allow Viet Nam to consolidate, accelerate, and complete the pace of macroeconomic stabilization and structural adjustment as well as mobilize substantial concessional loans and grants.

As to the 1993-94 economic program, we endorse the key macroeconomic objectives, particularly the pursuit of strong economic growth, the containment of the existing inflationary pressures, the strong reduction of inflation by end-1994, and the buildup of net foreign assets of the banking system. On the structural front, we welcome the authorities' commitment to reform the tax system, to further liberalize the trade system, and to let interest rates be determined by market forces.

With respect to fiscal policy, we share the staff's view that the authorities need to streamline the tax system with a view to enhancing state revenues through improving tax collection and widening the tax base. Moreover, such a reform should mitigate the distortive nature of the present tax system. On the expenditure side, the strict control of both current and capital expenditures must be enforced, and the implementation of wage reform is crucial in this respect. We wonder whether a 20 percent reduction of government employment is a realistic assumption and would appreciate some further elaboration from the staff on this point. We welcome the existence of what the authorities define as a relatively extensive social safety net, but it is difficult to assess this mechanism on the basis of the limited information provided in the staff paper. We would have welcomed more detail on that point. We are concerned by the measures that are planned to reduce health care expenditures and other public services in a country with widespread poverty. We would appreciate further elaboration by the staff on the possible social consequences of these measures. On capital expenditures, we support the staff's warning that nonconcessional borrowing must be avoided or at least be kept under strict control. I wonder whether the staff has a clear indication whether it will prove possible to mobilize up to $800 million of concessional assistance in the years to come.

As regards monetary policy, we urge the authorities to implement--in combination with a tight fiscal policy--sound financial measures aimed at fighting the actual resurgence of inflation. To this end, a strict tightening of domestic credit is crucial. We share the staff's view that a comprehensive banking system reform should be a major element of the authorities' medium-term adjustment program. Indeed, this reform will foster private domestic saving as well as the efficiency of financial intermediation and resource allocation.

In our view, the authorities' exchange rate policy is appropriate under the present circumstances. However, we would like to see a more rapid liberalization of the exchange and trade systems; in particular, import restrictions should be lifted as soon as possible. We support the staff recommendation not to approve the multiple currency practice related to the existence of a tax on profit remittances from foreign direct investment. We urge the authorities to set a clear timetable to eliminate these restrictions.

On external debt issues, we agree with the staff that Viet Nam should seek to obtain, on concessional terms, the restructuring of external arrears and the rescheduling of debt obligations from the Paris Club as well as other creditors. In this respect, we urge the authorities to stick to the program and eliminate all external arrears by end-June 1994.

I would appreciate some clarification from the staff on one point. I cannot understand fully the background of the striking relaxation of policies that occurred at the beginning of this year. The staff paper provides some economic reasons, but strong political forces also seem to be at work. For example, the staff indicates that the increase in rents, insurance premia, and education fees "have been retained by relevant authorities." I would be interested to know whether there is strong opposition to the reform and stabilization policies inside the Government and administration and, if so, whether it represents a danger for the fulfillment of the program.

With these comments, we support the 1993-94 economic program and look forward to approving Viet Nam's request for the Fund's financial support.

Mr. Shaalan made the following statement:

I am heartened by the extent of the support that the international community is extending to Viet Nam, and welcome Viet Nam's impending clearance of its arrears to the Fund.

Although much remains to be done, Viet Nam has been consistent in its commitment to structural reform since 1986 and in its adoption of stabilizing macroeconomic policies. Indeed, the fruits of its policies have been manifest since 1989 in terms of a strong GDP growth and a significant reduction in inflation. The fact that an extensive social safety net system was already established must have contributed to making the process of structural reform both palatable to the population and feasible overall. Allow me to add that this particular aspect of Viet Nam's experience in economic reform may carry instructive lessons concerning the Fund's structural reform programs in low-income countries or in economies in transition.

The Vietnamese authorities have, however, relaxed their fiscal and monetary policies during the first half of 1993, although there is some justification for that relaxation as it reflected, in part, a temporary but necessary outlay for a power transmission line connecting the northern and southern parts of the country. In this respect, I hope that the projected tightening of fiscal and monetary measures during the second half of 1993 and in 1994 will be carried out by the authorities. This will make the objective of the single-digit inflation of 7 percent by the end of 1994 a more realistic prospect.

I share the staff's assessment of Viet Nam's positive economic performance and favorable prospects.

Mr. Havrylyshyn made the following statement:

The Vietnamese authorities have in the recent past been undertaking steps toward stabilizing and reforming the economy. I expect that this program and the financial support of Viet Nam's balance of payments needs will solidify and accelerate these past efforts and reverse the relaxation of policies noted by several Directors. I am in broad agreement with the staff paper, and would support the proposed program subject to completion of Support Group discussions. I have only a brief remark on certain structural reform issues.

The program, perhaps appropriately, focuses on stabilization efforts, but may inadequately emphasize structural reform. Perhaps this will be the focus of a successor program; nonetheless, particularly on the financial side, I would have preferred something more than what is envisaged under the 1993-94 program, as monetary policy continues to rely entirely on direct measures through a complex system of administered interest rates. At the same time the incipient private financial sector is at a disadvantage vis-à-vis the state-owned banks and needs to be allowed to function freely as soon as possible. There is also a need to introduce prudential regulation and a banking supervision mechanism. An early effort in this area would increase confidence in the banking system and, hence, in the domestic currency. In the same spirit, I believe earlier consideration could have been given to trade liberalization, especially in view of Viet Nam's already successful first steps in world export markets. I make these remarks with the hope such shortcomings can be addressed as soon as possible, and certainly by the time an ESAF successor program is developed.

Mr. Zoccali made the following statement:

The Vietnamese economy has made substantial progress in recent years, reflecting in large part the authorities' commitment to stabilization and structural reform as well as the persevering efforts of the Support Group and the Fund to bring about yet another successful case of normalization of relations with the international financial community.

As I endorse the thrust of the staff's appraisal and policy recommendations and share previous Directors' comments, particularly those of Mr. Quattrociocche, I can be brief.

Notwithstanding the good economic performance through September, sustaining high growth rates with lower inflation will require a stable macroeconomic environment supported by firm financial policies so as to facilitate the structural transformation. This is an area where much remains to be done, including setting up an appropriate legal and regulatory framework; modernizing the financial system; and accelerating public enterprise reform, privatization, and trade liberalization in order to improve efficiency and sustain investment.

In view of the progress made by the Support Group in mobilizing the resources needed by Viet Nam to clear its arrears with the Fund and the otherwise strong record of cooperation shown by the authorities since the end of 1988, and despite the slippages observed during the first half of the year, this chair endorses the Managing Director's proposal for dealing with the lifting of Viet Nam's ineligibility. We also stand ready to support Viet Nam's request for the use of Fund resources on the basis of the economic program envisaged for 1993-94, which if adhered to, marks the beginning of a new phase of development for Viet Nam.

Mr. Mojarrad made the following statement:

We are pleased by the imminent clearance of Viet Nam's arrears to the Fund, and we stand ready to support the authorities' request for the use of Fund resources. We welcome Viet Nam's preparedness to normalize its relations with all external creditors and to embark on a comprehensive macroeconomic and structural reform program that could be supported by the Fund and other creditors. We would like to take this opportunity to commend the efforts and financial support that have contributed to reinforcing the credibility and usefulness of the intensified collaborative approach in resolving the problem of arrears to the Fund. It is all the more gratifying for the Fund since today's Board agenda includes also the normalization of Cambodia's relations with the Fund, as well as the review of the progress achieved by a former arrears case, namely, Guyana.

We have had the opportunity during the frequent reviews of economic developments in Viet Nam to appreciate the authorities' efforts to move toward a market-based system. This commitment was reflected in the measures introduced since 1986 and centered around land reform, price liberalization, tax reform, and exchange rate unification. The result has been a strong rate of economic growth, reduced inflation, and an improved external position. These achievements are all the more commendable because the country operated with limited financial support and access to foreign markets while enduring the impact of the collapse of the CMEA trading system.

