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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 93/99

2:30 p.m., July 14, 1993

M. Camdessus, Chairman

Executive Directors	Alternate Executive Directors
M. Al-Jasser	A. A. Al-Tuwaijri
T. C. Dawson	J. B. Wire, Temporary
	G. A. Heinen, Temporary
	V. Kural, Temporary
I. Fridriksson	J. Solheim
H. Fukui	S. Ishida, Temporary
K. P. Geethakrishnan	L. E. N. Fernando
	A. Raza, Temporary
J. E. Ismael	K. Hetrakul
	W. Ch. Keller, Temporary
	R. Ferrillo, Temporary
A. Kafka	J. Jaramillo
K. Kagalovsky	B. M. Lvin, Temporary
G. Lanciotti	J. Papadakis
J.-P. Landau	P. Bonzom, Temporary
	D. Desruelle, Temporary
R. Marino	G. Torres
	O. Kabbaj
	B. S. Dlamini
	Y. Patel, Temporary
D. Peretz	J. Dorrington
G. A. Posthumus	
	Y.-M. T. Koissy
S. Schoenberg	B. Esdar
	Y. Y. Mohammed
D. E. Smee	G. Murphy
	K. J. Langdon, Temporary
	G. Lindsay-Nanton, Temporary
E. L. Waterman	A. Tetangco
	Wei B.
	Yang X., Temporary
A. Zoccali	A. Jiménez de Lucio

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

<u>Also Present</u>
IBRD: K. Ikram, East Asia and Pacific Regional Office; P. Levy, Latin America and the Caribbean Regional Office; K. Matin, Africa Regional Office. African Department: M. Touré, Counsellor and Director; E. L. Bornemann, Deputy Director; E. A. Calamitsis, Deputy Director; R. K. Basanti, C. Brachet, K. J. Cady, M. T. Hadjimichael, S. M. Hossain, G. Kalinga, M. Nowak. Central Asia Department: H. Neiss, Director; B. B. Aghevli, Deputy Director; C. Anderson, M. W. Bell, M. Braulke, G. B. Mulder, Y. Yokoyama. European II Department: E. Brau, Deputy Director. External Relations Department: R. R. Brauning, P.-M. Falcone, G. Hacche, J. Starrels. Fiscal Affairs Department: V. Tanzi, Director; C. Liuksila. Legal Department: R. H. Munzberg, Deputy General Counsel; H. Elizalde, J. L. Hagan, Jr., J. M. Ogoola. Middle Eastern Department: M. A. Tareen. Monetary and Exchange Affairs Department: D. E. Duenas. Policy Development and Review Department: J. T. Boorman, Director; T. Leddy, Deputy Director; S. B. Brown, M. E. Edo, V. Galbis, A. K. McGuirk, B. E. Rourke, A. G. Santos, J. F. van Houten. Research Department: M. Goldstein, Deputy Director; M. S. Khan, Deputy Director; R. A. Feldman, P. Isard, D. J. Mathieson, C. A. Vegh. Secretary's Department: J. W. Lang, Deputy Secretary; A. Leipold. Southeast Asia and Pacific Department: D. Buyantogtokh. Treasurer's Department: D. Williams, Treasurer; L. Aylward, J. E. Blalock, J. C. Corr, R. H. Floyd, D. Gupta, P. R. Menon, O. Roncesvalles, G. Tavlas, T. M. Tran, M. A. Wattleworth. Western Hemisphere Department: S. T. Beza, Counsellor and Director; M. Cortes, K. Gerhaeusser, J. P. Guzman, M. E. Hardy. Personal Assistant to the Managing Director: G. R. Saunders. Advisors to Executive Directors: J. M. Abbott, A. Cserés, S. K. Fayyad, W. Laux, N. Mancebo, P. A. Merino, R. Meron, B. A. Sarr. Assistants to Executive Directors: H. M. Al-Atrash, M. C. B. Arraes, G. M. Blome, J. H. Brits, Chen M., J. A. Costa, C. D. Cuong, M. Dzervite, A. Giustiniani, H. Golriz, T.-M. Kudiwu, J. Mafararikwa, G. J. Matthews, S. C. McDougall, F. Moss, S. del C. Olgiati, J. K. Orleans-Lindsay, T. Oya, R. K. W. Powell, S. K. Regmi, A. Sighvatsson, F. A. Sorokos, R. Thorne, V. Y. Verjbitski, Wang X.

1. REPORT BY MANAGING DIRECTOR

The Managing Director commented that he had attended the latest monthly meeting of central bank governors in Basle. Those meetings offered a good opportunity in the period between Interim Committee meetings for him to be in touch with the monetary authorities of many countries. He had met first with Governor Duisenberg, of the Netherlands, the Chairman of the EC Governors, to discuss the present situation of the European Monetary System (EMS) and to review the exchange of information that could make the Fund's surveillance work as effective and confidential as possible. He had also met with Governor Godeaux to review the Fund's role in the provision of technical assistance in the monetary field to the countries of the former Soviet Union. At the governors' restricted dinner in Basle he had been invited to explain the main concerns of the Fund at the present time. He had also met with Mr. de Larosière, with whom he spoke about the situation of the French franc and recent developments in the EMS. He subsequently had similar discussions with Governor Schlesinger, Governor-Designate Tietmeyer, and with Mr. George, the Governor of the Bank of England. At the Group of Ten Governors' meeting he was invited to make a presentation on the utilization of the systemic transformation facility by Russia and other countries. Participants in the meetings had posed various questions, particularly about the monetary aspects of the Fund's agreement with Russia, and he had expressed his confidence that all necessary steps in that field would continue to be taken; indeed, his confidence had been confirmed by the Russian authorities' most recent policy actions. At the end of the discussions, he had been particularly encouraged by governors' expressions of confidence in the Fund's ability to help in the implementation of a realistically ambitious and comprehensive adjustment program in Russia and all the other countries in transition.

At another meeting of governors in Basle he had also been asked to comment on the world economic situation, and in doing so he had had in mind the Board's recent discussion on world economic and monetary developments, the Managing Director said. He had given particular emphasis to developments in Eastern European countries, as several governors from those countries were participating in the Basle meetings.

Immediately thereafter, he had met in Paris with the Chairman of the Paris Club to review the present schedule of meetings of the Paris Club and discuss further developments in connection with Paris Club work and Fund-supported programs, the Managing Director commented. He had then met in London with the Chancellor of the Exchequer--his first meeting with that official. Like his predecessors, the current Chancellor of the Exchequer attached great importance to the work of the Fund and to cooperation with the institution. He and the Chancellor had reviewed basic issues the Fund was currently addressing, and he had been cheered by the encouragement that the Chancellor had given.

The Executive Directors took note of the Managing Director's statement.

2. SDRS - RATIONALE FOR, AND IMPLICATIONS OF, AN ALLOCATION IN PRESENT CIRCUMSTANCES; FUTURE AS A RESERVE ASSET; AND POST-ALLOCATION DISTRIBUTION

The Executive Directors continued from EBM/93/95 (7/7/93) their consideration of staff papers on the rationale for, and implications of, an SDR allocation in present circumstances (SM/93/123, 6/9/93); the future of the SDR as a reserve asset (EBS/93/89, 6/15/93; and Cor. 1, 6/16/93); and a post-allocation distribution of SDRs (EBS/93/90, 6/15/93). They also had before them background information on the pattern of use and holdings of SDRs (EBS/93/104, 6/28/93) and on the concept of long-term global need to supplement reserve assets and the objective of making the SDR the principal reserve asset (SM/93/146, 7/6/93).

The Chairman made the following summing up:

We have had a very useful discussion of the issues related to the question of an SDR allocation, along with a productive exchange of views on the issue of post-allocation redistribution, and on the future of the SDR as a reserve asset.

Most Directors agreed with the staff that there is presently evidence of a long-term global need to supplement reserves. These Directors felt that the global demand for reserves could be projected to expand substantially and, in that light, they supported the Managing Director's suggestion to allocate SDRs in the amount of SDR 36 billion during the remainder of the sixth basic period. They noted in particular that many developing countries and countries in transition currently have very low levels of reserves relative to commonly applied standards of reserve needs. Many Directors expressed strong concerns about the widespread incidence of reserve stringency, the need for many countries to build reserves to protect their reform and adjustment efforts, and the fact that 38 members of the Fund had not participated in previous SDR allocations.

A number of Directors took a different view of the evidence on current reserve holdings and did not see a convincing enough long-term global need for reserve supplementation at this time. These Directors emphasized that reserves to import ratios were currently at relatively high levels for the developing countries as a group and at normal levels for the industrial countries, and that reserve stringencies, even for a relatively large number of countries, did not provide a case for allocation. In their view, credit from private markets is in general a satisfactory source for reserve creation provided countries follow sound policies to enable them to gain access to such credit; indeed, potential access to the private markets should provide an incentive to improve policy performance. Moveover, these Directors stressed that improved policy performance rather than the creation of additional reserves was the way to strengthen the growth performance of the world economy.

Some Directors considered that the SDR Department had been established on the basis of assumptions about the international monetary system that no longer held true. Moreover, the view of several of you with regard to the SDR system differs from those who developed the SDR as well as from the rationale for the 1978 allocation. Thus, there appears to be a need to reflect further on the role of the SDR in the current system of managed floating exchange rates.

In considering whether an allocation of SDRs would meet the growing demand for reserves in a manner consistent with the objectives set forth in the Articles, Directors generally agreed that the stances of monetary and fiscal policies in the major industrial countries would not be affected by a moderate-sized allocation, and accordingly, that such an allocation would not be inflationary. Moreover, several Directors asked themselves whether continued failure to allocate SDRs would be compatible with the objective of making the SDR the principal reserve asset in the international monetary system, even though this is not a criterion for justifying an allocation of SDRs. A number of Directors also felt that, in the present circumstances, reducing the need for countries to acquire reserves through capital inflows and to rely heavily on private sources of credit when reserve needs increased unexpectedly, an SDR allocation would meet the growing demand for reserves in a manner consistent with increasing the stability of the international monetary system.

A number of Directors expressed concerns about the relatively high costs of building reserves through borrowing or the compression of domestic demand and net imports. In this connection, some Directors noted that, in the absence of an allocation, the countries in transition and the low-income developing countries will be able to acquire the additional reserves they need to protect their transformation and growth efforts only at an economic and financial cost that substantially exceeds the economic opportunity cost of creating reserves through allocation.

Several Directors recognized the case for taking steps to correct the imbalance in the distribution of SDRs with respect to new members that had not participated in previous SDR allocations. However, some speakers did not see this as sufficient reason for an SDR allocation. In this connection, while a few Directors indicated that they might be willing to consider a reallocation of existing SDRs for new members, it was emphasized that the Fund's Articles did not include provisions for an SDR allocation owing to increases in Fund membership.

Several Directors considered that the low level of reserves in the economies in transition and in the low-income developing countries could most appropriately be addressed through the special facilities that the Fund has created to assist them, namely, the systemic transformation facility and the successor facility to the ESAF, or other official sources of finance that combined the implementation of appropriate macroeconomic adjustment and stabilization policies with financial assistance. Some Directors suggested that a re-examination of the Fund's access policies may be warranted in light of the role of the Fund in supporting growth-oriented economic adjustment. Of course, that would point to a need also to consider other issues, such as the adequacy of Fund resources.

Some Directors noted that countries holding SDRs in excess of their cumulative allocations receive a competitive return on their holdings and are not burdened by the prolonged net use of SDRs by other countries. In discussing the fact that some countries have not rebuilt their holdings of SDRs as quickly as their other reserves, it was noted that this may be related to difficulties in their acquiring SDRs, including the reluctance of some large SDR holders to release SDRs to the system. Emphasis was also placed on Fund surveillance to help insure sound policies, and thus a buildup of reserves following an allocation. Directors generally did not favor the reimposition of a reconstitution requirement.

A number of Directors agreed that a new SDR allocation should be accompanied by a post-allocation redistribution of SDRs, although it was observed that such a scheme could also be considered without a new allocation. Several Directors considered that the establishment of an Administered Account ("Trust") mechanism in the Fund would seem an appropriate way to share the risks involved in any transfer of SDRs to members using the GRA in the upper credit tranches. A few Directors felt that the Fund should bear the credit-risk associated with the onlending of SDRs and were attracted by a scheme along the lines proposed by the Japanese and Belgian authorities, which would involve lending to the General Resources Account (GRA).

Any post-allocation distribution scheme would, of course, be voluntary and cannot be made a condition for an SDR allocation. The legislative requirements for some members to participate in such a scheme were emphasized. Moreover, for such a scheme to work in practice, it was important that many or most of the creditors would be prepared to lend the equivalent of at least a substantial part, if not all, of any SDRs that might be allocated to them.

Most Directors also commented on the role and future of the SDR as a reserve asset. It was generally agreed, from both the technical and operational points of view, that the SDR is a well constructed and competitive asset that serves its purposes well. It was also generally agreed that the standard basket approach in valuing the SDR in a world of managed floating exchange rates is an appropriate form of valuation. There was little support to change the present method of valuing the SDR in order to introduce a more systemic hardening of the asset or to make it more inflation proof, for the reasons spelled out in the staff papers. A number of Directors felt that the limited use of the SDR, in the final analysis, reflected the fact that a viable private market in SDR-denominated instruments had not developed and the limited availability of SDRs in general, rather than procedural or legal limitations on its use. There was, however, very little support for the Fund itself to engage in developing such a market. Nevertheless, we understand that the staff is invited to keep the functioning of the SDR as a reserve asset under continued review and to report periodically to the Board on this matter.

Based on the views expressed by Directors, it appears that the requisite support for an allocation is so far lacking. A draft Report to the Interim Committee will be prepared on the basis of this discussion for consideration after the Executive Board recess. I intend to consult you informally before finalizing the draft Report, as several major issues are to be properly considered.

3. GHANA - 1993 ARTICLE IV CONSULTATION; AND PURCHASE TRANSACTION - COMPENSATORY AND CONTINGENCY FINANCING FACILITY - FLUCTUATIONS IN EXPORTS

The Executive Directors considered the staff report for the 1993 Article IV consultation with Ghana and Ghana's request for a purchase under the CCFF (EBS/93/95, 6/16/93; and Sup. 1, 7/9/93). They also had before them a background paper on recent economic developments in Ghana (SM/93/138, 7/2/93).

Mr. Kabbaj made the following statement:

At the outset, let me commend the staff for having produced a forthright and insightful report on Ghana's current economic situation and its prospects over the medium term. The report was prepared under a very stringent time constraint, and my authorities are grateful to the staff for its exceptional effort. They share much of the staff's analysis of economic developments in 1992 and 1993 and the key policy challenges that lie ahead.