We encourage the authorities to build on this progress by cooperating with the Bank and the Fund to formulate a comprehensive medium-term adjustment program designed to capitalize on the potential of the Vietnamese economy, particularly its location in the high growth and dynamic area of South East Asia.

In the meantime, the authorities should seek through the implementation of the 1993-94 program to re-establish a stable macroeconomic environment and to correct the financial imbalance. To this end, the authorities are encouraged to adhere to rigorous fiscal and monetary policies in order to reverse the expansionary trends allowed in the beginning of 1993. In addition, and in order to sustain the momentum of reform, we would emphasize the importance of reforming the tax system and liberalizing the trade regime and interest rates.

In view of the significant progress achieved by Viet Nam and the authorities' commitment to move rapidly toward a more open economy, creditor and donor support of the country's efforts through the provision of appropriate rescheduling and adequate concessional financing is essential. We look forward to the authorities' request for a stand-by arrangement and a purchase under the STF.

Mr. Raza made the following statement:

I welcome the efforts made by the friends of Viet Nam to help clear its arrears to the Fund and thus pave the way for the normalization of its relations with the multilateral institutions. I welcome this discussion on Viet Nam's request for a stand-by arrangement and a purchase under the STF.

In 1986, Viet Nam started to dismantle its centrally planned economic system and embarked on a wide-ranging and comprehensive program of macroeconomic stabilization and structural reform. Its record in this respect is commendable--even more so because it pursued reform measures despite an adverse external environment and without much support from the international community.

Its record of progress during this period is equally impressive--in fact, it is much more impressive and credible than that of any other country in transition. In terms of growth of output, the progress can only be compared with that of other dynamic economies of Southeast Asia. Thus, during the five years ending 1993, real GDP grew by nearly 7 percent--agriculture by nearly 4 percent, industry by 6 percent, and services by almost 11 percent. During the same period, the rate of liquidity growth has been brought down from 190 percent to 27 percent. The inflation rate has been reduced from 96 percent to 10 percent over the period, and to 8 percent for the 12 months ending in July 1993. On the fiscal side, tax revenue increased from 4.5 percent of GDP in 1989 to over 15 percent of GDP in 1992, and is programmed to reach 18.3 percent of GDP this year. Although current noninterest expenditure remains high, it has generally been kept within a narrow range of 15-19 percent. The fiscal deficit was reduced from 8.5 percent of GDP to just about 3 percent of GDP. The record of progress clearly demonstrates the determination and unwavering commitment of the authorities to go ahead with the program even against heavy odds.

There have, of course, been policy slippages. The three areas that readily come to mind are monetary policy, fiscal policy, and the functioning of state enterprises. The visible slowdown of the process of structural reform is also unfortunate.

As regards monetary policy, signs of the slackening of demand management policies were clearly visible during the first half of 1993. During the year ending June 1993, domestic credit expanded by 47 percent and broad money by 34 percent. Moreover, although interest rates on deposits have been adequately raised, they seem to be somewhat higher than lending rates; this will neither promote healthy growth of the banking system nor ensure the efficient allocation of resources.

The looseness of fiscal policy is reflected in the sharp increase in current expenditure owing to public sector salary reform and the consequent increase in the fiscal deficit, both on cash and accrual basis, during 1993. Expansionary financial policies have put pressure on the balance of payments. As regards state enterprises, their ready access to bank finance has not only contributed to the large liquidity expansion but apparently has also discouraged these enterprises from becoming more self-reliant. These issues need to be tackled on an urgent basis.

Both the staff and Mrs. Hetrakul confirm that the authorities are concerned about these emerging problems and have initiated measures to set the course right. They are according high priority to containing inflation. The authorities should be encouraged to follow a cautious monetary policy, maintain a tight rein on the growth of current expenditure, particularly the civil service wage bill, hasten the pace of privatization, reform the tax structure, and accord high priority to financial sector reform. The restructuring of state enterprises also needs to be expedited. Enterprises should be made more self-reliant and resource efficient.

The broad contours of the economic program for 1993-94 are set out in the staff paper. I am happy to note that in line with the key macroeconomic objectives, the authorities are according high priority to the tightening of monetary and fiscal policies with a view to containing the underlying inflation. They also intend to move forward with systemic reforms in other areas, including tax, interest rate, and trade policies.

On fiscal policy, the staff is right in suggesting that the authorities should go slow in the matter of ongoing wage reforms. Toning up administrative efficiency is a laudable objective. However, I am not sure that a performance-related system of civil service remuneration is necessarily the best way to achieve this. Also, a relatively higher salary does not necessarily attract better talent to the civil service. While on this point, it is also pertinent to note that, according to staff estimates, the proposed high salary level can be sustained over the medium term only if the program of retrenchment of government employment is accelerated. Moreover, while the staff notes the slow progress in this area, it fails to comment on the social and economic consequences of growing unemployment in the country--a problem that, given the nature of the program, is likely to be accentuated over time. Preliminary estimates suggest that the restructuring of state enterprises has resulted in a loss of around 400,000 jobs in 1991-92 alone. This is a serious problem that needs to be addressed before it gets out of hand. The staff has made a passing reference to a "relatively extensive" social safety net, including retraining and employment-creating schemes. There is, however, no indication whether a sizable number of jobs have in fact been created under the scheme. The failure to address the unemployment problem is a serious shortcoming of the program. I would welcome staff comment on this point.

The financial program is designed primarily to dampen the resurgence of inflation. I welcome it. However, to be effective, the monetary authorities need to urgently develop indirect monetary policy instruments. I note that a Fund technical mission has already submitted a comprehensive set of recommendations in this regard. I hope that the authorities will seriously consider these recommendations and act on them expeditiously. I also note that the large increase in bank credit notwithstanding, state-owned banks are maintaining excess reserves with the State Bank. To the extent excess reserves are unremunerated, I wonder why banks maintain such reserves. Does this indicate a lack of lending opportunities?

I am pleased to learn that the authorities have at last been convinced of the need to reform the complex interest rate structure and have agreed to move toward market-determined rates. This will improve the allocation and the efficiency of bank lending. While on this point, I understand that, henceforth, while the determination of lending rates will be left to the market, subject to a ceiling and floor set by the State Bank, deposit rates will continue to be administratively determined. In my view, as deposit and lending rates are two sides of the same coin, reforming one without reforming the other will only create distortions.

As regards the medium-term scenario, the staff has rightly emphasized the urgent need for a sharp increase in investment not only to add to the capital stock but also to the efficiency of the existing stock. This will, however, require a large increase in the savings by public, government, and state enterprises alike. The need for large concessional external assistance to supplement domestic savings would also remain.

The 1993-94 program is a bold exercise. In view of their past track record, I am convinced that the authorities will fully implement it. I support the program. I also endorse the request for a stand-by arrangement and am convinced of Viet Nam's eligibility to use the STF. I support the proposed decisions.

The 1993-94 program should, however, be only a beginning. The authorities should follow it up with a medium-term adjustment program.

Mr. Al-Tuwaijri said that he wished to join previous speakers in welcoming Viet Nam's clearance of its arrears and the normalization of its relations with the Fund. Certainly that was a direct result of the close cooperation between the Vietnamese authorities, the staff, and the donor community. It was an effort that deserved to be commended. He had no hesitation in supporting the authorities' economic program and the eventual use of Fund resources under a stand-by arrangement and the STF.

The staff representative from the Central Asia Department, commenting on why the value-added tax was not yet in force, observed that the first step toward the introduction of the value-added tax was being taken in the form of reducing the complications in the turnover tax. It was envisaged that a full-fledged value-added tax would take some time because such a tax required an extensive change in the administrative structure. Nonetheless, it was the authorities' intention to move in that direction.

It was possible that a number of steps to be taken toward liberalizing trade, including a reduction in tariffs, would have a temporary negative impact on government revenue, the staff representative remarked. The program, however, included measures to offset any impact--which was not expected to be large--by other tax measures as outlined in the staff paper.

As to the current safety net, according to the World Bank's extensive work in that area, Viet Nam's safety net was relatively well advanced, in light of the country's stage of development, the staff representative commented. The safety net primarily consisted of job creation programs and retraining schemes. In consultation with the World Bank, the authorities were looking closely at that aspect of policy, and the staff would provide Directors with an update of developments in that area at the time of the first review of Viet Nam's program.

On debt rescheduling, the economic program assumed that Viet Nam would receive enhanced concessions from Paris Club creditors and similar treatment from other creditors, the staff representative stated. In making that assumption, the staff had taken into account that Viet Nam was an IDA-eligible country in view of the fact that its current per capita income--at about $200--was only one quarter of the operational cutoff level for IDA lending. In addition, Viet Nam's debt burden was heavy, with ruble-denominated debt amounting to almost Ru 11 billion and debt to convertible currency area creditors amounting to $3.8 billion. In the medium-term scenario, the debt-service ratio was assumed to decline to a relatively manageable level over the medium term, but that was precisely because the staff had assumed enhanced concessions in 1993 and early 1994. Otherwise, the debt-service burden would be onerous.

The specific mix of financing that had been proposed took into account Viet Nam's need for a program with upper credit tranche conditionality--namely, under a stand-by arrangement--in order to fully normalize relations with the international financial community, including Paris Club creditors, the staff representative explained. However, following a thorough analysis of the comprehensive data that had been provided during the staff mission to Hanoi, particularly on trade with the CMEA, the staff had concluded that Viet Nam was eligible for the STF, with a maximum access of 50 percent.

The staff had consulted with the authorities about the mix of financing, and they had indicated a preference to draw a limited amount under the STF besides drawing under the stand-by arrangement, and to see the effects of the collapse of trade with the CMEA taken into account in the determination of Viet Nam's access under a possible ESAF-type arrangement, the staff representative stated.

The staff had had an opportunity to discuss the extent of domestic political support for the authorities' ambitious program on the occasion of a visit with the Deputy Prime Minister of Viet Nam, the staff representative remarked. The Deputy Prime Minister had reaffirmed that the authorities were prepared to fully support all elements of the program. In view of Viet Nam's policy track record and the political support of the highest authorities, the staff believed that Viet Nam would stick to the program.

As to the prospects for attaining the public civil service retrenchment target of 20 percent, it should be noted that since the end of 1990, a retrenchment of 8 percent had been achieved, the staff representative commented. The wage increases envisaged in the program, although lower than the budgeted amount, would play havoc with stability in the fiscal position as well as macroeconomic stability if substantial retrenchment, however difficult, was not achieved. Thus, attaining the target was an important element of the staff's negotiations with the authorities and of any future program.

On the feasibility of mobilizing the $800 million in concessional assistance in the medium term as envisaged under the program, it should be noted that in relation to the size of the economy, that amount would only keep pace with the amount of financing--$500 million--that, as a percentage of GDP, was being envisaged for 1994, the staff representative explained. Moreover, the Asian Development Bank planned to commit about $250 million and the World Bank about $350 million over the period, with different speeds of disbursement. In that light, it was possible that the amount of concessional financing might exceed $800 million. Nonetheless, the efforts of bilateral donors would still be needed to fully finance the program.

On the consistency of savings behavior and the incremental capital output ratio (ICOR), he wished to note that Viet Nam's low ICOR was perhaps also related to the fact that a centrally planned economy had been liberalized in a relatively rapid manner, the staff representative commented. Technical progress and its efficiency gains were furthermore reflected in the ICOR, which was a rough gauge for the efficiency of capital investment. It was possible that the two factors--the efficiency of investment and the technical efficiency that was generally attributable to changes in the economic regime--were both present. In any event, the technical progress to be achieved from further reforms could be expected to diminish as the reform process continued because of the great impact of the first reform package. As the staff assumed that the ICOR would rise in the future, the program envisaged higher savings and investment to support the projected economic growth.

It had been suggested that the emphasis on reform in the program was inadequate, the staff representative from the Central Asia Department recalled. He would note that in view of the extensive need for reform, any program would look inadequate. The staff considered that it had done all that it could to reach a viable agreement with the authorities on policies that they could feasibly implement and enforce in the program period. It remained to be seen whether the authorities were prepared to follow up with the kind of reform program that would be needed to support an ESAF-type arrangement in the future.

Mrs. Hetrakul said that she wished to convey to the Board that the current meeting marked one of the most joyous days for her Vietnamese authorities. After ten years, Viet Nam was walking toward the end of the dark tunnel and was beginning to see some light. That, however, could not have happened without the strong support of its friends in the international financial community, particularly France and Japan. In that connection, she wished to reiterate her authorities' gratitude for all the assistance extended to Viet Nam, both financial and technical, as well as for moral encouragement. Special thanks were due to donor countries, namely, Austria, Australia, Belgium, Canada, Finland, France, Japan, Sweden, and Switzerland, and also to the Banque Française du Commerce Extérieur and the Export-Import Bank of Japan, which had made possible the clearance of arrears for Viet Nam.

She also wished to express the high appreciation of her authorities for the Fund's support and leadership and for the excellent program designed for Viet Nam, Mrs. Hetrakul continued. Without the guidance and strenuous efforts of the Managing Director and the staff, the economic performance of Viet Nam would not be at its current stage of development.

She also wished to thank Directors for their constructive comments and support, which would be faithfully conveyed to her authorities, Mrs. Hetrakul remarked. The staff's complete and comprehensive responses to Directors' comments and questions were greatly appreciated.

As she had mentioned earlier, her Vietnamese authorities were looking forward to pursuing the economic program outlined by the staff, and they had reaffirmed their intention to take additional measures, as necessary, to ensure that the overall objectives of the program were attained, Mrs. Hetrakul concluded.

The Executive Directors concluded for the time being their discussion of Viet Nam's economic program for 1993-94. 1/

2. CAMBODIA - PURCHASE TRANSACTION - SYSTEMIC TRANSFORMATION FACILITY

The Executive Directors considered a staff paper on the 1993-94 economic program for Cambodia together with Cambodia's request for a first purchase under the systemic transformation facility (STF) in an amount equivalent to SDR 6.25 million (EBS/93/144, 8/26/93; and Sup. 1, 10/1/93).

Mr. Oya made the following statement:

Last Friday, I was informed that Cambodia had cleared its overdue financial obligations to the Fund after more than 18 years. I welcome Cambodia's return to the international financial community.

The efforts to improve Cambodia's relations with the Fund have been fraught with difficulties. Despite the ceasefire agreed under the Paris Accord of October 1991 following a long and devastating civil war, incidents of interfactional violence have been common. Even after the first Support Group meeting was held in January 1993 and sufficient pledges were received to cover the amount of the arrears, progress was slow owing to political conflicts and the general elections.

Despite these circumstances, at the last Support Group meeting on September 28, co-chaired by France and Japan, six of the nine participating countries pledged grant contributions, the total of which was sufficient to clear Cambodia's arrears to the Fund. These countries recognized the importance of helping Cambodia's return to the international financial community at this juncture. Japan, as one of the co-chair countries, commends their willingness to support Cambodia. In addition, I would like to commend the staff and management for their efforts, especially for sending a mission to Cambodia after the formation of the interim government and for completing negotiations on a program to be supported under the STF in a short period of time. I also commend the authorities for preparing a program with quantitative objectives in full cooperation with the Fund and for implementing the economic reform measures for transition to a market economy.

It is also significant that this occasion marks the first time a country outside the former Soviet Union has requested a purchase under the STF. I am pleased to see that the common

---

1/ Viet Nam's request for a stand-by arrangement and a purchase under the systemic transformation facility was approved at EBM/93/141 (10/6/93).

understanding at the time of the STF's establishment--namely, that countries outside the former Soviet Union would be eligible to use the facility--has materialized.