As Directors will recall, following the successful completion of the recent three-year ESAF arrangement, which saw a major turnaround in Ghana's economic performance, the authorities sought to maintain the thrust of their adjustment and reform effort in the context of a program under arrangements for enhanced consultations. Accordingly, a program was developed for 1992, against the background of an updated medium-term policy framework, which aimed at accelerated growth in an environment of tight financial policies and low inflation, a deepening of the process of structural reform across a broad front, and the achievement of a comfortable external position. The implementation of the program was to be monitored by the Fund through quarterly financial and structural benchmarks.

However, as the staff report notes, 1992 proved to be a very difficult and eventful year in Ghana. On the positive side, it marked a watershed in the country's political history, when, after 11 years in office, the Provisional National Defense Council handed over power on January 7, 1993 to a democratically elected Government. This peaceful transition was an outcome that was widely hailed, and the authorities rightfully feel proud of this achievement.

But 1992 was also a year in which the economy was beset by a combination of adversities. While the transition to democracy was completed successfully, the direct and indirect cost of the elections proved to be much larger than had been anticipated. The latter was reflected in a certain lack of discipline in the revenue-raising agencies, which impacted adversely on efforts at revenue collection. At the same time, the acceleration of the political liberalization process added to the pressures for a strong increase in government spending. This was particularly true with regard to the large pay increase demanded by the civil service.

Superimposed on the strains in the fiscal area emanating from intense domestic political pressures, the economy was also subject to two further shocks. First, export prices of cocoa and timber fell sharply, hurting much-needed fiscal revenue and foreign exchange earnings, and putting further pressure on the external position, which had already started to weaken under the impact of expansionary financial policies. Second, amid concerns over the weakening macroeconomic picture, IDA and a number of cofinancing donors suspended disbursements of program assistance pending signs of a restoration of macroeconomic balance.

Taken together, these factors severely constrained the Government's ability to adhere to the adjustment program for 1992. The fiscal position weakened significantly, and, as a consequence, monetary expansion was rapid. These demand pressures quickly manifested themselves in a sharp deterioration of the external position, an upturn in inflationary pressures, and a depreciation of the cedi.

Despite the political pressure to delay a response to the weakening macroeconomic picture, the authorities resolved that the national interest required speedy and resolute action to restore financial balance and put the agenda for accelerated growth back into focus. Accordingly, they formulated a program for 1993 that was aimed at securing a major turnaround in the fiscal position, zero money supply growth, and a marked improvement in the balance of payments. The strength and quality of the various measures taken in the fiscal and monetary area, as well as the agenda for accelerated structural reforms, are impressive. They are well documented in the staff report and need not be repeated here. Suffice to say that the program represents a bold and determined effort at re-establishing internal and external balance and at bringing the economy back onto a more stable path.

The authorities' 1993 program has achieved some important early successes. For example, the improvement in the fiscal position has been quite dramatic. It has allowed for a net repayment of domestic government debt of 44 billion cedis in the first quarter alone, compared with the target of 84 billion cedis for the year; the sale of Bank of Ghana bills through the weekly debt auction has led to a decline in reserve money of 17 percent on a seasonally adjusted basis. There was zero growth in broad money. Given these favorable trends, the authorities remain confident that, with the continued resolute implementation of their corrective policies, the slippages that occurred in 1992 will be reversed and macroeconomic stability restored. The successful outcome of the recently held Consultative Group meeting, on June 24-25, 1993--at which aid pledges substantially exceeded the Government's own request--provides a good measure of the confidence that has been expressed in the authorities' ability to get the macroeconomic situation back on track.

Looking ahead, the authorities recognize that Ghana is now entering a new phase of its economic reform program, a phase that calls for building on the successes of the past to establish stronger foundations for accelerated and sustainable growth and poverty eradication. In this context, the authorities and the World Bank completed in 1992 a study on the conditions that would be necessary to achieve their objectives. The authorities welcome and broadly share the conclusions of the study. In addition to a commitment to broad-based human resource development, capacity building, and public sector reform, rapid and sustainable growth will require a vigorous private sector and a liberal investment environment. Much has been achieved in removing the impediments to private sector initiative and in establishing a consistent and transparent legal framework for business activity in Ghana. Following on from these initiatives, in 1993 the authorities will enact a new Investment Code, which will lay the basis for increased private sector activity as the cornerstone of the strategy for accelerated economic growth.

Finally, a word about the authorities' request for a purchase under the CCFF. The purchase, which is in respect of an export shortfall owing to factors beyond the control of the authorities, will augment the level of gross official reserves and is intended to provide a cushion against contingent risk. As the staff notes, Ghana fulfills all the requirements that are pertinent to a drawing under the CCFF.

Mr. Dorrington made the following statement:

The informally monitored program before us today offers Ghana the opportunity to return to the record of strong performance that it had enjoyed until last year. Ghana had achieved a reputation as one of the economic success stories of Africa--not just because of its adherence to Fund programs, but also because of its consistently strong growth. This is surely not a coincidence; Ghana's significant positive per capita growth clearly demonstrates the benefits of adjustment.

It is in this context that the slippages in performance last year were especially disappointing, particularly as they were only to a very limited degree exogenously caused. In Mr. Kabbaj's words, "...the direct and indirect cost of the elections proved to be much larger than had been anticipated." Of course, the peaceful transition to democracy was a major achievement, but it is important to remember that an unstable economy is never the best basis for stable political conditions. And fears that serious slippages might recur in advance of future elections will certainly not help in achieving the all-important long-term target of encouraging private investment. In this context it is essential that the efforts this year toward reversing the slippages of last year are successful.

Even under the agreed informally monitored program, Ghana will have effectively lost at least two years of reform, because the fiscal and balance of payments positions this year will still not be back to their levels in 1991. Even so, the fiscal correction planned for this year is in one sense ambitious, as some elements of last year's slippage, such as the rise in civil service wages, set spending at a new level, which will carry forward into 1993. On the other hand, the program represents the minimum needed to keep the reform process going. The 20 percent inflation projected for this year could threaten the planned civil service wage freeze, and there must also be a danger that last year's civil service rise will spill over to the private sector. I very much hope that these fears prove unfounded. But, at the same time, I am glad that the authorities recognize the need for further tightening if prices and wages turn out stronger than programmed.

The budgetary position is clearly the area of greatest past slippage and of need for adjustment. Election-related revenue and spending slippages should be reversed where at all possible. Particularly given the failure to achieve tax administration gains last year, I support the staff's cautious approach in not including any gains from revenue administration in their forecast. This should provide some scope for positive surprises. Nevertheless, the programmed increase in revenue as a proportion of GDP from 11.1 percent to 17.5 percent is very substantial, indeed, and I would be grateful for staff comments on how certain we can be that it will materialize. I gather that much is accounted for by the effects of currency depreciation and petroleum price rises. I wonder whether broad-based indirect tax increases were considered for this year, or, indeed, whether they are under active consideration for the future.

The public enterprise divestiture program should provide helpful revenue gains, but, of course, this is a one-off measure, and so further measures will be needed for the future to cement the part of the deficit reduction achieved from this source. The prime motivation for divestitures should of course be to improve efficiency, and it is in this spirit that I welcome recent government statements of the authorities' determination to accelerate the divestiture program and further improve the legal and administrative environment for the investor.

On the subject of the Cocoa Board, controlling its costs remains a vital task. The staff paper refers to large unforeseen increases in costs last year. Could the staff say a little more about the extra costs and how confident we can be that the planned measures for this year will have their desired effect, whereas those in previous years have not?

I welcome as well the sharp tightening in monetary policy that is planned, including the weekly debt auction. Maintenance of positive real interest rates will, of course, be a necessary part of policy. In the foreign exchange market, I support the staff's calls for a competitive market, allowing the rate to be set by supply and demand. In addition, I hope that some progress has been made in reducing spreads on domestic banking business. Perhaps staff could comment on that.

I very much hope that Ghana's performance this year will re-establish its track record and enable it to enter a period of formal enhanced surveillance. When that time comes, it is crucial that such arrangements incorporate the same degree of adjustment and policy discipline, and that they be monitored just as carefully and transparently as if the Fund's own resources were involved. Only then will enhanced surveillance be fully able to deliver the other benefits of a conventional program, including inspiring the necessary degree of donor confidence. I am glad that the Board's biannual review of surveillance codified the procedures for enhanced surveillance more precisely than before, and that these procedures include quarterly benchmarks and a midterm review.

The absence of a midterm review for Ghana's enhanced consultations last year caused a delay in the Board and donors' realization of how seriously policies had gone off track then. Given the size of last year's slippages, I very much support the approach of having an informally monitored program before attempting to agree on another enhanced surveillance arrangement. That is what we would expect if Ghana were negotiating an arrangement involving the use of Fund resources.

As an aside, an obvious shorthand for the informally monitored program is to call it an IMP. Some may think it is impertinent, given that one meaning of the word "imp" is "a mischievous child," but I was struck by a far more appropriate alternative definition in my dictionary in the context of falconry--that is, "to engraft feathers in a damaged wing so as to restore or improve the powers of flight." In Ghana, the fiscal wing of policy has indeed been badly damaged, but I hope that, with the help of some feathers from the Fund, Ghana will soon be soaring high again.

Of course, one important purpose of an IMP is to gain donor confidence, and in this context I particularly welcome its transparency with preannounced benchmarks, giving the opportunity for a clear signal on adjustment performance to donors. It will be important to be kept informed of performance, both against these benchmarks and, more generally, during the rest of 1993 and beyond. Could the staff please say something about how the Board will be kept informed?

Ghana's graduation from consecutive Fund-financed arrangements represents a form of external viability, although only in a narrow sense. Substantial official transfers will continue to be needed, albeit less in the form of balance of payments assistance and more as direct investment and project lending. The move to these slower-disbursing forms of assistance needs careful management, and there is a role both for the international financial institutions and for donors in this.

External sources will also need to react, as necessary, to exogenous shocks, and it is in this context that I welcome the CCFF request. While I have no doubt that there is a balance of payments need in the formal sense, I am concerned that an ESAF-eligible country is about to pay an arrangement fee and a turn on the resources that will be added to reserves. I also note that the IMP includes a benchmark for new nonconcessional debt of one to five years that is lower than the size of the CCFF purchase.

I would welcome any further comments on this issue from staff or Mr. Kabbaj.

Despite the fact that last year's program went badly off track and the record for this year remains to be seen, I agree with staff that the agreement on a tough informal program meets the necessary criterion of cooperation for the CCFF, a test that I note is weaker than the conditionality required for an upper credit tranche arrangement. A viable external position combined with sustained noninflationary growth remains within Ghana's grasp, and I derive great comfort from its past record of adjustment. But this desirable long-run outturn will, of course, depend on rigorous program implementation over a period lasting far beyond the IMP. The CCFF application demonstrates the exposure of Ghana to external shocks. It is being invoked for compensatory purposes, but I wonder what thought is being given to contingency arrangements to deal with further exogenous shocks or, indeed, contingent measures to offset any domestic policy slippages, beyond the rather general statement on page 5 of the staff report. Of course, a CCFF for contingency purposes can only be attached to a formal Fund arrangement, but could the staff, or Mr. Kabbaj, please say more about contingency arrangements either within the informal program, or within any subsequent enhanced surveillance. Last year's experience makes it all the more important to plan potential offsetting measures for slippages.

Finally, I note with satisfaction that Ghana has eliminated all external payments restrictions. It has been true for some time now that Ghana has maintained no restrictions under Article XIV. There is thus no possible advantage at all, either now or potentially in the future, in Ghana not immediately accepting Article VIII status. I am glad to see that the authorities have stated their intent to accept Article VIII in the near future. Could staff please say what the probability is that this will have been achieved by the next time the Board discusses Ghana?

Mr. Esdar made the following statement:

Like Mr. Dorrington, I very much regret that the performance under the 1992 program has been very disappointing, which was due partly to the export shortfalls, but also partly to policy slippages in several areas, including the large pay increase in the public sector and weaknesses in tax collection. Looking ahead, I welcome the authorities' intention to address these slippages by a comprehensive stabilization and structural reform program for 1993. This program would constitute an important step in the right direction and could, if vigorously implemented and strengthened in some areas, contribute to bringing the economic performance back on course. It would thus re-establish Ghana's encouraging track record under former ESAF arrangements and would lay the basis for a successor program that could be monitored under the enhanced surveillance procedure. With regard to the possibility of continuously including elements of this enhanced surveillance procedure, I very much support the interesting ideas of Mr. Dorrington.

Let me now comment on specific elements of the 1993 program. First, on the general policy framework, while admitting that most program targets are ambitious, I still wonder whether they are ambitious enough in view of the fact that several important economic indicators will deteriorate further in 1993. This holds true in particular for the inflation rate, which will nearly double to 20 percent, and the external current account as well, which has increased continuously in the past five years from 1.7 percent of GDP to 5.9 percent in 1993. The external debt has risen to nearly 70 percent of GDP in 1993, and the external debt-service ratio has now reached the level of 37.7 percent. I share the staff's view that, in financing these deficits, to rely exclusively on growing external assistance may prove to be too optimistic or even unrealistic. Therefore, Ghana will need to generate the savings necessary to fund investment and growth from domestic sources. To this end, a further strengthening of fiscal policy might be advisable in order to reduce or, better, eliminate that part of the central government deficit that is not covered by foreign grants. Monetary policy could support this approach by a reduction in broad money in order to mop up part of the existing excess liquidity in the economy. To sum up, more moderate economic growth targets and somewhat more ambitious targets in the area of financial policy could accelerate the necessary adjustment process.

Let me now turn to specific issues of fiscal policy. Here, I have noted that the targeted improvement in the government budget balance is to be achieved solely by revenue measures, in particular by an increase in petroleum duties and by sales of shares in public enterprises, while government expenditure is programmed to rise further by 1.5 percent of GDP. I also note that some of the revenue measures, in particular the restructuring of the Cocoa Board and the planned acceleration of the divestiture program, might be difficult to implement, which, in turn, could at least lead to delays in revenue collection. I would thus urge the authorities to supplement the planned revenue measures by cuts in central government current expenditures. Let me point out in this context that current expenditures in relation to GDP have considerably increased since 1991 and that the growth rate is particularly high in 1993. Therefore, I assume that there is ample room for further savings in this area, in particular with regard to the government wage bill.