The clearance of Cambodia's arrears is a significant step, but it is only a first step toward economic reform leading to a market economy. I would like to emphasize that because the STF is a temporary facility, it is crucial that Cambodia make an early and smooth transition to an ESAF arrangement--or its successor--by agreeing on a medium-term economic program with the Fund so as to consolidate its economic reforms.

In order to support Cambodia's efforts for economic reform, Japan announced at the Support Group meeting that it stood ready to provide Cambodia with a grant of $29.1 million. In addition, Japan is ready to provide technical assistance to facilitate Cambodia's economic effort.

Economic reforms in Cambodia are beginning to yield benefits, and a new political regime, Royal Cambodia, has just been established. Although Cambodia's prospects are uncertain, the authorities have announced their intention to implement economic reform measures decisively and to cooperate closely with the Fund. The success of Cambodia's economic reform will depend on whether it sticks to its commitment. I would like to suggest that the international financial community encourage Cambodia's efforts toward economic reform in the period ahead. I also would urge more countries to participate in supporting Cambodia so as to accelerate economic reform and help Cambodia establish its credibility in the international financial community.

With these remarks, I support the proposed decision.

Mr. Autheman made the following statement:

Cambodia's situation has clarified markedly since our Article IV consultation discussion in May (EBM/93/65, 5/5/93). Free elections have been held, a new constitution has been adopted, and a formal economic program has been defined in cooperation with the Fund. These developments are further evidence that Cambodia is progressively overcoming the legacy of decades of war, internal strife, and exceptional tragedies, and that it is building upon the first measures that have been put in place, over the last few years, with a view to reforming and strengthening the country's economy.

In this context, a further and major step was taken last week toward the full normalization of Cambodia's relations with the international financial community. Indeed, a group of countries responded favorably to the invitation of Japan and France and settled Cambodia's arrears to the Fund. I thus fully welcome the occasion we have today to discuss the resumption of our institution's financial assistance to a country that urgently needs it and that has already made strong efforts in the framework of its informal program with the Fund.

The STF arrangement before us correctly aims at laying the foundation for a more medium-term program. In Cambodia's circumstances, and after the mixed performance registered in the first half of this year owing to the unsettled political situation during the run-up to the elections, laying the foundation means, first, pursuing the reform process and, second, allowing this process to occur in a stabilized macroeconomic context.

Reforming Cambodia's economic structures--or, more accurately, perhaps, establishing appropriate economic structures--is a task of paramount importance. As stressed by the staff, considerable progress has already been made: the decollectivization of agriculture has been carried out, property rights have been restored, most prices have been liberalized, foreign direct investment has been forthcoming, and many state enterprises have been either closed or privatized.

The authorities have established a detailed timetable for further progress in these areas, and I will just comment on three key priorities.

First, the strengthening of financial administration will be crucial. This should include, in the budgetary area, better expenditure control, debt management, and tax administration. In the monetary area, I fully concur with the staff that the National Bank of Cambodia should concentrate on its central banking and supervision activities.

Second, continued emphasis must be put on the restructuring of public enterprises. I welcome the authorities' intention to formulate a detailed, firm-by-firm program in this area. This program should include, whenever feasible, further privatization but also, for those firms that will remain temporarily in the public sector, provisions for management contracts and full commercialization. In this regard, the adjustment of public tariffs, with a view to covering production costs, should be considered--especially in the electricity sector. More generally, the restructuring program should include bankruptcy provisions as well as an adequate assessment of market structures and the degree of competition in the various industries.

Third, as regards the trade and exchange system, I welcome the authorities' intention to allow for only small and diminishing differentials between the parallel and the official exchange rates. I also agree that the unification of those rates will have to be considered now that stable conditions have been restored in the country. As to the restrictions imposed on agricultural exports, I tend to share the staff's view, and I would thus advise a relaxation of those restrictions so as to increase incentives for local producers.

The full benefit of all those structural reform efforts will not be realized if the stabilization of the economy is not pursued in parallel. The authorities should be commended for what has already be done, despite extremely difficult circumstances, in this area. It is thus especially welcome that the de facto "prior actions" they have implemented, as well as the reduction in political tensions, already seem to have generated positive results in terms of, inter alia, revenue mobilization, and inflation control.

In the fiscal area, I agree that a top priority is ensuring that the recent reversal in the decline of revenues--which are still low at approximately 6 percent of GDP--constitutes a lasting trend. The broadening of the revenue base must therefore be pursued in a determined manner. Expenditures must also be kept under close scrutiny. I welcome, in this latter regard, the authorities' intention to calibrate capital expenditures to external assistance, reduce unproductive expenditures as much as feasible, and keep wage increases at a modest level. In this area, the best way to solve the dilemma raised by the persistence of extremely low real wages at a time when a strengthening of administrative capacities is needed will consist, first, in reducing the risk posed by inflation on real wages--which is being done--and, second, in reorganizing and downsizing the civil service--which is envisaged. A tight control of current expenditures will be needed, in any event, if Cambodia is to increase, over the medium term, its room for maneuver as regards capital expenditure, which will improve growth prospects and social safety nets, thereby facilitating the redeployment of the work force.

In the monetary area, I welcome the information provided by the staff regarding recent price trends. The authorities should continue to exert caution in reducing interest rates, and they should certainly consider the level of inflation and the exchange rate as useful indicators for this endeavor.

In concluding, I would like to insist on the fact that the international financial community must support Cambodia's commendable efforts. Further technical assistance is certainly warranted. Financial assistance will also be needed. France will continue to fully support Cambodia's economy. It will also support, if needed, a regularization of Cambodia's official debt situation, which could take place in the context of a Paris Club agreement.

The resumption of discussions between Cambodia and the World Bank--which, I understand, took place during the Annual Meetings--is certainly a most welcome and most needed development. In view of the immensity of the task ahead in the structural area, the Bank should be forthcoming with financing at a level commensurate with the historic opportunity that now exists in that country.

The role of the Fund, with its advice and its financial assistance, can hardly be overstated. During the last few years, the staff has done a very good job in counseling Cambodia's authorities. When the time is right, we will have to discuss also possible adjustments to Cambodia's quota, which would put a final note to the normalization of our relations with that country. For the time being, and in view of the shock Cambodia has suffered in its external trade and the efforts and commitments it has made, I strongly support the staff's recommendation regarding Cambodia's eligibility to use the STF and on a first purchase under the facility in support of the authorities' program. I look forward to the discussions on a medium-term program, which--in view of Cambodia's GDP per capita--should be supported by an ESAF-type arrangement. I certainly hope that these discussions can take place at the outset of 1994.

Mr. Waterman made the following statement:

The restoration of full relations with the Fund is an important milestone in Cambodia's process of rejoining the international community and revitalizing its economy. I would particularly like to thank my Japanese and French colleagues for their great efforts in ensuring that Cambodia's arrears to the Fund were cleared. And, as for Viet Nam, the efforts of management and the staff have been exceptional.

I welcome Cambodia's access to the STF. It is pleasing that countries in transition outside of the former Soviet Union will be able to benefit from the facility. There is no doubt that Cambodia is a country in transition, and its access to the STF is entirely appropriate.

I agree with the staff that this program should be regarded as a transitional one. As one of the world's poorest countries, Cambodia's intention to move directly from an STF arrangement to an ESAF arrangement is welcome. It is essential that Cambodia move toward a medium-term program of macroeconomic stabilization and structural reform as soon as possible. In the intervening period, this STF arrangement will provide the authorities with the opportunity to establish a good track record in implementing a

Fund-supported program. The importance of that cannot be understated. That all key elements of the informal monitoring arrangement were implemented is indicative of the authorities' resolve.

While the macroeconomic situation was severely disrupted by political developments in the past year, there have most recently been some positive initial signs of movement toward stabilization. The staff paper describes how inflation is now being brought under control. The recent appreciation of the riel is also a significant development. We do not want to understate the challenges that Cambodia faces, but these are positive signs that confidence in the Cambodian economy and in the ability of the authorities effectively to manage the economy are improving.

The staff report on the 1993-94 economic program highlights the early actions that the authorities have taken to improve their revenue base. The rise in revenue has eliminated the need for bank financing of the deficit in recent months--a very positive advance.