On monetary policy, I note that the authorities have sold large amounts of Bank of Ghana bills in recent months in order to reduce reserve money. I wonder what impact these transactions might have on the overall liquidity in the economy. While these transactions may lead to a temporary reduction of the overall liquidity, they may not be sufficient to absorb the existing excess liquidity permanently. In addition, these operations might also put a strain on central bank finances. It might thus be more favorable to influence broad money growth primarily by changes in the rediscount rate or in the reserve requirements. In present circumstances, this might require a further increase in the re-discount rate. While noting that real interest rates are already high, I feel that somewhat higher real interest rates could be necessary temporarily in order to break the entrenched inflationary expectations. Perhaps the staff could elaborate on these views.

On structural policies, I would like to emphasize the staff's recommendation to terminate the monopoly over cocoa exports. I also feel that the authorities should consider further privatization in view of the fact that the public enterprise sector is relatively large, that economic performance of these enterprises is mixed, and that public enterprises rarely pay taxes and dividends to the Government. At present, the authorities only intend to sell part of their share in the Ashanti Goldfields, in the largest banks, and in a number of other companies, while 14 core enterprises are to remain in public hands. This strategy seems not to be very ambitious. Finally, I regret that the authorities will not achieve their original objective of reducing the size of the civil service by 11,500 employees in 1993. I would thus urge the authorities to accelerate the reform in this sector.

Mr. Bonzom made the following statement:

The staff report makes it clear that Ghana's economic performance and policies deviated quite markedly from the adjustment path set forth by the 1992 program under arrangements for enhanced consultations. As is stressed in the papers before us, economic growth slowed down; inflation is now over 20 percent; the current account balance has worsened; considerable new medium-term borrowing has taken place; and both the exchange rate and the foreign reserves have declined.

Various causes help explain this turnaround from Ghana's previous, favorable performance. The terms of trade, which had been scheduled to decline by 1 percent in the program, dropped by 8 percent in 1992; this affected, of course, the external position. But slippages in policy implementation also occurred: a large fiscal deficit, covered by recourse to bank financing, resulted from large expenditure overruns and from a shortfall in revenue. Also, in Ghana the process of political transition has entailed economic consequences that are difficult to manage in the short term.

The authorities have taken, at the beginning of this year, corrective measures aimed at re-establishing Ghana's economic performance. As stressed in Mr. Kabbaj's helpful statement, there are already indications, based on data covering the first quarter of 1993, that some results have been achieved, both on the monetary and fiscal fronts. However, I concur with the staff that the 1993 program is ambitious and the persistence of inflationary pressures remains a cause of concern.

As far as monetary policy is concerned, the authorities have considerably reinforced their efforts by tightening credit conditions: interest rates have risen substantially, from 18 percent for the Bank of Ghana's rediscount rate in June 1992 to 35 percent in March 1993; excessive liquidity of commercial banks is being neutralized through intensified open market operations and through the welcome, upward adjustment of reserve requirements. I agree with the staff and the authorities that monetary developments should continue to be closely monitored, and that further raises in interest rates should not be excluded in order to reach the monetary targets of the program. However, it is clear that the task of bringing money supply growth back under control will also depend on the fiscal performance.

In this regard, the objective of the 1993 program of improving the Government's budget balance by about 5 percent of GDP is indeed ambitious. This effort hinges heavily upon a sharp increase in government revenue, by 6.4 percent of GDP to 17.5 percent of GDP. Even if we take into account transitory revenue effects, those figures seem high by historical standards. Both the rise in revenue and the containment in the expansion of expenditures could thus prove difficult to achieve.

The commendable measures already taken by the authorities to increase revenue from the petroleum tax and to strengthen the tax collecting agencies' efforts already contributed to improving the fiscal performance, which allowed, at the end of March, for the reimbursement of domestic debt by about half of the end-of-year targeted level. However, the full-year objective of the program relies heavily on further increases in the taxes on petroleum products, which will again require raising retail prices; the authorities will thus have to ensure that wage negotiations are not unduly disturbed by those necessary increases in taxes. Furthermore, the revenue that the Government can expect from cocoa exports will be determined by the indispensable expenditure containment effort of the Cocoa Board. Finally, the targeted yield from sales of the Government's share in the public enterprise sector is closely linked to the acceleration of the divestiture program, including leading companies, such as Ashanti Goldfields.

Despite significant efforts to terminate transfers and equity investments to the main public enterprises, public expenditures will remain on an increasing trend reflecting the consequences of last year's decisions regarding wages and end-of-service benefits. I fully concur with Mr. Esdar on the worrisome trend in this regard.

The authorities' intention to avoid any general pay increase this year is thus highly commendable, but ensuring the containment of the wage bill would also call, in my view, for a stronger commitment to reduce the size of the public service. In this latter regard, I understand the necessity of adequately staffing the new parliamentary institutions. I wonder, however, whether this should preclude any reduction in overall public employment during the year. I note with satisfaction, however, that the authorities have suppressed autonomous hiring practices of subverted agencies, and I look forward to the result of the comprehensive review in this area that is scheduled to take place this year.

On the external side, a further degradation of the trade balance, resulting partly from considerably lower cocoa prices, is probable. In addition to the measures of financial stabilization, the acceleration of the divestiture program could generate substantial foreign exchange inflows. The authorities should also try to fulfill conditions for the disbursement of funds that had been delayed in 1992. In this regard, the recent release of the second tranche of the World Bank's financial sector adjustment program loan is an encouraging development. These efforts are of paramount importance to achieving the overall balance of payments objectives and to reducing pressures on the exchange rate. Otherwise, a further depreciation of the cedi would endanger the deceleration of inflation that is projected in the program.

The medium-term projections of the balance of payments provided in the staff report confirm that Ghana's dependence on external assistance will continue. This assistance will reach a peak in 1993, when Ghana is expected to repay nonconcessional borrowing contracted in late 1992 and build up its foreign exchange reserves. It is noteworthy in this regard that in the period 1994-96 official grants and long-term concessional loans are still projected at higher levels than in the period preceding 1992.

Given this continued, high dependency on foreign aid, I share the staff's view that structural reform must continue to complement financial policies in fostering domestic savings, in removing impediments to the development of the private sector, and, finally, in establishing the proper conditions for the diversification of exports. The authorities' agenda seems correctly focused on strengthening incentives for private investment, the divestiture program, the reduction in the operating and marketing costs of the Cocoa Board--the ending of the Cocoa Board's monopoly on exports would be a move in the right direction--and on keeping constraints arising as a result of state involvement in productive sectors.

The divestiture program, besides its already-mentioned positive effects on both budgetary and external accounts, constitutes a significant move in the right direction. In the same vein, I welcome the launching of a restructuring plan for the cocoa sector. Through the reduction in the operating and marketing costs of the Cocoa Board, this plan will allow for the strengthening of incentives to producers. This will indeed be a key development. I share the staff's view that another objective should be to end the Cocoa Board's monopoly on exports.

In conclusion, the staff report makes it clear that Ghana fulfills the criteria for the purchase under the CCFF to compensate for shortfalls in export earnings. Given the current orientation of the authorities' policy and their commitment to bring the economy back to its previous good track record, this chair supports the proposed decision.

As an aside, I wonder whether recent developments in Ghana do not validate the doubts this chair expressed earlier on the usefulness and appropriateness of an arrangement for enhanced consultations, but I am quite confident that, as stressed by Mr. Kabbaj, the Ghanaian authorities will apply all their energy to reversing the consequences of the recent setback. I share the staff's view that this program, together with the renewed support of donor countries, will contribute to Ghana's return to a high but sustainable rate of growth.

Mr. Koissy made the following statement:

Ghana's economic performance over the past decade has been remarkable. Growth of real GDP has been sustained at an average level of 5 percent per year. Inflation has been significantly reduced, and the external position has been strengthened, with external payments arrears cleared, and international reserves built up to a comfortable level. In addition, comprehensive structural and institutional reforms have been implemented, including liberalizing the exchange and trade system, strengthening the legal and regulatory framework, as well as reforming the financial and state enterprise sectors.

Against such a promising background, it is regrettable to read from the staff papers that Ghana's 1992 program under the arrangements for enhanced consultation suffered a severe setback and most of the program's benchmarks were missed.

As fully explained by the staff, the weaknesses in policy implementation in 1992 were brought about not only by the difficult external environment characterized by weak market prices for the major exports of cocoa and timber but also by the unstable sociopolitical environment that prevailed during the run-up to multiparty parliamentary and presidential elections. We applaud the country's successful transition to the new system of government. However, the policy slippages that occurred during that period, while understandable, give cause for concern, as they threaten to wipe out the hard-won gains of the past decade. It is therefore refreshing to note that the Ghanaian authorities are determined to offset these slippages and thus restore Ghana's excellent record of program implementation.

In this regard, I welcome the Government's economic and financial program for 1993, aimed at re-establishing fiscal discipline, reinforcing control over the monetary aggregates, as well as rebuilding the external reserves position. The macroeconomic objectives of the program are ambitious, particularly in respect of the government budget, which is expected to shift from a deficit of about 5 percent of GDP in 1992 to a surplus of 0.3 percent of GDP in 1993. Here, I agree with the staff that the success in achieving the macroeconomic objectives of the program will critically depend on the vigorous implementation of the measures envisaged in a number of key policy areas.

In the fiscal area, we agree that the authorities should intensify their domestic resource mobilization efforts. Indeed, we are of the staff's view that Ghana will need to generate the savings necessary to fund investment and growth from domestic sources. In this connection, we welcome the emphasis being placed on raising revenue, as evidenced by the doubling of fiscal revenue in 1993. While we note that the bulk of the increase will come from further substantial increases in the prices of petroleum products, we wonder whether such large increases can be sustained in view of their potential adverse effects on production costs throughout the economy. Staff elaboration on this would be appreciated.

In the same vein, it seems to us that petroleum product prices will continue to escalate as long as petroleum duties are computed on the basis of costs arising from the continued depreciation of the cedi. My own view is that while these short-term measures are appropriate, for the longer term the authorities will need to broaden the tax base and strengthen tax administration and generally look for more permanent ways of mobilizing domestic resources. As far as revenue from cocoa exports is concerned, we share the view that the rising operating costs of the Cocoa Board should be drastically restrained, and the authorities need to monitor developments closely. It is encouraging to note, therefore, that some room has been found to accommodate the recent increase in cocoa producer prices for the coming crop year. This should help to boost cocoa revenues. On the expenditure side, we believe that the authorities face a major challenge in keeping a firm control on the wage bill for 1993, and as recommended by the staff, we can only encourage them to resist the pressures for a general pay increase for the civil service, particularly in view of the large increase granted last year.

Given the surge in liquidity that occurred during the last quarter of 1992 and the risk of inflationary pressures that could arise from wage demands during the year, monetary and credit policies should appropriately support the relatively tight demand-management stance being pursued. All in all, there is need to restrain money supply growth. The steps being taken by the central bank to mop up excess liquidity and contain monetary growth through intensified open market operations thus appear appropriate. The substantial repayment of government debt in the first quarter of the year is encouraging and augurs well for the attainment of the target for the whole year.

As far as public enterprise reform is concerned, there seems to be a perception that the Government is unwilling to accelerate the pace because of pressures from vested interests. Could the staff comment on this and on the transparency of the entire divestiture program?

On the request for a purchase under the CCFF in respect of a shortfall in merchandise exports, I believe that Ghana satisfies all the criteria under the guidelines, and I have no hesitation in supporting the proposed decision.

Finally, it is encouraging to note from the staff appraisal that "implementation of the 1993 program remains on track." And given the authorities' established record of program implementation, it is our hope that they will persevere in order to reverse the slippages that occurred in 1992.

Mr. Ishida made the following statement:

It is disappointing that right after the Ghanaian authorities completed the three-year ESAF arrangement in 1992, Ghana's economy proved to be very vulnerable to external shocks, as the export industrial structure is still composed mainly of cocoa, gold, and timber, as we saw before the start of the ESAF arrangement.

However, as the major reason for the export shortfall in 1993 is the temporary fall in the prices of cocoa and timber, and the authorities have kept a good relationship with the Fund, particularly during the ESAF program, I support the request for the CCFF.

With respect to fiscal policy, I am concerned about the authorities' ability to steadily implement the tough policy under the program. The authorities should be aware that the excessive wage increase for the civil service in 1992 caused a spiral of economic crisis, as the budget deficit expanded, the inflation rate increased, and the current account deficit was larger than expected. The authorities should firmly resist political pressure for a large wage increase for the civil service in 1993. Even if the authorities want to allow the wage for the civil service to increase, the authorities should cut the number of the civil servant in order to avoid expansion of public expenditure. The expenditure of wage increase will be financed by the surplus from cutting the number. On the revenue side, I would expect the authorities to continue to make their best effort to strengthen the capacity of the tax administration and collect dividend revenue from the state enterprises.

With respect to monetary policy, it is necessary for the authorities to tighten credit conditions sharply in order to absorb the excess liquidity created in 1992.

Lastly, I think that one of the weaknesses in the cocoa industry is the existence of the Cocoa Board, which has a monopoly over the cocoa transactions in Ghana. It seems that the Board buys cocoa beans at unfairly low prices from farmers and sells them in the world market at a relatively high price in order to make up for the high cost of the Board. Needless to say, the authorities are strongly recommended to reform the Cocoa Board.

Mrs. Hetrakul made the following statement:

It is unfortunate to witness the deterioration in the 1992 Ghanaian economic performance after very favorable developments on all sides in 1991. However, I commend the authorities for having reacted promptly in correcting the slippages in policy implementation and redirecting the economy along the right course. I agree with the staff that priority should be given to restoring fiscal discipline and bringing monetary growth firmly back under control while reconstituting the international reserve position.

The policy framework for 1993 looks very impressive and quite ambitious to me, particularly the targeted turnaround in the government budget balance from a deficit of 4.8 percent of GDP to a surplus of 0.3 percent of GDP, as well as zero growth in broad money compared with 53 percent growth in 1992. As I broadly share the thrust of the 1993 program, and the views presented by other Directors, I will briefly make only a few specific comments.

First, in my opinion, the most ambitious target is the envisaged improvement in the government budget, amounting to 5 percent of GDP. On the revenue side, 3 percent will be from the increase in revenue from petroleum duties, 1 percent from revenue from cocoa, and 1.5 percent from the acceleration of the divestiture program. I am concerned about the heavy dependence on petroleum tax revenue. As of January, premium petroleum prices were raised by 60 percent. I would be interested to hear the staff's comments on how firmly based these expectations of improved revenue are, and on the extent of the further required price increase to reach the revenue target of 3 percent of GDP, and its impact on inflation.

Second, the projection of increased revenue from cocoa amounting to 1 percent of GDP is also questionable. With the depressed world market prices for cocoa in 1993, I wonder whether this is possible even with the serious limitation of expenditure of the Cocoa Board.

Third, regarding expenditure, the Government's plan to have expenditure increase by 1.5 percent of GDP seems to be ambitious. With high inflationary expectations, I agree with the staff that one particular area of concern is still the civil service wage bill. The authorities may encounter strong pressure to grant general pay increases again this year. Moreover, additional spending on the end-of-service benefits and on personal emoluments is also required, while the reduction in the size of the public service may not be realized. I would like to emphasize that, in order to attain the budgetary target, the authorities must be extra firm in these respects.

Fourth, on the monetary policy front, the task of retarding the money supply growth rate sharply by more than 50 percent is a challenging task indeed. In this respect, it is encouraging to note from Mr. Kabbaj's statement that, through the sale of Bank of Ghana bills, the authorities have managed to succeed in controlling reserve money and thus broad money growth to the desired level in the first quarter of this year. However, although this policy is necessary to reverse and restore economic stability, the authorities should be cautioned about the quasi-fiscal deficit arising from the issuing of large amounts of bills. Because the authorities recognize the importance of maintaining positive real interest rates, this could, on the other hand, incur vast amounts of expenditures for the central bank.

Finally, I encourage the authorities to strictly adhere to the stabilization policy and to accelerate structural programs as set out in the comprehensive policy framework for 1993. In view of Ghana's excellent track record of policy implementation in the past, I am certain that the economy can wade through all the obstacles with no major problems.

With these comments, I can endorse the proposed decision.

Mr. Al-Tuwaijri made the following statement:

Ghana's track record in implementing far-reaching structural and financial reforms is impressive. Since 1983, the country has embarked on an ambitious stabilization and reform program supported by successive Fund arrangements. This effort has resulted in a substantial improvement in the country's financial and economic performance.

Unfortunately, the 1992 program went off track, and most of its benchmarks were not observed. The budget deficit amounted to 4.8 percent of GDP, compared to an envisaged surplus of 1.8 percent under the program, and the recourse to domestic bank financing of the deficit helped rekindle inflation. In addition, Ghana's external position deteriorated sharply, and international reserves declined. The staff attributes this disappointing performance to the weak world market conditions for cocoa and timber. Moreover, in an effort to maintain a stable political environment during a year of significant political change, the Government granted a large wage increase to civil servants, which contributed to a major expenditure overrun.

Notwithstanding these major setbacks to Ghana's economic reform program, it is heartening to note from the staff report and Mr. Kabbaj's helpful statement that the Government is determined to correct the slippages in policy implementation that occurred during 1992. To attain this objective, the Government has formulated a macroeconomic program for 1993, which, if implemented, will restore fiscal discipline, control the money supply, and reconstitute Ghana's international reserves.

As I am in agreement with the thrust of the staff's appraisal and most of the staff's recommendations, I will confine my intervention to a few selected comments.

One of the basic targets of the program is the improvement of the government budget balance by approximately 5 percent of GDP, which will be achieved through different revenue measures. Notwithstanding this ambitious goal, it is noted that over 3 percent represents additional revenues from petroleum duties. According to the staff, most of the adjustment in petroleum product prices will compensate only for the exchange rate depreciation, but, nevertheless, this clear dependence on one source of revenue carries a large amount of risk and raises a number of issues related to competitiveness and inflation. While the staff report focused on the revenue components of an oil price increase, its impact on competitiveness of the Ghanaian economy was not reviewed. More important, an increase in oil prices of such a magnitude, coupled with the staff's recommendation for further increases, will certainly rekindle inflation and will adversely affect the forthcoming wage negotiations. Could the staff elaborate on these two points.

With regard to structural policies, I welcome the Government's recognition that continuing structural reform will be necessary to improve the incentives for the private sector and to ease the constraints on growth arising from inefficient public entities. In this regard, the restructuring plan, which has been launched to contain the costs of the Cocoa Board, is welcome, and I support the staff's recommendation to terminate the Board's monopoly over cocoa exports. Moreover, it is important to ensure that the divestiture program remains on track.

I have no hesitation in supporting the authorities' request for a purchase under the CCFF. Ghana has a good track record of policy implementation and cooperation with the Fund, and the staff is satisfied that the shortfalls in export earnings are due largely to circumstances beyond the authorities' control. Moreover, the continuous involvement of the Fund in monitoring Ghana's macroeconomic and structural policies has proven to be a valuable contribution to the country's reform process. It is important to have this involvement continued, and I welcome the possibility of Ghana entering into an enhanced surveillance procedure.

Mr. Wire made the following statement:

Given Ghana's good progress over the past decade, including completion of a three-year ESAF arrangement in 1992, like other speakers, we are greatly disappointed with the very significant deviations that occurred last year from the targets envisioned under the enhanced consultations approach. Rather than the planned fiscal surplus, the budget was in deficit to the tune of 4.8 percent, a shortfall of more than 7 percent of GDP. Growth fell to 3.9 percent from a planned 5 percent. Reserves fell to the equivalent of 2.6 months of import cover, reducing Ghana's ability to respond to external shocks. As the staff report notes, only a portion of this deterioration was related to factors outside the authorities' control; the primary cause was the result of a substantial loosening in fiscal and monetary discipline.

These policy slippages contributed to a weakening of the economy that is extending well into 1993. In particular, the lagged inflationary pressures from the recourse to bank financing of the deficit, compounded by significant petroleum price increases, have caused annual inflation rates to rise quickly during this year. As a result, there has been substantial erosion of the progress that had brought inflation down to 10.3 percent at the end of 1991. Even with a significant tightening of financial policies in 1993, end-year inflation is projected to reach 20 percent.

We agree with the staff that there must be a profound tightening of fiscal policy. Strong measures on both sides of the ledger are needed to redress the poor outcome of 1992, which saw revenues fall far short of target, owing to lower than envisaged cocoa revenues and weak tax administration. Likewise, expenditures shot up, owing to large increases in civil service salaries and benefits. With regard to the corrective actions proposed, we strongly concur with the need to limit costs at the Cocoa Marketing Board, while noting that it is not clear from the staff paper why these costs escalated so much last year. We also strongly agree that the authorities need to resist strongly yet another pay increase for the civil service.

On the revenue side, we welcome the planned efforts to improve tax collection and administration. With regard to other proposed measures, we wonder whether the reliance on petroleum price increases is excessive. Over three fifths of the projected improvement in the budget balance is to be derived from this source. We would be interested in knowing to what extent the price increase merely compensates for the effects of the devaluation in 1992. More broadly, if political pressures succeed in limiting fuel price increases or forcing a general civil service pay increase, do the authorities have contingency measures in mind to ensure that budget targets are met? Staff comments are welcome on this issue. Another anticipated revenue source, equivalent to 1.5 percent of GDP, is the Government's divestiture program. While we are encouraged by the Government's intention to accelerate the privatization process, we are also concerned that one-time revenue sources, such as the Government's divestiture program, are being relied upon to finance the budget deficit.

With regard to monetary policy, we strongly support the staff recommendations and the authorities' intention to tighten monetary policy substantially.

Turning to structural and sector issues, full-scale reform of the Cocoa Marketing Board clearly must be a key priority for the authorities, especially in view of the budget implications already noted. We would have expected that reforms such as the elimination of the Board's export monopoly, reduction of excess employees, disengagement from noncocoa crops, and sale of cocoa plantations would have been accomplished much earlier in the reform process. Private traders clearly cannot operate successfully in the current environment.

With regard to development of a stronger private sector, the privatization program must be accelerated both to improve the efficiency of the public sector and to send a strong signal to the private sector about the Government's intentions. In this regard, we are encouraged that the divestiture program has received priority attention in the 1993 program, and we note that the new investment code also conveys a positive signal to the private sector.

With regard to other structural issues, we are disturbed that the structural benchmarks for 1993 do not include those that were missed under the 1992 program, namely, progress on bank divestitures, quarterly publication of economic data, preparation of a report on financial flows to state enterprises, and reform of the civil servant pay scale. Does the staff have any information on the authorities' intentions in this regard?

Finally, we can support Ghana's request for a drawing under the CCFF. We would note, however, that the decline in international reserves experienced in 1992 was not entirely "beyond the control of the authorities." Although external factors, such as the decline in commodity prices, contributed to the reserve drawdown, so too did excess government expenditures and expansionary monetary policy.

The staff representative from the African Department said that the Cocoa Board's increased costs in 1992 had been due mainly to the same problem that had afflicted the central government budget, namely, the large increase in pay and associated personnel benefits. To the extent that the Central Government could contain civil service pay in 1993, the demonstration effects should enable the Cocoa Board to contain its labor costs; in that event, the staff was confident that the targets for the Cocoa Board's overall expenditures could be met.

In March 1993, the authorities had increased the secondary reserve requirement and had reduced by a compensating amount the cash reserve requirement, the staff representative noted. As a result, the effective yield on commercial bank assets had risen by about 2 1/2 percentage points and there should logically have been some reduction in bank spreads. However, no such reduction had been seen yet. In fact, over the past two months, there had been a small increase in the spreads. However, the spreads tended to vary considerably from one month to the next, and it was perhaps still a little early to draw any hard and fast conclusions about the impact of the March measures on bank spreads. The staff would certainly hope that, in the near future, there would be some reduction in bank spreads from their present relatively high level.

As to the contingency measures that were built into the program, on the domestic side the staff had discussed with the authorities a range of measures that could be taken both to fill the small remaining gap--about 0.3 percent of GDP--and to fill any gap that might arise during the course of the year, the staff representative commented. The measures included, inter alia, a sales tax increase. The present sales tax rate was well below the rate prevailing just a few years earlier; hence, there was some scope for a sales tax increase should the situation require it. The staff had also discussed with the authorities the possibility of an import surcharge, and it, too, would be considered as a possibility should the need arise.

On the external side, the staff representative continued, the authorities would use international reserves as the first line of defense in the event of any external shock. The requested CCFF purchase would build up the reserve position. At the same time, the authorities were obviously anxious to maintain a healthy gross reserve position and would be willing to use the exchange rate as an instrument to protect against adverse external shocks. In that sense, to some extent, imports would also bear a part of the adjustment burden.

The Board and donors would be informed of progress under the program for 1993 through various channels, the staff representative remarked. There would be periodic country briefing sessions for the Board, the staff would consider issuing to the Board a statement describing performance under the program, and, as was currently happening, the resident representative in Accra would be informing donors on a continual basis of the performance under the program.

It had been suggested that there might be an inconsistency in having an ESAF-eligible country use CCFF resources, the staff representative recalled. The purpose of the CCFF--and the reason why the Ghanaian authorities were anxious to use the facility--was essentially to bridge a shortfall in external assistance. Toward the end of 1993 the authorities expected a large increase in foreign exchange inflows arising from the proceeds of the divestiture of public assets. At the same time, donor flows were expected to be restored to more normal levels. The proceeds from the CCFF purchase would be added to reserves, and in that sense the actual interest cost would be minimal--i.e., the difference between the cost of borrowing from the Fund and the interest the authorities would earn from investing those reserves elsewhere.

During the latest contacts with the authorities, they had stated that they intended to move expeditiously to Article VIII status, the staff representative commented. The staff hoped that they would actually make the move before the next Board discussion on Ghana.

The monetary program was based on the central bank controlling or attempting to influence broad money by gaining direct control over reserve money, the staff representative said. The question obviously arose as to the best method of acquiring control over reserve money--reserve requirements and changes in the rediscount rate versus open market operations. Most industrial countries were currently targeting monetary aggregates through open market operations rather than through the more blunt instrument of reserve requirements, and that was what the Ghanaian authorities had adopted as a strategy, with the staff's support. At the same time, the authorities were using reserve requirements as a second line of attack in meeting the monetary targets, and, as was noted in the staff report, reserve requirements had been increased recently. The central bank rediscount rate had been, and would continue to be, raised as a signal of impending increases in treasury bill rates; but the increase in treasury bill rates had to come about by stepping up open market operations, with the central bank selling more treasury bills and more central bank debt in the market in order to force up the rate on treasury bills.

Speakers had raised questions relating to petroleum price increases, their impact on competitiveness, and the authorities' apparent undue reliance on petroleum taxation to effect budgetary adjustment, the staff representative recalled. The increase in petroleum prices in January 1993 was 60 percent, about half of which was needed to catch up for the slippage in 1992 owing to the Government's failure to adjust petroleum prices following the considerable depreciation of the currency. The depreciation had squeezed the tax take for the Government.

Obviously, the petroleum price increases would be inflationary in the short run through its cost-push impact, the staff representative continued. However, over time, the absolute level of prices was determined by monetary developments. The authorities intended to reduce the rate of growth of the money supply from 53 percent in 1992 to near 0 percent in 1993--an indication of their determination to contain the rate of inflation.

The inflation target for 1993 of 20 percent was perhaps a little high, the staff representative commented. However, most of that increase had already taken place and reflected the considerable expansion of liquidity toward the end of 1992. The authorities were fully aware that the larger the increase in petroleum prices the stronger the case the unions could make for an increase in wages. The Government was determined to avoid a general wage increase in 1993. If pressures to prevent an increase in wages were too strong to bear, the sort of contingency measures that he had mentioned would be brought into effect to ensure that the fiscal targets were met.

There were two reasons why the staff had not included as structural benchmarks some of the performance criteria missed in 1992, the staff representative from the African Department commented. First, the staff had not wanted to overload the program with structural benchmarks; the program already contained several such benchmarks. On previous occasions, Directors had suggested that the staff should keep the benchmarks to the minimum. Second, Directors had also suggested that clear priorities should be assigned to individual benchmarks. The benchmarks that were currently included in the program were regarded as the most important ones--which did not mean that the staff was ignoring the importance of action in other areas.

Mr. Tetangco made the following statement:

> In considering the economic performance of Ghana, we should not overlook the progress achieved under its economic adjustment and reform program between 1983 and 1991, which is well documented in the staff papers and referred to by previous speakers. The measures toward greater market orientation, fiscal discipline, and comprehensive structural and institutional reforms implemented during the various phases of adjustment resulted in improved economic performance characterized by satisfactory GDP growth

averaging 5 percent per annum, a reduction in the rate of inflation to 10 percent by end-1991, a surplus in the balance of payments, and a comfortable level of international reserves. It is precisely this progress, however, that sets off the marked contrast with the recent loosening of recent policies and the failure to carry out certain structural measures. The costs of elections proved higher and more immediate than anticipated, and should serve as a meaningful example to members of the costs of policy slippage--reflected in a resurgence of inflation, a weaker external payments position, and slowed output growth.