Although income levels are very low, with one of the lowest revenue ratios in the world, attention will need to focus on developing additional sources of revenue. However, as indicated in May, we believe that the authorities should concentrate their efforts on improving the existing tax system rather than on moving toward more complex systems of taxation in the short term.

On the financial side, the use of direct credit controls on the commercial banking sector may well be necessary in the short term. But over time, as the economy and the banking system continue to develop, these direct controls should be replaced by indirect methods of monetary control. The authorities' plan to unify the exchange rate is both welcome and important.

A further key element of the authorities' program is the development of institutions of macroeconomic management. Training and institution building will contribute importantly to success on that front. Cambodia will have extensive technical assistance needs for the foreseeable feature. I welcome the technical assistance that has already been provided to Cambodia as well as the impressive list of assistance planned for the coming year.

Cambodia has had to compress imports greatly in recent years. As the staff analysis draws out, Cambodia will have exceptional external financing requirements for many years to come, and the international community will need to be prepared to contribute importantly to that need. I support the proposed decision.

Mr. Abbott made the following statement:

We strongly support Cambodia's request for an STF arrangement. Against the backdrop of a turbulent political situation that spilled over to the domestic economy, the authorities have made reasonably good progress under the informal monitoring arrangement. The recent transition to a permanent government and the adoption of a constitution should help induce a greater element of macroeconomic stability. Indeed, two worrisome trends seem to have been reversed over the past month: inflation is once again declining and the currency has stabilized.

Yet by any measure, Cambodia still faces an extremely difficult situation. The macroeconomic stabilization effort needs to be strengthened to restore price stability and confidence in the riel. The rudimentary institutional capacity for macroeconomic management must be strengthened. Domestic and foreign resources must be mobilized to restore physical and social infrastructure. These are daunting tasks, but with full implementation of the policy framework contained in the STF arrangement and strong support from the international community, the authorities should be able to make further substantial progress toward a market-based economy.

Rapid progress toward price stability is of paramount importance, particularly since the significant acceleration of inflation in the first half of 1993 leaves it well wide of the mark under the informal arrangement. We are encouraged that inflation is expected to fall dramatically in the second half and that the original target for end-1994 is achievable. As the authorities appear to recognize, this will require tightening of financial policies, and in this connection, we commend their resolve to limit bank financing of the budget and freeze new net credit to state enterprises.

We agree that, along with an end to monetization of the fiscal deficit, fiscal policy must be reoriented away from current expenditures toward infrastructure development. We thus welcome the planned reduction in both defense spending and support to state enterprises. However, more progress needs to be made in the near term to reduce both direct and indirect support to state enterprises and to downsize quickly the public sector, in view of the need to compensate for the unsustainable decline in real wages. On the expenditure side, we welcome the news that the customs measures proposed in the staff paper have now been implemented, and look forward to rapid approval of other tax measures before the new parliament. Increased foreign financing should also help fill much of the gap, but we think that the authorities would be wise to stick with their planned contingency measures should shortfalls materialize.

It is critical that the authorities complement their fiscal policy with a tighter monetary stance. As bank financing of the deficit is curtailed and net credit to enterprises is frozen, redirecting liquidity to private businesses will encourage much-needed private sector development. It also will be important for the authorities to keep their commitment to maintain interest rates at positive real levels, to carry out the institutional changes that will more firmly establish the capabilities of the central bank, and to develop more indirect means of monetary control. Of course, increased confidence in the currency and in the banking system will help in these tasks.

We strongly agree with the importance of significantly increasing the quality and scope of bank supervision, including improved licensing procedures and attention to the fitness of owners and managers. However, we are somewhat troubled by the suggestion that too many new bank licenses have been granted, and as a result, some may be rescinded. We are well aware of the importance of well-run and well-capitalized institutions, and can see that there might be too many institutions for such a small financial market. However, we are concerned by the anticompetitive signal that rescinding licenses could send, and also about the implications for well-qualified new entrants, domestic or foreign, that have not yet applied for a license. Our preference would be for a procompetitive policy that permitted both entry and exit rather than a policy that favored a restricted total number of licensees. Could the staff comment on whether prudential requirements could be implemented without arbitrarily limiting the number of licensees?

On the structural side, the detailed timetable of reforms and the early implementation scheduled for many areas is commendable. In addition to the measures to improve the financial sector, a focus on private sector development will be crucial to attracting the foreign investment inflows that Cambodia seeks and needs. In this connection, it will be essential to rationalize and privatize remaining public enterprises, and improve the legal framework for private sector activities.

While mindful of the danger of overloading the reform agenda, we see several areas where faster progress seems warranted, especially in the external sector. In particular, we share the staff's view that the mid-1994 target date for unification of the official and parallel exchange rates is too far off. We would urge the authorities to accelerate this process. In view of Cambodia's weak export base, we also see little reason to retain the export ban on rice, as we understand that the domestic price is not controlled and therefore the domestic market would appear to be clearing.

The staff paper has noted the inadequacies of the present statistical base. Technical assistance in this area is of great importance. As one important example, we note that the consumer price index is defined by a narrow basket of goods for Pnomh Penh only. A broader basket sampled over a wider area would provide a better measurement of price trends.

In view of Cambodia's continuing need for external financing, including as yet unidentified financing for 1994, and the desirability of moving to an ESAF arrangement at some point down the road, it will be important for the authorities to establish a good track record under the STF arrangement. Based on their past performance, we are confident that they will be able to do so.

The staff representative from the Central Asia Department said that limiting the number of bank licenses was not likely to inject an anticompetitive element into that sector. Unlike a number of other countries in the region, Cambodia was experiencing a large inflow of new private foreign banks. The only concern was that so far, the process had been treated administratively within Cambodia as a foreign direct investment issue: the committee that licensed foreign direct investment had been licensing banks. No attention had been paid to other important aspects, namely, whether banks met certain criteria, such as experience and capital backing, in awarding licenses. The staff was urging a halt to that practice. There was certainly no intention to limit the entry of sound groups that could offer competitive banking services.

Mr. Lanciotti made the following statement:

Cambodia is struggling to rebuild an economy shattered by years of war and internal strife. The collapse of traditional trade and financial links with CMEA countries and the still feeble political setting exacerbate the already sizable difficulties associated with the reconstruction process. Against this background, the Government has reaffirmed its commitment to persevere in the process of market-oriented reform and macroeconomic stabilization. The considerable progress already made in reorienting the domestic economic structure on the basis of the tenets of a market economy and the significant prior actions implemented in the area of taxation are clear evidence of this commitment. This is a fruitful starting point, but the road ahead is still long and filled with difficulties. The economic agenda before the Government is broad. It ranges from improving the legal framework for private business to reversing the extensive dollarization of the economy; from creating or strengthening the institutional setting that usually underpins a market economy, to unifying the official and parallel market exchange rates and removing quantitative export restrictions.

Although prioritizing these measures is difficult owing to their implicit synergies, fiscal policy lies at the core of the stabilization effort. In fact, the low demand for riel-denominated assets magnifies the effects of a monetized deficit, negligible in terms of GDP, on inflation and the stock of official reserves. In the first half of 1993, the authorities have shown their readiness to cut expenditures in reaction to a shortfall in budget revenues owing to external trade sluggishness and the lack of appropriate instruments and administration. This effort is commendable but hardly sustainable in light of the need for ensuring the rehabilitation of the most critical public infrastructure and maintaining the delivery of essential services to the population. Strengthening tax administration and broadening the tax base are therefore crucial to keeping budget developments consistent with the stabilization effort.

Monetary stability in Cambodia is plagued by an extensive dollarization of the financial system. Reducing inflation and maintaining positive real interest rates on riel-denominated financial assets are necessary conditions to reverse the process. The recent appreciation of the exchange rate suggests that such a shift might have started. However, the above-mentioned conditions might turn out to be insufficient, and a potential inertia in the de-dollarization process might emerge, if they are not complemented by the restructuring and modernization of the financial sector. An effective two-tier banking system and a central bank with sufficient autonomy to conduct monetary policy and adequate powers to implement banking supervision are essential to developing an efficient, sound, and resilient financial market. This, in turn, is crucial to fostering a better allocation of scarce savings, facilitate payments settlements, and provide instruments for the conduct of monetary, fiscal, and exchange rate policies.