While the significant political changes in 1992 were undoubtedly desirable, they did make simultaneous pursuit of continued economic reform more complicated. Still, good economic performance is an important component of a stable and healthy political environment. What is needed now is clearly a return to sound economic management, and I welcome the commitment of the new authorities to tighten the financial stance.

On fiscal policy, I agree with the staff on the need for a sharp improvement in the budget balance, and I welcome Mr. Kabbaj's update describing early successes on the fiscal front. It would be desirable if the move to raise petrol prices proves to be the first step toward full deregulation of that sector. Furthermore, I agree that the effectiveness of tax administration needs to be improved following the drop in revenue effort in 1992. The impact of large public sector wage increases on total government expenditure was marked in 1992, and the authorities did work hard to avoid any repetition of this slippage.

On monetary policy, I also agree with the staff's assessment of the need to address the excess liquidity created through financing of the Government's deficit last year. I appreciate the readiness of the authorities to engage in open market operations to the extent necessary to achieve the targeted contraction in reserve money. However, I wonder whether the reduction in cash reserve requirements is consistent with the objective of holding down liquidity. While secondary reserves have been raised, these particular Bank of Ghana bills feed back into the monetary base through interest paid, which has led Ghana to raise interest rates. I would appreciate staff comments on this.

The significant turnaround in anticipated private capital inflows forecast for 1993 will depend on the continued credibility of government policies. Given the significant amount expected from divestiture of assets, which has not only a balance of payments but also a fiscal effect, I was struck by the exclusion of privatization measures from the structural benchmarks for the 1993 program and thought that it would have been desirable to include them for this year. Should this rather optimistic forecast for capital inflows not materialize, additional consolidation measures will be required to avoid any further deterioration of the external position.

In light of the significant decline in export earnings from cocoa, I can agree to the request for a CCFF arrangement. However, I do note that reduced earnings are anticipated this year resulting from selling the crop forward at what turned out to be an unfavorable price and exchange rate, which, perhaps, underscores the need for reform of the Cocoa Board to remove its monopoly. I welcome steps already taken to restructure the Board by ending the marketing of noncocoa products and the recognition of the need to stem the Board's costs, and I would encourage further steps toward opening the market to greater competition.

The authorities' strong commitment to work closely with the Fund to reverse the problems of 1992 gives cause for confidence. It is perhaps in welcome recognition of such confidence that the Consultative Group has agreed to continue generous support. It is my hope that the next time this Board discusses Ghana a return to the progress of previous years can be reported.

Mr. Ferrillo made the following statement:

A combination of adverse external price developments and lack of fiscal discipline created the conditions for disappointing economic results in 1992. As a matter of fact, most of the program benchmarks were not observed. Real GDP growth in 1992 fell to 3.9 percent, well below expectations. The balance of payments experienced a deficit, and international reserves fell to 2.6 months of imports. In order to finance the large 1992 fiscal deficit the Central Bank of Ghana pursued an expansionary monetary policy and, consequently, inflation rose rapidly to 23 percent at end-March 1993. Finally, although some progress has been achieved in several important areas, the pace of structural reform slowed down during 1992.

The Ghanaian authorities are right to immediately correct these slippages in policy implementation, to restore financial discipline, and to speed up structural adjustment. In this perspective, I welcome the ambitious 1993 program, which put emphasis on financial and structural policies. Firm policy implementation will pave the way to re-establish Ghana's strong track record of policy performance, to restore external viability, and to create the conditions for self-sustained growth.

Being in broad agreement with the staff appraisal, in particular with the measures to be taken in a number of key areas, I will limit my remarks to some specific issues.

I share the view of the staff that continuing structural reforms is crucially needed to improve, in particular, the incentives for the private sector and to ease the constraint on growth from inefficient public entities. In this latter respect, I would strongly recommend setting clear targets for the Government's divestiture program.

I commend the intention of the Ghanaian authorities to apportion 10 percent of its capital expenditure to expand basic social infrastructure. I feel uncomfortable, however, with the apparent lack of measures to take care of redundant civil servants. The development of human resources--here the retraining of civil servants--is an important factor conditioning future economic growth. Is the staff aware of a training program for them? The staff's comments would be appreciated.

On the external sector, I agree with the staff appraisal that it is imperative to now terminate the Cocoa Board's monopoly over the export of cocoa in order to take full advantage of the structural reform implemented toward end-1992. Promotion of nontraditional exports and suppression of the various impediments to the development of the agricultural sector are, in my view, also crucial. In this respect, I did not find in the staff paper what measures are contemplated to further diversify Ghanaian export revenues in order to reduce Ghana's vulnerability to the external environment. Nevertheless, these objectives must take into account environmental requirements, such as reforestation and recycling of by-products from gold exploitations.

I share the view of previous speakers that Ghana's reliance on external assistance at the present levels is not sustainable in the medium term. Although growth is likely to remain for some years a function of the volume of external assistance, the full implementation of the 1993 program is a step in the right direction, as it will create the framework in which to mobilize more domestic savings that is consistent with an accelerated growth path.

With these remarks, I support the proposed decision.

Mr. Mohammed made the following statement:

After nearly a decade of very good performance, supported by a series of Fund arrangements, the economic situation in Ghana took a turn for the worse in 1992. Undoubtedly, the challenges posed by the transition to democratic rule and exogenous factors contributed to this development, particularly given that Ghana is a small open economy with a relatively narrow export and production base. However, slippages in policy implementation, particularly on the expenditure side, also contributed to the deterioration in the economic and financial position.

At this stage of the discussion, I will make only a few remarks on the proposed use of Fund resources and on fiscal policy, as well as structural issues.

Let me first start by saying that I welcome the efforts made to correct the slippages of last year. I note from Mr. Kabbaj's informative statement that the authorities' 1993 program has already achieved some success in re-establishing internal and external balances and in bringing the economy onto a more stable path.

I can support Ghana's request for a purchase under the CCFF, although I am not sure that the CCFF is the most appropriate vehicle for extending Fund financial assistance to this low-income country. The case before us illustrates the need for the Fund to have the ability to respond to the financial needs of its low-income members with the kind of concessional resources that have demonstrably proved to be well suited to the circumstances and needs of these members. In this connection, I believe that Ghana's present balance of payments need could have been met more appropriately under a fourth-year ESAF arrangement. A staff comment on this issue would be appreciated.

On financial policies, the authorities envisage an improvement in the budget balance in 1993 of about 5 percent of GDP; this is indeed ambitious. I note that the majority of this improvement is to come from higher petroleum duties. Can the staff inform us how petroleum prices in Ghana compare with prices in neighboring countries? I ask this out of the consideration that, where feasible, reliance on a narrow tax base should be avoided. Rather, emphasis should be on an overall improvement in the structure of the budget. In this regard, we wish to associate ourselves with the remarks of Mr. Al-Tuwaijri.

Regarding the large wage increase granted to the civil service in 1992, I realize the importance that is rightfully placed on retaining the highest quality of the public sector labor force. Yet emphasis should also be put on civil service reform and rationalization to offset the budgetary impact of large salary increases. This is all the more necessary in light of the pressures to grant a further pay increase in 1993.

Finally, on structural policies, we welcome the decision of the Government to allow licensed private traders to compete with the Cocoa Board. However, like the staff, we encourage the authorities to terminate the monopoly of the Board over cocoa exports.

Mr. Dlamini made the following statement:

Since 1983, when Ghana initiated its Economic Recovery Program, the authorities have established a good track record of policy implementation, evidenced by the successful completion of a three-year ESAF program. Consequently, by 1991, the fiscal and balance of payments position had swung to a surplus, inflation had moderated considerably, and annual GDP growth rate was sustained at an average of 5 percent. In addition, Ghana maintained a healthy gross external reserves position.

It is regrettable that in 1992 in the immediate post-ESAF period, higher than anticipated election-related expenditures, reduced donor disbursements, and incessant labor unrest forced up wages and contributed significantly to Government expenditure overruns. In addition, the unfavorable weather conditions and the decline in export commodity prices resulted in the widening of the current account deficit and the erosion consequent of external reserves.

It is against this background that I welcome the authorities' 1993 macroeconomic policy package, which seeks to redress these concerns. On the fiscal front, the authorities' commitment to adjust petroleum prices in line with exchange rate developments and the recent measures taken to strengthen tax administration are steps in the right direction. However, additional tax measures may be required to help the authorities meet their revenue target for the year. Fiscal action should also appropriately emphasize expenditure cuts. Specifically, the authorities should contain increases in their wage bill and should substantially reduce outlays on goods and services. A reduction in the operating costs of the Cocoa Board, through the laying off of excess labor and removal of noncore operations of the Board, is crucial to enhancing revenue receipts from cocoa. Meanwhile, the strategy of announcing the producer prices ahead of the crop season provides the necessary incentives to increase supply. We encourage the authorities to dismantle the monopoly of the Cocoa Board by allowing licensed dealers to actively participate in the procurement and exports of cocoa. Also, action on civil service reform and the public enterprise divestiture program should be expedited.

Developments envisaged in the monetary sector in 1993 call for vigilance on the part of the Bank of Ghana to remain ready to contain credit expansion that could arise from increased banking system liquidity attributable to increased public preference for bank deposits over currency holdings. On the external sector, Ghana should, in addition to maintaining a liberal exchange and trade regime, adopt measures to diversify the country's export base. The external sector remains extremely vulnerable to changes in the world cocoa market.

I commend the Ghanian authorities for their unwavering commitment to reform. I believe that their 1993 program is strong enough to reverse the pitfalls of 1992, and the Board's approval of the CCFF will go a long way in supporting their efforts.

We support the proposed decision.

Mr. Yang said that he agreed with the comments of previous speakers. Savings and investment in Ghana were modest compared with other developing countries, increased investment was required to accelerate growth over the medium term, and the present high level of reliance on external assistance was unsustainable. Therefore, the authorities should enhance domestic savings by strengthening the measures they had introduced to generate savings.

He agreed with previous speakers' views on how to streamline the Cocoa Board, Mr. Yang commented. As the cocoa sector played a major role in employment and foreign exchange generation, it was important to end its monopoly over exports as soon as feasible. At the same time, while encouraging private traders to compete with the Cocoa Board, the authorities should be careful to avoid taking measures that would negatively affect the development of the sector; to that end, they should take some precautionary measures.

The authorities should be encouraged to implement strictly the 1993 stabilization and structural reform program to regain the momentum of macroeconomic adjustment, Mr. Yang said. Given Ghana's previous good track record, he could support the country's request for a purchase under the CCFF.

Mr. Heinen made the following statement:

Ghana has become an unfortunate example of how quickly a solid performance in macroeconomic adjustment can be thrown off track, and some of its most notable achievements reversed, whether in the area of fiscal restraint, inflation control, or domestic growth. Indeed, it is somewhat awkward that this major downturn in the Ghanaian economy occurred between two regular Article IV consultations, with no clear forewarning given during last year's consultation.

To the extent that Ghana's political reforms had been waiting in the wings for some time, the risk that a fiscal relaxation would be used to smooth over the political transition process was nevertheless predictable on the basis of similar patterns observed in many other countries. Maybe future Fund consultations should make more explicit allowances for such political realities and come up with recommendations for counteracting the economic costs of democratization.

In Ghana's case, however, the macroeconomic deterioration was only partly due to political concessions, the other major factor being the significant worsening of Ghana's terms of trade, especially in the cocoa business. We agree with the staff's assessment of the shortfall in export earnings and can therefore fully support the authorities' request for a purchase under the CCFF as outlined in the draft decision. As to the projected value of future cocoa exports, however, we wonder why the estimated unit price for cocoa exported in 1993 is 4 percent lower than the projected world price, when Ghanaian cocoa is normally sold at a premium owing to its superior quality. The staff's observations on this issue would be appreciated.

With regard to the new medium-term policy framework, we concur with most of the staff's recommendations and will therefore limit our comments to the following points. Based on the economic indicators presented to us, we are concerned that Ghana's economic development model not only relies excessively on official capital flows, but, in addition, has not succeeded very well in fostering private investment, either foreign or domestic. For example, a recent World Bank study shows that Ghana benefited from capital inflows amounting to about 8 percent of GDP in recent years, which is much higher than the amounts other countries (notably in Southeast Asia) received at comparable stages of their development. On the other hand, this large external assistance has included only a very small share of private sector capital flows, amounting to only one tenth of the total. On the domestic front, the rate of private investment also remains very low (around 8 percent of GDP) compared with other developing countries. In view of the empirical evidence pointing to a strong correlation between private investment levels and GDP growth, could the staff please give us their assessment of Ghana's outlook, and also give us a feeling for the prominence this issue was given during the recent policy discussions?

Mr. Raza made the following statement:

The exemplary performance of Ghana's economy during the past three years notwithstanding--in fact, against that background--the all-around policy slippages during 1992 were highly disappointing. I only hope that these were transitory in nature, and that Ghana will take strong measures to enable it to resume its march toward achieving the three key objectives of sustained growth, price stability, and a viable external position. In this, I am encouraged by Ghana's past record, measures already taken, and actions initiated by the authorities. However, there are some developments that make me uneasy.

First, a key element of the 1993 program is a targeted improvement in the fiscal balance. The improvements in tax collection procedures are most welcome. However, there is no apparent effort to raise revenue on a sustainable basis. The large increase in petroleum prices and the sale of shares in government enterprises would give only one-time increases. On the increase in petroleum prices, I fully share the comments made by Mr. Al-Tuwaijri. Furthermore, although growth of capital expenditure is being curtailed, growth of current expenditure in 1993 is projected to be even larger than in 1992. This would make the task of fiscal consolidation difficult.

Second, the authorities are aiming at zero growth in broad money. This is most welcome. However, this would be nullified by the projected sharp increase in velocity. Overall, inflationary pressure may remain intense.

There is no indication of any systemic reform to enhance the efficiency of state enterprises.

The already low levels of domestic savings and investment have declined further. There is no indication of any effort to raise their levels. This would act as a drag on growth.

The role of the state remains as dominant as before. In fact, over time there has been some increase in the share of government in total consumption and gross fixed investment; the share of the private sector has correspondingly declined. This is not consistent with the objective of promoting the role of the market.

Ghana satisfies all the criteria for a purchase under the CCFF. I therefore endorse the proposed decision. The task before the authorities is arduous. I wish them well.

Mr. Posthumus made the following statement:

In March 1992, at the expiration of Ghana's ESAF arrangement and on the occasion of its Article IV consultation, we, like other chairs on this Board, commended the authorities on the successful implementation of their stabilization and structural adjustment program. The results up to the end of 1991 were indeed encouraging. We did, however, warn that consolidation of the achievements made would require perseverance in maintaining tight fiscal and monetary policies, particularly as 1992 was an election year, with all the pressures that this implied for relaxation of policies.

In the event, our fears were justified, insofar as the year did bring a significant loosening of policies, with the concomitant results of worsening fiscal and external imbalances and a buildup of inflationary pressures that are now expected to be fully felt in 1993.

The slippages of 1992 will require tougher action now, and the more complicated life of a new political framework will require more flexibility and willpower to get the economy back on track. However, the promising results of 1991 have shown us that Ghana is capable of sacrifice and determination in adopting and implementing appropriate economic policies. We would therefore urge the authorities to implement fully the agreed program for 1993, particularly as the international community has shown it is prepared to support them in their efforts.

The heavy dependence on increasing petroleum duties makes the budget, of course, rather vulnerable. I therefore wonder what the possibility is of speeding up the introduction of the value-added tax to an earlier date than the end-1994 envisaged dateline, which would naturally help widen and deepen the tax base.

Finally, I note that while cocoa trading domestically has been liberalized, the Cocoa Board monopoly of exports has been maintained. Apart from the fact that the high costs of the Board are a problem, as they reduce the revenues that could accrue to the budget, and the fact that private sector trading in cocoa is discouraged by maintaining the status of this Board, a large part of the foreign exchange earnings of Ghana do not go through the market but are surrendered by the Board to the central bank. This may well be a contributory factor in the exchange shortage noted in late 1992, which was compounded by the reticence of the central bank to supply foreign exchange before queues began to form--a situation that suggests the market is not being permitted to function properly. Thus, for both budgetary and foreign exchange market reasons, I would strongly urge the liberalization of the cocoa export trade, with possibly the privatization of the Board's functions.

I have no problem in agreeing with Ghana's purchase request.

Ms. Lindsay-Nanton made the following statement:

As other Directors have noted, 1992 represented a watershed for the Government and the people of Ghana. On the one hand, while it marked the relatively peaceful transition to democratic rule--and this should be applauded--it was also a year in which economic performance was very disappointing. Real GDP growth was lower than programmed, inflation accelerated to 13 percent, and the budget surplus turned into a deficit of close to 5 percent of GDP.

I view 1992 as an extraordinary year, and I welcome the efforts already taken to correct the slippages that occurred. Mr. Kabbaj, in his helpful statement, has pointed to some early successes of the 1993 program. In particular, the raising of premium petrol prices earlier this year and the greater discretion allowed now in the adjustment of oil prices, without specific recourse to Parliament, are to be welcomed. Equally important are the steps to limit the expenditures of the Cocoa Board, and I strongly endorse the call for the participation of licensed traders in the export of cocoa.

On the expenditure side, the large pay awards granted in 1992 were perhaps unavoidable in view of the significant political changes taking place. I think it is all too easy to underestimate the difficulty in bringing about such political change in a relatively peaceful manner. But I would argue that much more should be done to sensitize the populace to the implications of large salary increases that governments are pressured to make and which have, in turn, to be accommodated by recourse to bank financing.

Having said this, I would emphasize that, for accelerated growth over the medium term, gross investment for a higher growth of exports and domestic savings will have to be lifted. This would imply a significant government contribution to the savings rate, and the authorities' commitment not to grant further across-the-board wage increases in 1993 should be firmly adhered to.

In the area of divestment, the staff notes that the program is to be accelerated greatly and some 30 public enterprises are to be offered for sale. While I note from the background paper that there are no published comprehensive consolidated accounts of the state enterprise sector, I was curious about the words "many state enterprises whose financial prospects are uncertain." Could the staff elaborate on the activities in which these enterprises are engaged and what plans there may be for their privatization. In addition, the staff notes that a number of other enterprises that make large profits pay no taxes to the Government, and that a new law to remove the tax-exempt status of these enterprises is being considered. Does the staff have any knowledge of the timing of the passage of this new legislation?

Regarding monetary developments, I endorse the staff's call for careful monitoring over the coming months. A smoothly functioning foreign exchange market is essential in order to facilitate private sector activity and bring about rapid and sustainable growth.

In addition, the central bank must be ready to engage actively in open market operations in the event that the public's currency/deposit ratio falls by more than is anticipated.

Ghana's poor economic performance in 1992 stemmed in part from a weakening of world market prices of cocoa and timber, which further impacted negatively on the balance of payments and the government budget. As Ghana satisfies the requirements for a purchase under the CCFF, I can support the request. I wish to emphasize, however, that if Ghana is to get its macroeconomic situation back on track, the authorities' commitment to correct slippages in policy implementation must be followed through with strong determination and resolve.

The Chairman said that he, too, had been impressed by the reference in Mr. Kabbaj's statement to the authorities' pride in having conducted a peaceful transition to a democratically elected government. Of course, such a transition had its costs. In Ghana, those costs might have exceeded expectations, but the authorities' efforts to catch up and to move back onto the path of sustainable growth deserved the Fund's support.

The staff representative from the African Department said that he agreed with Mr. Tetangco's comments on the fiscal impact of the increase in interest payments arising from the reduction in cash reserve requirements and the corresponding increase in secondary reserve requirements. Previously, the cash reserve requirement had been 18 percent, which had led to major distortions in savings and commercial banking decisions. That requirement was an implicit tax on the commercial banks; the revenue involved would be much better raised through corporate income taxation. The secondary reserve requirements obviously involved higher interest costs. The budget did include measures designed to cover those costs, which were included in the overall targets in the program.

It had been suggested by Mr. Wire that privatization of public assets could usefully have been included among the structural benchmarks, the staff representative recalled. It was very tempting to do so, but he had reservations about that action: he would not wish to put the authorities in the position of having to accept a lower price for their public assets simply to meet a structural benchmark under the program.

The authorities had developed a training program--albeit a fairly limited one--for retrenched civil service workers, the staff representative noted. The program was financed in part by the Official Development Agency in the United Kingdom. In addition, the Government had provided generous end-of-service benefits for retrenched civil service employees.

The staff had decided not to recommend a fourth-year ESAF arrangement, the staff representative remarked. The relevant guidelines explicitly stated that such an arrangement was to be exceptional in nature and should be restricted to those cases in which a strong track record had been clearly demonstrated--something that was not applicable in the case of Ghana. In any event, in the circumstances of Ghana, the CCFF was the more appropriate choice: Ghana had a short-term, bridging balance of payments problem that the ESAF was not designed to address.

The staff was confident that, over time, private flows could replace official flows as the source of balance of payments financing, the staff representative from the African Department commented. The divestiture program would produce the maximum amount of revenues in 1993 but would be ongoing thereafter. The staff was also confident that foreign investment would continue to rise each year. The investment code was already being met with favorable responses in Europe and elsewhere. Apparently the projections in the program for foreign investment in 1993 had already been exceeded.

Mr. Esdar said that, while he fully agreed with the argument that price effects should be taken into account when formulating privatization policy, a benchmark on privatization could be formulated without affecting the Government's sale price; the benchmark could be formulated entirely in terms of procedural objectives--for example, a deadline for the start of the relevant negotiations. Saying that including benchmarks on privatization in Fund-supported programs was too difficult would unduly bind the Fund's hands.

Mr. Dorrington commented that he agreed that, for the reason mentioned by the staff, the net cost for Ghana of using the CCFF would be fairly small. Still, even that cost would be significant for an ESAF-eligible country. Hence, he hoped that if and when reserves were built up to levels that would otherwise be adequate without the CCFF resources, Ghana might consider an early repurchase, which would be in its own best interest.

The staff representative from the Policy Development and Review Department commented that Mr. Esdar's proposal was one way in which to encourage the authorities to establish a process under which they would be certain to make their best effort to achieve the desired privatization. Under some other Fund-supported programs, that objective was sought through a general review clause; under that approach, while there might not be a specific target date, it was clear that the performance with respect to privatization was one of the factors that would justify completion of the review.

Mr. Kabbaj made the following statement:

> First of all, I would like to thank Executive Directors for the interest they have shown in Ghana. Their comments and advice have been noted and will be passed on to the authorities, who, I am sure, will give Directors' views the most careful consideration.
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> Directors have expressed disappointment in the outturn in 1992. I think the authorities would share that assessment. But, as I stated in my opening statement, 1992 was an exceptionally difficult year, when the economy was confronted with many challenges. There was the complex task of making the transition to democratic constitutional government. This was managed successfully, but at a price. To make matters more difficult, the economy was also hit by an adverse terms of trade shock. And the impact of this shock was compounded by the suspension of disbursements of programmed assistance.
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> Against the background of this combination of adversities, the authorities' decision to take bold and decisive corrective measures was recognized. It reflects the authorities' belief that

macroeconomic stability provides the foundation for continued reform. There were many pressures tc delay the response, but these were firmly resisted.

Developments in the first quarter of 1993 have been especially encouraging. They suggest that the program is on track, and that the policies in place will be sufficient to re-establish Ghana's strong record of policy performance. However, as the staff notes, despite the tight stance of monetary policy, it is unlikely that inflation can be brought down very quickly. This could have implications for the forthcoming round of wage negotiations in the public and private sectors. The authorities have indicated that they stand ready to tighten financial policies even further in the event price and wage trends turn out to be less favorable than anticipated.

In short, the authorities are confident that the program targets for 1993 will be met and that the economy will be returned to an adjustment path that is consistent with balance of payments viability and sustained growth. The authorities, as their past record indicates, will continue their fruitful dialogue with the staff and have an open mind on the form of cooperation with the Fund to be adopted in the future.

Looking to the future, the Government recognizes that macroeconomic stabilization will have to be complemented by deepening and accelerating the process of structural reform. This will entail enhancing incentives for the private sector, accelerating public enterprise divestiture, improving performance of state enterprises, and strengthening public sector management. The authorities are confident that their commitment to macroeconomic stability and continued policy reform will lay the foundations for accelerated growth and sustained poverty alleviation.

Ghana continues to maintain a liberal exchange and trade system. The authorities have indicated that they intend to accept the obligations of Article VIII in the near future.

The Chairman made the following summing up:

Executive Directors were in broad agreement with the staff appraisal. They noted with concern that performance under the 1992 Fund-monitored program had been disappointing, particularly when compared to Ghana's strong record of economic performance under the preceding three-year ESAF arrangement. Some of the deterioration was due to factors beyond the control of the authorities, including a decline in the prices of Ghana's key export commodities. Directors observed, however, that fiscal discipline also weakened considerably, as evidenced by the large pay increase which was awarded to civil servants during the run-up to multiparty elections. Thus, the fiscal deterioration of almost

7 percent of GDP had contributed significantly to the resurgence in inflationary and balance of payment pressures. At the same time, Directors were impressed with Ghana's peaceful transition to a democratically elected government.

In that context, Directors welcomed the authorities' commitment to return the economy to an adjustment path consistent with the restoration of external viability and sustainable growth. In this regard, they noted with satisfaction the adoption of a comprehensive stabilization and structural reform program for 1993, which would be monitored by the Fund staff. Despite the worsened external environment, the program aimed at eliminating the fiscal deficit through an improvement in the budget balance by 5 percentage points of GDP, while tightening monetary policy to reduce the growth in broad money. Some Directors regretted the heavy reliance on increases in taxation of petroleum products to the extent of the equivalent of 3 percentage points of GDP in the Government's fiscal program, and Directors generally encouraged the Ghanaian authorities to rely more on broad-based tax measures. Also, the projected further increase in government expenditure as a share of GDP suggested that the authorities should be more rigorous in pruning current outlays.

Directors pointed out that achieving the inflation and balance of payment targets for 1993 was critical for the quick restoration of financial stability. In fact, questions were raised whether these targets should perhaps have been more ambitious. At any rate, Directors urged the authorities to stand firm in their resolve to take without delay further fiscal actions that might be necessary to meet the fiscal targets. Directors commended the Government's decision not to grant a pay increase to the civil service in 1993, given the very large award granted in 1992. Directors concurred with the monetary policy actions already taken and emphasized the need for the Bank of Ghana to step up the scale of its open market operations, as necessary, to achieve the objectives of the monetary program for 1993 and thus sharply reduce inflationary pressures.

Directors supported the strategy to reinvigorate structural reforms and enhance the incentives for private sector development by accelerating the divestiture program, while improving the performance of those enterprises remaining in the public domain. In particular, they emphasized the importance of successfully containing the operating costs of the Cocoa Board in order to safeguard budgetary revenues, and of maintaining adequate price incentives for cocoa farmers. Directors underscored the sense of urgency for reforms in the cocoa sector at a time of faltering world cocoa prices, and urged the authorities to terminate the Cocoa Board's monopoly over the export of cocoa.

Finally, noting that Ghana's dependence on external assistance was projected to continue at high levels for a number of years, Directors emphasized that successful economic stabilization in 1993 and progress with structural reforms and increased domestic savings and investment were critical for progress toward external viability. Directors welcomed Ghana's elimination of all exchange restrictions on current international transactions and urged the authorities to accept the obligations of Article VIII.

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

The Executive Board approved the following decision:

1. The Fund has received a request by the Government of Ghana for a purchase in an amount equivalent to SDR 47.0 million for the compensatory financing of a shortfall in export receipts from merchandise under Section II of the Decision on the Compensatory and Contingency Financing Facility (Decision No. 8955-(88/126), adopted August 23, 1988, as amended).

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

Decision No. 10418-(93/99), adopted
July 14, 1993

4. ARGENTINA - 1993 ARTICLE IV CONSULTATION, AND REVIEW UNDER EXTENDED ARRANGEMENT

The Executive Directors considered the staff report for the 1993 Article IV consultation with Argentina and the fifth review under the extended arrangement (EBS/93/101, 6/18/93; and Sup. 1, 7/9/93). They also had before them a background paper on recent economic developments in Argentina (SM/93/137, 7/1/93).

The staff representative from the Western Hemisphere Department stated that the data for the month of June showed that inflation had moderated, as the consumer price index had risen by 0.7 percent--about 9 percent on an annualized basis--while the wholesale price index had declined slightly. In the public finances, tax revenues in the second quarter were about Arg$500 million--about 0.8 percent of quarterly GDP--below the revised program projections of February 1993, which confirmed the staff's concerns in that area. The shortfalls had been in almost all revenue categories, but in particular in the value-added tax--which had accounted for about half of the shortfall--the corporate income tax, and--to a much lesser extent--social security collections.