The large investment required to rebuild Cambodia's dilapidated infrastructure coupled with the limited capacity to generate domestic saving makes Cambodia highly dependent on foreign financing. The unpredictability of capital inflows over the medium term implies a degree of risk for the renewed Fund support; a risk, I believe, that the Fund has to bear. At this critical juncture, it is crucial that the Fund support the efforts of the Cambodian authorities in their stabilization and rehabilitation program, thus giving to the international community a clear sign of confidence in Cambodia's prospects. In this light, I endorse the proposed decision, and I hope that Cambodia will be able to move quickly to a more comprehensive, medium-term adjustment program that could be supported by an arrangement under the ESAF or its successor.

Mr. Fridriksson made the following statement:

I am pleased to note that with the clearance of its arrears to the Fund, the way has been paved for Cambodia to use the Fund's resources. This is an important milestone in view of the country's projected large and long-term need for external financing.

It is encouraging that the domestic security situation appears to have improved since the spring. Nevertheless, it is fraught with uncertainty, compounding the challenges that lie ahead.

An encouraging sign in the economic policy area is the apparent determination of the Cambodian authorities to reduce monetary financing of the budget and the priority given to reducing inflation. At the Board's last discussion on Cambodia in May, monetary financing was estimated as running at 2 percent of GDP. The authorities will now limit it to 0.1 percent of GDP for the second half of 1993 according to the economic program. Clearly, this is an ambitious objective and, if achieved, would represent a significant change in Cambodia's financial policies. It is equally clear that this objective cannot be achieved if there are shortfalls or delays in disbursements of external financing.

The Fund now assumes a crucial and catalytic role, through its technical assistance and financial support, to bring Cambodia's economic stabilization and reform program onto the right track. This is an economy that--in many respects--is starting from scratch; and the three key elements of the economic program--namely, macroeconomic stabilization, strengthening of the central macroeconomic institutions, and broader structural reforms--are appropriate. In particular, the comprehensive efforts listed under the program's objectives with respect to strengthening the macroeconomic institutions are important. The Fund must provide technical assistance in its fields of expertise. To name just one area, to reverse the collapse in revenue, assistance will be needed on making tax enforcement more effective or improving the administration of existing taxes, and on the introduction of new taxes.

This is only a beginning for Cambodia's economy, but a purchase under a STF arrangement, to be followed as early as possible by an ESAF arrangement, would be an essential step in the right direction.

In present circumstances, the authorities need to move firmly in implementing their current program and in formulating a medium-term program. This requires wide-ranging technical assistance from the Fund and others, in light of Cambodia's limited administrative and technical capacity. In the absence of such assistance, the reform process may become stalled. In the expectation that it will be forthcoming, and in view of Cambodia's efforts to date, I support the proposed decisions.

Mrs. Kotova made the following statement:

We welcome this opportunity to discuss Cambodia's economic program. .The Cambodian authorities are undertaking enormous efforts to maintain sound macroeconomic management and create the preconditions for a systemic transformation. This is being done against an extremely unfavorable background of continuing political instability, an ongoing general security problem, and the collapse of the traditional system of external economic relations. The economic and social infrastructure has deteriorated in this turbulence, and weak export performance has been accompanied by a lack of external financing. Nevertheless, the authorities plan to formulate and pursue an ambitious, well-balanced and carefully calibrated program of reforms. I am confident that, despite the risks associated with the political and external factors, the authorities' comprehensive efforts will soon provide for economic recovery.

In assessing the program, I would like to associate myself with the comments of previous speakers, particularly Mr. Abbott and Mr. Lanciotti. It is especially commendable that both the strategic avenues and the immediate tasks are elaborated upon in the program, and the elements of the contingency planning only strengthen the belief that the program can be implemented as planned. The restoration of macroeconomic stability is being given top.priority, even though it will require slowing down the growth of GDP to about 5.5 percent in 1993 and 1994. Especially commendable is the fact that the program provides a clear picture of how each category of budgetary requirements will be matched with available domestic and external resources. The fiscal objectives are prudent and realistic: efforts are seen both on the revenue and expenditure sides. For example, the authorities intend to keep the public sector wage bill in line with available resources and will not increase salaries, although they are unsustainably low at present. They envisage a certain increase only after a careful assessment of the initial yields from the tax measures taken in the first half of the year. In any event, the authorities are ready to downsize employment in the civil service sector.

Another proof of the quality of the program is that the authorities are resolutely reducing budgetary support to the state-owned enterprises, thus paving the way not only for the rehabilitation of public finance but also for structural reform in the real sector. At the same time, they envisage expanded spending on the rehabilitation of the economic and social infrastructure. Although such programs are extremely costly, in the long run this is the most rewarding strategy for public spending.

Success was observed on the privatization front, with virtually all small enterprises having been either privatized or closed. Without doubt, this contributed to the rehabilitation of public finances and also established a precondition for economic recovery based on private sector development.

Still, both the economic situation in general and in several specific areas is cause for serious concern. The level of revenues--at some 7 percent of GDP--remains among the lowest in the world and is unsustainable. Quite correctly, the program puts at the forefront efforts aimed at increasing revenue collection. Certainly, strengthening tax administration and broadening the tax base are indispensable measures, as envisaged by the program. At the same time, these efforts are obviously not sufficient, and a fundamental solution of this problem cannot be found without a general economic recovery and the creation of conditions for rapid private sector development. To this end, more consideration should now be given to improving the legal framework. I strongly agree with Mr. Abbott that although today the country is not in a position to support the private sector through financial policies, it is time to start developing the required institutional framework for private sector development. In this regard, regrettably little attention is being given to the task of developing domestic financial institutions, and, in general, systemic reforms in the financial sector are largely limited to improving bank supervision. It is worth remembering that nonbank sources of financing have already proved to be of primary importance in the development of the emerging private sector in a majority of the countries in transition.

The program also lacks policies aimed at initiating export growth. Meanwhile, with a highly negative trade balance of the magnitude of $150-200 million, the current account can hardly be kept balanced in the long run primarily through external borrowing. It is hoped that this problem will be given the fullest consideration in designing the mid-term program.

With these remarks, I wish to express the hope that the Cambodian authorities can maintain a strong track record in implementing the program as designed. I endorse the proposed decision.

Mr. Dorrington observed that the last substantive sentence in the staff appraisal stated that "a strong track record on the implementation of both the macroeconomic and structural policies contained in the present transitional program will be needed to help pave the way for the early adoption of a more comprehensive, medium-term adjustment program." That was certainly true. The fact that the Cambodian authorities had shown impressive determination in sticking to the informal monitoring arrangement in difficult circumstances, combined with the fact that they had clearly thought about contingencies as well within the program in support of an STF arrangement, helped to inspire confidence that that would indeed be the case. He therefore agreed with the staff appraisal and the comments of earlier speakers and supported the proposed decision.

Mr. Laux made the following statement:

I am in broad agreement with the staff appraisal and would like to make only a few points.

Like other speakers, I welcome the progress that has been made in normalizing relations between Cambodia and the Fund. I also have no problems supporting the proposed decision.

Cambodia is facing the daunting task of reconstruction after years of devastating war. Its financing needs are certainly long term and structural in nature, and the country will probably need external assistance on a long-term basis. It also appears--and events in the first half of 1993 underline this fact--that the authorities' ability to influence macroeconomic aggregates is limited and that the economic situation is characterized by a high degree of volatility, uncertainty, and vulnerability to political events. The foremost objective, therefore, must be to strengthen the administrative capacity of the authorities and to lay the institutional foundations for macroeconomic management. I therefore welcome the detailed timetable on institutional measures and the technical assistance that is being provided to the authorities. In this context, I would caution against a premature conclusion of a Fund-supported program as long as we cannot be confident that institutional capacity is sufficiently developed to ensure an orderly implementation of a program and enable the authorities to meet the standard conditionality. As long as these conditions are not met, I see the Fund playing a major role in providing advice and technical assistance to the authorities.