Mr. Zoccali commented that while tax revenue collections in the second quarter had fallen somewhat short of the ambitious growth targets, the June targets were expected to be met. The reduction of taxes that had distorted the cost structure of firms was seen as a healthy qualitative change. In fact, forgone revenue with respect to the first semester of 1992 from those taxes--such as the tax on bank debits, the stamp tax, the tax on corporate assets and on heavy fuels, and the 5 percent special levy on public enterprises--would have exceeded Arg$1.8 billion in constant terms. Total tax revenue in the first semester of 1993, compared with the same period of 1992, had still increased by about Arg$2.4 billion in constant terms, of which Arg$1.5 billion represented higher value-added tax collections. Revenue growth during the second semester from measures already taken by the authorities was expected to show an important increase. The change that was taking place in Argentina could best be summarized by the line in Table 1 of the staff report, that the overall balance of the public sector in percent of GDP had shifted from a deficit of 10.5 percent in 1981-85 to a projected surplus in excess of 1 percent in 1993. That situation was not expected to change.

Mr. Zoccali then made the following statement:

Since July 1991, the Argentine economic program has been reviewed by the Executive Board on eight occasions, under the previous stand-by arrangement and the successor extended arrangement, now in the middle of its second year. The main conclusion to be drawn is that the convertibility law of April of 1991 has served to eradicate the inflation tax which was the principal cause of instability and stagnation in Argentina. This was achieved not through administrative prohibition, but rather, as a result of the freedom of its residents to legally substitute currency.

A consensus of domestic public opinion has also enabled the authorities to look beyond the exigencies of short-term stabilization and establish the conditions for sustained growth based on a redefinition of government responsibilities and a new outward orientation for the economy. Simply put, government's new role is to invigorate private initiative and reduce the fiscal burden associated with the exercise of discretionary authority or administrative inefficiency, while at the same time providing an effective social safety net and a more reliable legal framework. Public debate surrounding the specific instruments to bring about these objectives is considered a healthy signal, evidencing increased participation in a democratic decision-making process.

Congress has been supportive of the vigorous economic reform effort with enabling legislation. First and foremost, it has reinstituted the sound practice of balancing revenue and expenditure, tightened the budgetary control process, and acted rapidly on the revamping of the tax system and its administration to increase collection and reduce the distortionary effects of the prevailing tax structure. It has also given the Central Bank independence, within a currency board configuration, which precludes both government and private sector financing, and has abolished contractual indexation. All these measures have encouraged a process of strong remonetization of the economy. Congress has also advanced labor market flexibility and deregulation, more prominently in the energy, mining, telecommunications, and transport sectors, as well as the regulatory frameworks necessary for the full implementation, by the end of this year, of the far-reaching privatization program, which is well on schedule.

These actions, and the strong commitment and ingenuity with which the executive branch has been pursuing the adjustment and reform agenda, support its claim that satisfactory implementation of social security reform in the near term, and increased labor market flexibility toward the end of the year, are both attainable. In addition, after the congressional elections scheduled for October 1993, my authorities intend to devote their attention to advancing public sector reform at the provincial level through a new federal fiscal pact to be negotiated in 1994, along the lines of the ones that already have made possible the transfer of education and health programs from the federal government to the provinces, as well as the shift of 15 percent of coparticipated revenue to buttress the social security system.

One of the main reasons for having so forcefully launched the sale of the country's largest enterprise, Yacimientos Petrolíferos Fiscales (YPF)--the eleventh-largest oil company in the world--following the long-awaited implementation of the debt accord with foreign commercial banks, is precisely to show the extent to which Argentina is prepared to press on with those reforms. The strong demand for the public share offering in domestic and international financial markets is expected to permit an initial transfer of 58 percent of voting share capital to private investors. The proceeds from the sale, in excess of $3 billion, will be used in accordance with program understandings to further reduce public indebtedness, supplemented by the decision of the authorities to sterilize the monetary impact of the injection into the economy of the associated net receipts from abroad.

Real GDP growth of close to 9 percent in 1991-2 was fostered by a 30 percent annual increase in investment. The strong growth trend continues in 1993, albeit at a slower pace. Annualized rates of inflation through June, as measured by the consumer price index and wholesale price index, declined to 11 and 4.6 percent, respectively. Wholesale prices have hovered at international levels since mid-1991, and a single-digit cumulative annual rate of consumer price increase is within reach for the first time in 20 years. It is in this context, and with the program's performance criteria for end-March 1993 observed, that my authorities have requested the modification of the performance criterion applying to the timing for congressional approval of the social security reform bill already passed by the House of

Representatives. Although the parliamentary process has advanced slower than envisaged, all efforts are directed at having the reform enacted before the next program review.

The recent reform effort coupled with the support of the international community, in particular of the Fund, has afforded Argentina a unique opportunity to unlock its potentially large supply response. My authorities share the broad thrust of the staff appraisal, in particular the need to foster domestic savings both public and private, and they view sustainability not only in terms of adherence to strong macroeconomic fundamentals, but also in light of consistent policies aimed at securing productivity gains. In assessing Argentina's future prospects, perhaps three issues deserve special attention: relative prices and competitiveness, monetary policy and capital inflows, and domestic versus foreign savings.

Productivity gains in the manufacturing sector have led to an increase in the relative prices of nontradable goods and services, affected by usually slower improvements in productivity. Nominal wages in the industrial sector, deflated by the consumer price index, declined on average by 11 percent in the period March 1991-February 1993. The relatively higher industrial productivity explains part of the gap between tradable and nontradable prices. Another important factor is the normal pick-up in aggregate demand following stabilization. The rate of growth of consumption is now, however, slackening as pent-up demand has been satisfied. At the same time, competition is beginning to have an effect on the prices of nontradables, as is higher investment, fueled by deregulation and privatization. Differentials in sectoral productivity growth leading to a real appreciation of the exchange rate are to be expected at this stage of the adjustment process.

Rather than being the cause of the real appreciation of the peso, the fixed nominal exchange rate has probably slowed the appreciation that would have taken place under a more flexible system, in conditions of rapid re-establishment of access to international financial markets. This has been achieved without giving rise either to a quasi-fiscal deficit or to incremental inefficiency in domestic financial intermediation, which adversely affects, in particular, the competitiveness of smaller- and medium-sized firms.

On monetary policy, the Central Bank remains essentially passive, intervening to smooth out short-term fluctuations in interest rates through open market operations. The expansion of the money supply is determined largely by net purchases of foreign exchange by the Central Bank, which amounted to almost $1.05 billion through the first week in July. The monetary base remains fully backed by international reserves, and the rate of monetization, as noted in the staff papers, is still below its historical levels. Legal currency substitutability is seen as providing a cushion, in that a shift in currency preference will not necessarily lead to a credit squeeze for the economy as a whole. Nevertheless, my authorities are closely monitoring liquidity creation and have undertaken to sterilize the exceptionally large net inflows associated with the YPF operation. At the same time, they are intensifying their efforts to improve the solvency of the system through more stringent capital adequacy requirements and the tightening of bank supervisory practices. The still wide intermediation spread constitutes another concern. The policy on reserve requirements has aimed at improving the effectiveness of monetary control and at lengthening the maturity structure of bank liabilities. While the weighted average reserve requirement on both dollar- and peso-denominated deposits, including vault cash, stands at 20.1 percent, its average on peso bank liabilities exceeds 28 percent. Reducing the inefficiency of financial intermediation and lowering spreads between deposit and lending rates are indispensable for fostering savings and investment.

Economic analysts in Argentina regard recent net private inflows as but a proportion of the cumulative outflows of the past. While depressed international conditions have served to catalyze the process, progress with structural transformation and the maintenance of fiscal balance are seen as the underlying causes of its dynamism. The much-improved prospects for consolidating a competitive leap forward provide the assurances that external financing will not constitute a constraint on Argentina's modernization drive.

Last, but certainly not least, it is recognized that a widening of current account imbalances over time could jeopardize Argentina's solvency and credibility. Rather than prematurely discouraging capital inflows through administrative or monetary means, the major policy challenge facing the economy today is to increase domestic savings, thereby reducing its reliance on external financing.

The rate of national savings fell from 18 percent of GDP in 1990 to 14 percent in 1992. The sizable trade surplus of 1990 was not a by-product of strong macroeconomic fundamentals, but rather the result of an acute contraction of economic activity. Investment had declined to 14 percent of GDP and significant capital outflows were recorded. In 1992, however, gross fixed investment had increased to 16.7 percent of GDP. The resulting turnaround in the current account--to a deficit position--is not considered permanent or attributable to unsound policies.

To achieve annual real GDP growth rates of 5-7 percent, investment will need to increase, even though trade and financial liberalization have reduced the relative price of capital goods compared with consumer goods, and the marginal productivity of investment has clearly risen. The authorities' plan for increasing domestic savings and for achieving current account balance gradually is based on a medium-term strategy that combines measures directed at the determinants of savings as well as endogenous growth effects. These include higher labor productivity, which will increase the savings propensity of younger generations; a further reduction of the tax burden on capital formation, to enhance the marginal productivity of capital net of taxes and improve the return to savers; a deliberate reduction in public consumption in GDP terms; and the effects of the deepening of structural reforms. To end on this note, the envisaged social security reform is expected to contribute between 1 percent and 2 percent of GDP to the growth in domestic savings, while providing a permanent source of long-term capital which, as the Chilean experience shows, has served to sustain high levels of real investment and growth.

Mr. Torres made the following statement:

Since the approval of the convertibility law in April 1989, the Argentine economy has made significant and remarkable progress. Economic growth has averaged 9 percent for the last two years, the public finances have been strengthened considerably, the inflation rate has declined substantially, international reserves have increased to the level of 10 months of imports, and the external debt has been reduced. Large and significant structural reforms have also been successfully undertaken, among the most important of which are the trade liberalization and the privatization program. Particular mention should be made of the very recent and successful privatization of the state oil company, Yacimientos Petrolíferos Fiscales. The proceeds of this sale of more than $3 billion represent the largest privatization to date in the Latin American region, and one of the biggest in the world. The importance of this operation is not only related to the amount of the financial transaction that has been made, but also to the nature of the industry involved. The oil industry is one of those sectors that until very recently most governments in developing countries kept closed to private investment. Therefore, this recent achievement shows both the confidence of private investors in the Argentine economy and the strong commitment of the Government to continue with the structural reform program.

All these accomplishments are particularly noteworthy when we take into account the erratic economic performance of Argentina for the past 20 years, and the presence, until very recently, of some devastating phenomena, such as hyperinflation. For these reasons, Argentina may be mentioned as another example of the virtues and potentialities of a comprehensive economic reform program.

Nevertheless, with the process of recovery, some problems have arisen. The first--and probably the most important--relates to the exchange rate system. Since the approval of the convertibility law--which fixed the Argentine peso to the U.S. dollar--the national currency has appreciated, according to the staff's calculation, by about 32 percent. Such a real appreciation of the peso, if not corrected or compensated for by continuing the increase in productivity of the Argentine economy, could lead to a deterioration of Argentina's international competitiveness and threaten the long-term viability of the balance of payments. The problem may become even more difficult, as economic agents could view the situation at any particular moment as untenable, and difficult episodes, such as the run against the peso that occurred late last year, may emerge from time to time.

Certainly, the most attractive and easiest way to deal with this exchange rate problem might be to reverse in some way the convertibility law, so as to be able to adjust periodically the nominal exchange rate so that it remains stable in real terms. This is what many monetary authorities would usually do. However, we must bear in mind that, in Argentina, such a move would immediately remind economic agents of a very recent and dramatic economic past. For them, any small adjustment of the nominal exchange rate could mean a reversal of policies. This is clearly why the Argentine authorities, in opposing that scheme, have chosen a more difficult, but quite understandable, approach to regaining and maintaining international competitiveness. This approach includes fiscal measures directed to promoting investments and exports, structural reforms--such as privatization--aimed at increasing efficiency, and new regulations to make key markets--such as the labor market--much more flexible, in order to reduce production costs, among other reforms. So far, and according to the staff report, the fiscal and deregulation measures taken by the authorities have offset between one third and one half of the erosion of competitiveness produced by the appreciation of the national currency.

It seems therefore that half the job of offsetting the erosion of competitiveness has been done. The authorities are confident that industrial conversion, investment in the nontradables sector, and other policies, will permit productivity gains to compensate completely for the appreciation of the currency. I am in broad agreement with this approach. In an economy like that of Argentina, in which so many distortions and allocative inefficiencies have been developed over so many years, there must be significant margin for productivity gains. My only observation is that the problem we are dealing with is not a static process, but rather a very dynamic one; it is a moving target. To be able to correct completely the losses in competitiveness, the rate of structural and other economic reforms has to outpace the rate of appreciation of the national currency, and this has to be accomplished relatively quickly. This being the case, the authorities have to push very hard, given the fact that, while on the one hand the appreciation of the currency occurs automatically as a result of inflation, the structural reforms, on the other hand, imply institutional changes that are much more difficult to implement. Fortunately, as Mr. Zoccali's statement says, Congress has supported the economic reform effort by passing enabling legislation.

The second problem facing the economic program is the inflation rate. This problem is closely related to the first one: the appreciation of the national currency. Since the nominal exchange rate is fixed, the inflation rate is behind the appreciation of the currency. It is true in this regard, as the staff report says, that inflation remains above industrial country levels, but it is also true that the index of inflation has been declining significantly, from 84 percent in 1991, to 17.7 percent in 1992, to a projected figure of about 11 percent for 1993. Thus, as Mr. Zoccali says, a single-digit cumulative annual rate of consumer price increase is within reach for the first time in 20 years.

When analyzing the inflation indexes, one is surprised by the difference between the consumer price index and the wholesale price index. It seems to be an indication of large intermediary inefficiencies, which should be addressed. I would like to hear some comments from the staff on this particular issue.

Given the particular importance of quickly lowering inflation in the present Argentine situation--because of the fixed exchange system--I welcome the authorities' announced determination to take additional measures to strengthen public finances. I also welcome the authorities' decision to save the resources generated by the privatization of the oil company so that aggregate demand is not increased now. Nevertheless, I am concerned about the recently announced new subsidies, especially in view of the weaknesses in revenue collection observed in the first four months of 1993, according to the staff report.

The progress made in the area of financial intermediation is remarkable. The approval of the new Central Bank Law, which imposes limits on operations of the Central Reserve Bank of Argentina (BCRA) with the public sector and other financial institutions, and which also enhances the supervisory power of the Central Bank over the whole system, will allow a better management of monetary policy.