Mr. Wei made the following statement:

It is welcome news that with the assistance of the Support Group, Cambodia has cleared its overdue financial obligations to the Fund, which paves the way for its access to Fund resources.

Although Cambodia continues to face enormous challenges for rehabilitating the decade-long war-torn economy, it is encouraging to note that the authorities have already made progress on many fronts to stabilize and liberalize the economy. However, in view of the continued macroeconomic imbalances and structural impediments to sustained growth--mirrored, in particular, by excessive inflation and a weak external position--more effort has to be made during the 1993-94 program period and beyond.

The initiatives envisaged in the program are well conceived, and recent developments are encouraging. But, in view of the lack of necessary institutional arrangements and trained personnel--important factors in the successful implementation of the program--it seems that some objectives might be too ambitious.

Strengthening tax administration is no doubt in the right direction. But with insufficient well-trained personnel for such work and without a well-established administrative framework, it is difficult to imagine that tax administration will be strengthened significantly within the coming months. In addition, in light of the extremely narrow tax base, there is little room to generate large amounts of additional tax revenue in the short run.

The dollarization of Cambodia's economy is not unique. But the difficulty in the case of Cambodia is that its financial system is undeveloped, and an effective macroeconomic management framework has not been established. Thus, even though a temporary switch back into riel-denominated financial assets has been effected, reversing the extensive dollarization of the economy will be a formidable task. Increases in nominal interest rates will, to a certain extent, be conducive to addressing currency substitution in the economy. However, its success will rely on developments on the inflation front.

All in all, with these concerns, I agree with the authorities that policy actions in the 1993-94 economic program should be along the lines of helping economic rehabilitation. And, given the fragility of the Cambodian economy in the wake of decades of war, the short-term priority should be to foster economic activity, with the aim of improving living standards. In light of the lack of the necessary economic, social, and legal foundations, macroeconomic stabilization and systemic reforms should be formulated and implemented in a medium-term context. In this sense, the 1993-94 economic program is only the starting point for obtaining the Fund's continued financial and technical assistance in the medium term, catalyzing more concessional financial assistance from the international community at large, helping move the economy toward sustained development path in the longer run.

With these remarks, I support the proposed decision.

Mr. Heinen made the following statement:

Having overcome the difficult hurdles of general elections and national reconciliation, Cambodia seems to be getting its economic reconstruction back on track. Although the election process caused great disruption, most notably in the area of revenue collection, it was essential for ensuring long-term economic prosperity. Since we believe that the dismal economic performance of the first half of the year in terms of inflation, tax collection, and external trade mostly reflects this difficult political and economic transition, we do not think that these figures should be given much weight.

Looking to the future, we agree with the staff that Cambodia's potential for growth and stabilization is considerable. For these prospects to materialize, however, several important policy changes will be needed.

First and foremost, Cambodia's fiscal position must be fundamentally altered. Tremendous efforts will be required on the revenue side to increase the revenue base--at 5 percent of GDP, among the world's lowest--to more effective levels. We were therefore somewhat disconcerted to learn from the staff paper that the planned strengthening of enforcement of existing tax laws and the implementation of new tax measures will not increase government revenues beyond 6.5 percent of GDP in 1994. Could the staff explain this anomaly, especially when the present compression is mostly blamed on Cambodia's declining re-export trade to Viet Nam?

On the expenditure side, the sad state of Cambodia's physical and social infrastructures calls for substantial rehabilitation, which will be severely slowed and limited by scarce resources. The authorities' promise to match both current and capital expenditures to the availability of external financing, several times mentioned in the staff paper, is reassuring in terms of inflation control. However, there is doubt that adequate external financing will materialize: the staff itself sees a major risk that private capital and foreign aid flows will turn out lower than expected, leaving Cambodia "no choice but to adopt a slower, and much less desirable, pace of economic reconstruction." Would the staff please elaborate on this issue by providing some figures for such an alternative scenario?

On monetary reforms, we applaud the authorities' goal of unifying the official and parallel market rates of the riel by mid-1994. We agree with the staff that this unification, and the maintenance of positive real interest rates, will be crucial for restoring confidence in domestic financial assets and gradually "de-dollarizing" the economy. The staff paper also indicates that as of end-August, inflation seemed to be trending downward. Can the staff indicate whether this trend is still continuing? What are the implications, if any, for the authorities' liquidity growth targets?

We fully agree with the staff's analysis of Cambodia's eligibility and access under the STF and support the authorities' request for a first purchase under this facility.

Mr. Havrylyshyn made the following statement:

Last Friday, we experienced a milestone in relations between the Fund and Cambodia, when Cambodia cleared its longstanding arrears toward this institution. This paved the way for another milestone we will face today, namely, Cambodia's first Fund-supported program since its compensatory financing purchase in the beginning of the 1970s. I am pleased to see that the Fund is able to play its role in the reconstruction of the country--this role being made possible by the international community and the Cambodian authorities, who have committed themselves to a courageous but necessary stabilization and transformation agenda.

I am in broad agreement with the staff paper, and I support the proposed decision. In view of the extensive Board discussion we had on the occasion of the recent Article IV consultation, I will limit my remarks to a few areas only.

The staff rightly points to the extremely low revenue base, at around 6 percentages points of GDP, as an important threat to macroeconomic stabilization, which--in the circumstances--gives the authorities no other choice but to adjust the pace of nominal wage increases to match resource availability. This is an extremely dangerous situation as it threatens the quality of even the most basic government operations at a time when the Government faces severe challenges in transforming the economy. It is likely that needed external budgetary support will continue until measures to improve resource mobilization and cut an excessive government labor force have their full effect. However, I understand that the restructuring of the civil service will start only well into 1994. This means that for the time being, the authorities have only limited--if any--room to accommodate budgetary shocks, including shortfalls in external assistance, without having recourse to more domestic financing. It is obvious that a considerable increase in government revenues is urgently needed. In this respect, it is worrisome to note that in 1994 tax revenues will increase only by 1.5 percentages points of GDP, and most of this will be in the area of customs receipts. I would therefore ask the staff to elaborate somewhat more on the historic pattern of tax revenues and the medium-term prospects for increasing them. What was the revenue ratio in the 1970s? Are all segments of society being taxed? If not, what are the prospects of changing this? What measures are envisaged to increase tax revenues more significantly?

Monetary developments are difficult to predict in the present situation of demonetization and currency substitution, which can easily be reversed once stabilization is clearly under way. In this regard, I was somewhat disappointed to see in the monetary survey that the staff projects a decrease in the velocity of money of only 10 percent between mid-1993 and end-1994. Could the staff comment on why we cannot expect a sharper reduction? I agree with the staff, however, that these conservative estimates reinforce the argument for a cautious interest rate policy and a reassessment of monetary policy on a regular basis.

Regarding structural policies, I have the impression that, although the agenda is full, the task in Cambodia is less daunting than in many other former centrally planned economies, thanks to the relatively early decollectivization of agriculture. As I agree with most of the structural agenda the staff emphasizes in its report, I will only make two remarks on this. First, I support the staff in asking for an early unification of the exchange rate. Indeed, unification would be especially appropriate if prudent macroeconomic policies lead to a rapid restoration of price and exchange rate stability. In addition, it can be said that unification itself will reinforce stabilization policies. Moreover, if sustainable stabilization remains out of reach, it is doubtful that in an inflationary environment, a spread of 5 percent between the exchange rates will shield the population against price increases in the short term.

My second remark is that I do not understand the authorities' hesitation in freeing the prices of petroleum, cement, and steel, as actual prices do not seem to deviate much from underlying costs. It would seem easy enough to go the rest of the way, and I urge the authorities to do so.

Mr. Burdiel said that it was encouraging to see the Cambodian authorities' determination to implement a comprehensive program of adjustment and structural reform as quickly as possible, when the economy was still suffering from decades of war and the collapse of trade and economic relations with the former Soviet Union and other countries of the CMEA.

It seemed that currently, there were grounds for sustained economic recovery, combined with macroeconomic stability, based upon prudent financial policies, together with systemic reforms aimed at strengthening fiscal and monetary institutions, Mr. Burdiel continued. In that regard, the statement by the Cambodian authorities at the Joint Annual Meetings, only five days earlier, had been stimulating. Cambodia deserved the substantial technical and financial assistance required for the transitional economic program.

As Cambodia was current in its financial obligations to the Fund, thanks to the financial assistance provided by the Support Group and the technical help provided by the staff, he fully supported the proposed decision on a purchase under the STF, and hoped to discuss a request for an ESAF arrangement soon, Mr. Burdiel concluded.

Mr. Hammoudi said that he welcomed Cambodia's return to the international financial community. The authorities were to be commended for clearing Cambodia's arrears to the Fund and for their commitment to implement a structural adjustment program with the support of the Fund. He was pleased to see the implementation of appropriate measures in areas such as budget, money, and credit, as well as public enterprises and investment. If Cambodia was to succeed in its adjustment effort, the international financial community should assist the country financially and technically. He supported the proposed decision.

The staff representative from the Central Asia Department stated that the fundamental reason for the low tax/GDP ratio in Cambodia was that the country was in the process of re-establishing a government and an economic structure. Currently, the Government did little in the economic sphere: it raised little revenue because it had only a few sources of taxation--mainly customs duties. It also did little on the expenditure side: it met the costs of fighting the continuing civil war and related security concerns, as well as a number of basic administrative functions. As the situation changed over the medium term, a much broader tax base would have to be re-established and the provision of basic social and economic services--infrastructure services--would have to be expanded. It was certainly the Government's intention to move in that direction. How quickly it did so depended upon progress on the revenue and expenditure sides.

Tax/GDP ratios in the 1970s were unlikely to provide much guidance for the future, the staff representative observed. He agreed, however, with all speakers that the current tax/GDP ratio was not sustainable over the medium term. The ratio would have to be increased through greater efforts in indirect and direct domestic taxation. The first steps that had been taken in August/September 1993 were only a modest initial downpayment on that broader effort. Moreover, there had already been major efforts to improve the collection of existing taxes, and over the past few months, there had been a rapid increase in tax receipts. For instance, compared with June--the month prior to the formation of the provisional government--tax revenues in August had increased by 70 percent and were currently running at a higher rate than had been assumed in the program. Nevertheless, a great deal remained to be done in that area.

The re-export trade to Viet Nam had been a significant source of government revenue, raising as much as 3 percent of GDP--or one half of total revenues, the staff representative commented. Although the re-export trade was expected to decline beginning in 1994, there were indications that it had already begun to decline as a result of actions taken in Viet Nam.

As to the staff's monetary projections, the assumption of a relatively modest decline in velocity in 1993 was conservative, because the targeted growth in monetary aggregates was low, the staff representative explained. The targets had been established on the understanding that, if the return to domestic financial assets was faster than assumed, the Government would revise downwards its inflation objectives--it would aim for price stability faster than assumed in the program. That process seemed to be under way. The absolute level of prices--not the inflation rate--had fallen in the past two months. In that connection, the point made by Mr. Wei that one should not rely too much on short-term trends in a situation where the base of financial assets was very narrow and subject to wide temporary shocks was well taken. Nonetheless, one could see the beginnings of a return to financial stability.

As the staff paper had indicated, shortfalls in foreign financing and foreign direct investment were a significant risk to the program, the staff representative from the Central Asia Department remarked. In the staff's view, however, preparing a specific quantitative scenario taking those risks into account was unlikely to add much insight in that regard. The fact was that the Government had not yet been able to formulate its medium-term public investment program. It was currently undertaking that process: it was addressing the most immediate reconstruction and rehabilitation needs, and it expected to formulate the medium-term public investment program within the first half of 1994. The World Bank was heavily involved in that process. Once the public investment program was in place, one could assess the effects on the real economy of having to calibrate the program to available external financing. Since the staff paper had been prepared, however, a further meeting of the International Committee on the Reconstruction of Cambodia had been held in Paris in September, and the additional commitments and pledges made at that meeting were more than sufficient to match the financing assumptions of the program.

The Executive Board took the following decision:

1. The Fund has received a request from the Government of Cambodia for a purchase equivalent to SDR 6.25 million under the Decision on the Systemic Transformation Facility (Decision No. 10348-(93/61) STF, adopted April 23, 1993).

2. The Fund approves the purchase in accordance with the request.

Decision No. 10481-(93/139), adopted
October 4, 1993

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/93/138 (9/20/93) and EBM/93/139 (10/4/93).

3. AMENDMENT OF SECTION 14(d) OF BY-LAWS - GOVERNORS' VOTE

The Executive Board approves the report of the Secretary (EBD/93/150, Sup. 1, 9/21/93) on the canvass of votes of the Governors on Resolution No. 48-6, with respect to an amendment of Section 14(d) of the By-Laws. The Governors' vote on the Resolution is recorded as follows:

Total affirmative votes	1,458,934
Total negative votes	0
Total votes cast	1,458,934
Abstentions recorded	0
Other replies	0
Total replies	1,458,934
Votes of members that did not reply	30,768
Total votes of members	1,489,702

Decision No. 10482-(93/139), adopted
September 21, 1993

4. CAMBODIA - SETTLEMENT OF OVERDUE FINANCIAL OBLIGATIONS - TERMINATION OF SUSPENSION OF RIGHT TO USE GENERAL RESOURCES

The Fund decides that the limitation of Cambodia's use of the general resources of the Fund, pursuant to Executive Board Decision No. 5990-(78/200), adopted December 19, 1978, is terminated. (EBS/93/162, 10/1/93)

Decision No. 10483-(93/139), adopted
October 1, 1993

CAMBODIA - SETTLEMENT OF OVERDUE FINANCIAL OBLIGATIONS - TERMINATION OF SUSPENSION OF RIGHT TO USE SDRs

The Fund decides that the suspension of Cambodia's right to use SDRs, pursuant to Executive Board Decision No. 5989-(78/200)S, adopted December 19, 1978, is terminated. (EBS/93/162, 10/1/93)

Decision No. 10484-(93/139) S, adopted
October 1, 1993

5. ISRAEL - ACCEPTANCE OF OBLIGATIONS OF ARTICLE VIII, SECTIONS 2, 3, AND 4

The Fund notes with satisfaction that, with effect from September 21, 1993, Israel has accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement. (EBD/93/159, 9/27/93)

Decision No. 10485-(93/139), adopted
September 30, 1993

6. JAPAN - ADMINISTERED ACCOUNT - AMENDMENT

As requested by the Ministry of Finance of Japan (letter dated September 22, 1993, Annex I), the Instrument which was established pursuant to Decision No. 9091-(89/27), adopted March 3, 1989 and amended January 11, 1993, is amended by the Fund to conform to the text set forth in Annex II. (EBS/93/159, 9/22/93)

Decision No. 10486-(93/139), adopted
September 27, 1993

7. EXECUTIVE BOARD COMMITTEES - NOMINATION

The Executive Board approves the nomination of Mr. Autheman to assume the positions on the Committee on Executive Board Administrative Matters and the Committee on Interpretations as set forth in EBD/93/157 (9/24/93).

Adopted September 28, 1993

8. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 93/4 through 93/5 are approved.

9. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAM/93/165 (9/21/93), EBAM/93/166 (9/23/93), EBAM/93/167 (9/24/93), EBAM/93/168 (9/29/93), and EBAM/93/169 (9/30/93) is approved.

10. TRAVEL BY MANAGING DIRECTOR

Travel by the Managing Director as set forth in EBAP/93/61 and Correction 1, (9/30/93) is approved.

APPROVED: January 18, 1994

JOSEPH W. LANG
Acting Secretary