I am in broad agreement with the authorities about the long way the remonetization process still has to go in Argentina. This is totally true when a ratio of about 14 percent of broad money to

GDP is seen. My only concern would be about the rate of growth of the remonetization process, in view of the still relatively high inflation rate. In that light, a rate of growth of broad money of 60 percent and of bank lending capacity of 100 percent during the first four months of the year may prove to be excessive.

Two elements call for attention in the balance of payments. The first is the widening current account deficit, which has moved from 1.3 percent of GDP in 1991 to 3.6 percent of GDP in 1992. The second is the strong capital inflows, which have more than financed this deficit, and which have allowed a significant buildup of international reserves.

The reasons for the widening current account deficit are diverse: trade liberalization, a deterioration in the terms of trade, the appreciation of the peso, and the strong rate of growth of aggregate demand. Of all these factors, some have to be considered as temporal, and to a certain extent unavoidable--for example, the pent-up demand for consumer durables and capital goods after a long period of recession. Other factors, such as the appreciation of the national currency, have to be corrected by means of economic policies. These imply, in the first place, lowering the inflation rate to international levels as soon as possible.

I agree with Mr. Zoccali that the large net capital inflows represent but a portion of the cumulative outflows of the past. Therefore, one should not be afraid of the return to the family of what was once part of family in the first place. Nevertheless, the authorities need to be careful that the speed of the return does not add to inflationary pressures, and that the return of capital does not serve as a substitute for national savings.

A special reference should be made to a significant process that is very often missed in other economic reform programs, or that is usually not seen as part of an economic reform program, and which is playing a remarkable role in the Argentine economic program: the decentralization process. This process involves a whole new arrangement of the revenue and expenditure relationships between the federal and provincial authorities. Under the new scheme, important expenditure responsibilities in areas such as education and health are being transferred to the local governments. Provinces will be responsible for the debt service on loans contracted to finance projects in their territories, and provincial governments will be responsible for the economic performance of the provincial banks--which was not the case until very recently.

This chair supports the proposed decision, and commends the Argentine authorities for their remarkable commitment to a large and comprehensive economic reform program.

Mr. Fukui made the following statement:

Considerable progress in economic performance was achieved in 1992, as the result of the economic adjustment policy and structural reform. Economic growth was about 9 percent in 1991 and 1992, there was a rapid reduction in the inflation rate in 1992, and a strengthening of the fiscal position. I welcome this progress.

However, despite these favorable developments in 1992, the overall economic situation has begun to deteriorate in 1993. The deceleration of the inflation rate is not sufficient, and inflation is expected to reach 10 percent this year--more than double the program target. The external current account deficit in 1993 is expected to be much worse than programmed; and investment and economic growth are falling. More regrettably, the social security reform had still not been achieved as of the end of June, despite the authorities' efforts. Thus, it is a matter for concern that Argentina's economy is gradually losing its momentum of solid consolidation. We need to watch future developments closely.

With regard to fiscal policy, it is welcome that a surplus was attained in both the primary balance and the overall balance, partly through a restrained expenditure policy, including a monthly budget allocation system.

On the revenue side, judging from the revenue projection and the staff's analysis, the authorities' projection seems to be on the optimistic side. Therefore, room should be left for additional measures in order to attain the fiscal target for 1993, and also to strengthen savings. I would appreciate it if the staff could comment on possible additional revenue measures, if any.

With respect to monetary policy, the growth rate of M4 in April was over 60 percent, compared with the program target of 40 percent. Also, bank credit expanded rapidly--at an annual rate of 100 percent during the first four months of 1993. An expansion of the monetary aggregates resulted partly from foreign capital inflows, but it seems that the loosening of monetary policy, including the lowering of the reserve requirement, has also contributed, as referred to in the staff report.

It is obvious that a tighter monetary policy will be warranted as long as the reduction of inflation remains an urgent task to be tackled. The question is how to do this. Since at present it is hard to raise interest rates, as this would discourage investment and encourage capital inflows, it is recommended to gradually increase the reserve requirements, including on foreign currency deposits. It is also necessary to dampen inflation through further efforts toward sterilization of the liquidity from the strong capital inflows resulting from the continued interest rate differentials.

In this connection, the need for sterilization was discussed at previous board meetings. It seems, however, that the authorities have not been very decisive in their actions. I would appreciate it if the staff could comment on this. In passing, we welcome the consideration that is being given to supporting small- and medium-sized enterprises, given the rather high interest rate structure.

It is a matter for concern that external competitiveness is falling, owing to the more than 30 percent appreciation of the peso in real terms since March 1991. As long as the current exchange regime is maintained--in which the peso is pegged to the U.S. dollar--it will be all the more important that companies be flexible, in order to be able to cope with various changes, such as the real appreciation of the currency. In this connection, a reduction in labor costs should be a priority. In particular, it is necessary to keep wage increases in line with productivity growth. Taking this into account, the decree issued in March 1993 should be implemented prudently, with the aim of containing wage increases. Does this decree work to contain wage increases?

Regarding structural policy, since the strengthening of national savings is an important factor in attaining high investment and sustainable growth, it is crucial that the social security reform be approved by the Congress and implemented as early as possible. However, it is disappointing that it has not already been achieved, since a commitment was first made to put this reform in place at the Board meeting on the extended arrangement last March. Mr. Zoccali says in his statement that Congress has been supportive of the rigorous economic reform effort with enabling legislation. Social security reform is, I believe, part of this "rigorous economic reform," and it is in line with the authorities' economic strategy. I would appreciate Mr. Zoccali's comments on that matter.

This chair supports the proposed decision.

The Chairman said that he wished to express to Mr. Fukui and the Japanese people his condolences for the tragedy caused by the earthquake on Hokkaido Island in Japan.

Mr. Jaramillo made the following statement:

Over the past year, the Argentine authorities continued to consolidate their economic reform efforts and kept up their drive toward stabilization. Growth was impressive--increasing by about 9 percent last year--after a similar result in 1991. The public finances were further strengthened, giving rise to an overall surplus in 1992 equivalent to 0.5 percent of GDP. Argentina's international creditworthiness was consolidated, as evidenced by the agreement with commercial banks. Privatization maintained a steady pace, with the Government's goals in this area now close to being completed. Structural reform continued its pace on several fronts, contributing to much-needed increases in productivity.

Inflation also maintained a declining trend. However, the level is still above price increases--adjusted for exchange rate variations--in Argentina's major trading partners. The persistence of inflation reflects the behavior of nontradables, since the prices of most tradables came down rapidly to international levels, as witnessed by the trends in the wholesale price index which, to a degree, reflect the behavior of the exchange rate.

The conjunction of a fixed exchange rate with gains in productivity above those of major trading partners will eventually give rise to real domestic currency appreciation. This should not necessarily be a cause for concern, as it may simply be reflecting the operation of equilibrating forces within the economy. This effect has undoubtedly been present to some extent in Argentina, and it is picked up in the staff estimates indicating that tax and deregulation measures have offset a substantial part of the unadjusted erosion of competitiveness as measured by straight purchasing power parity calculations. However, real currency appreciation seems to have gone beyond this, affecting competitiveness to some degree, as seems to be shown in current account behavior. This has occurred despite the observed decline in real wages in the industrial sector of recent years.

Overall, although consumption grew substantially last year, the rapid expansion of the Argentine economy was led by private sector investment, which grew close to 30 percent per year during 1991-92, largely financed by capital inflows. Although the adjustment of the public sector, as measured by the overall fiscal balance, would indicate an apparent dampening of demand pressures, the fact is that overall public expenditure grew by 28 percent in 1992, about 10-12 percent in real terms. It seems that the fiscal stance, despite the surplus, was probably not sufficient to curb the overall demand surge. This was reflected in the persistence of relatively high inflation in the nontradables sector, and probably was behind the establishment of surtaxes on imports and subsidies on exports. The question is whether more can be done to check the prices of nontradables, and thus prevent further appreciation.

If inflation is to be checked in the presence of large capital inflows that are driving real domestic demand, a more stringent fiscal stance will be called for than would otherwise be the case. If such an extreme fiscal position is not viable, private sector expenditure will have to be curtailed somehow. In view of the limitations that capital mobility and a fixed exchange rate impose on monetary policy, checking private domestic expenditure that is being fueled by external capital inflows will probably require limiting these flows somehow.

Capital flows have given rise to very high rates of growth of broad money and to a very rapid increase in bank lending capacity. The staff's concerns about these issues are justified, and we feel that without some type of curtailment of capital inflows, there will be little scope to further tighten demand to reduce inflation.

Chile confronted capital flow surges by imposing restrictions on capital inflows via reserve requirements on foreign borrowing, apparently with some success. Despite the limitations of such measures--including market distortions and, eventually, enforcement difficulties--the fact is that restrictions may slow the unwanted flows, at least temporarily. The extra time may be just what the authorities need to pursue further their anti-inflation stance.

We find in the staff report that 40 percent of the proceeds from the privatization of YPF will be used to reduce government obligations to oil-producing provinces, and the rest will be to pay obligations to pensioners. The authorities see the need to prevent the income from the privatization of YPF from raising aggregate demand at this time. Consequently, in order to ensure that these resources are saved, the overall Government would obviously need to reduce its expenditures in a similar amount. We would appreciate a clarification from the staff on this issue.

With regard to the medium-term external prospects, it is true that minor changes in the assumptions of the baseline scenario have significant effects on the medium-term projections, and, of course, it is the downside risks that are worrisome. However, Argentina's terms of trade have deteriorated significantly in recent years, to a degree that reflects the unfavorable conditions and short-term prospects of the world economy. In the medium term, as the world economy recuperates, the reversal of the terms of trade trend is very likely. That result should, inter alia, not only be accompanied by the obvious improvement in the current account balance, but also by an increased overall savings ratio that would facilitate the achievement of the high investment ratios observed in Argentina in the past.

We support the proposed decision.

Mr. Dawson made the following statement:

As Mr. Zoccali notes in his statement, this is the eighth opportunity that the Board has had in the last two years to review the progress of Argentina's economic reforms. With so many reviews, it is hard to come up with fresh superlatives to characterize the accomplishments of the Argentine authorities in stabilizing, restructuring, and revitalizing the economy. Our admiration for what Argentina has achieved is undiminished.

I am concerned that monetary conditions are too easy. The currency board arrangement that is the linchpin of macroeconomic policy in Argentina requires a greater convergence between internal and external inflation than has been achieved so far. There is no doubt whatsoever that the legally constituted, rule-based, exchange rate-linked monetary policy, backed by supporting rigorous fiscal discipline, has suffocated the runaway inflation that had haunted Argentina for years. Even so, inflation in Argentina is still sliding along at low double-digit rates, while international prices are only increasing at low single-digit rates. The continuing coherence and credibility of Argentina's macroeconomic orientation depends crucially on the credibility of the exchange peg being maintained. If present price trends continue for another 12-18 months, maintenance of the exchange peg will certainly be in doubt.

With the passage of time, we are finding it harder and harder to sustain the point of view put forward in Mr. Zoccali's statement that the divergence between wholesale prices and retail prices, or more generally, the divergence between the prices of tradable and nontradable goods, is just a transitory feature of the turbulence of disinflation and decompression, or a reflection of divergent trends in productivity. All of these things have certainly been going on, but it looks increasingly like we are seeing the more familiar pattern of eroding competitiveness, as excess demand bumps up against a fixed exchange rate. Tradable goods prices are held down while demand pressure spills over into the nontradable goods sector.

In 1992, prices of imported goods rose 4.4 percent. Export prices did not rise at all. Consumer goods prices in Buenos Aires rose 17.7 percent. In the 12 months to May 1993, wholesale prices rose 3.0 percent; in the same period, the consumer price index rose 12.3 percent. The narrative on pages 3-5 of the background paper on recent economic developments reports that, in a variety of sectors facing international competition, prices and output were under pressure last year despite generally buoyant activity. In the more sheltered sectors, output and prices rose rapidly. Inflation was particularly rapid in education, utilities, housing, and private health services.

With the general reactivation of the economy, labor productivity was up a strong 5-3/4 percent of GDP. Even so, in some highly competitive manufacturing sectors, in which productivity would have been expected to have been strongest, real wages were being pushed down.

The appendix on recent changes in competitiveness provides five different indices of competitiveness, all of which show a progressive deterioration in competitiveness of anywhere from 11 to 32 percent since the exchange rate was pegged to the dollar in 1991.

These competitiveness trends are mirrored in the trade accounts. Export growth has been indifferent for the last three years, while imports have surged. The trade accounts have swung from surplus to deficit, with the current account deficit now of the order of 3.2 percent of GDP, and expected to stay at that level through this year.

So far, these price, output, competitiveness, and trade trends have not progressed to the point at which they are causing any particular problem. In fact, from one point of view, these trends are nothing more than the expected economic profile of a revitalized economy that has started attracting foreign capital. The real inward capital transfer can only be accomplished if the current account deteriorates. To adjust the current account, the terms of trade between tradables and nontradables need to adjust.

Our concern is that this adjustment process seems to be extending well past the point of equilibrium. If the adjustment overshoots, it will have to be reversed. Under the fixed exchange link, reversing the terms of trade between tradables and nontradables would require deflating the prices of tradables. That is not easy to do in a fixed exchange rate regime. If there are policy options now that can avoid having to confront in the future the choice between stagnation or devaluation, they ought to be taken.

Capital inflows are running ahead of the economy's capacity to adjust in an orderly way. The current account has opened substantially, but foreign funds continue to exceed financing requirements and flow into reserves, feeding a rapid expansion of money and credit. Under the currency board arrangement, traditional monetary techniques for sterilizing the inflow are limited. Given the massive reordering of the public sector that has already been accomplished, sterilizing the inflows through fiscal means is a very limited option. Just meeting the fiscal requirements of the Fund arrangement is beginning to require patchwork measures. The authorities should introduce marginal reserve requirements on short-term capital inflows, as necessary, to avoid an excessively rapid expansion of money and credit.

The recently concluded YPF floatation will soon generate a very large inflow of foreign exchange, much of which is committed to disbursement in one way or another in domestic peso payments. The authorities hope to effectively sterilize the impact of these inflows by offering recipients incentives to hold rather than spend the proceeds. We have doubts about how effective such procedures will be. Money is fungible. If sterilization is needed, would it not be better to do it at the front end, before economic agents see an increase in their financial wealth, rather than after? Comments about that from the staff or Mr. Zoccali would be appreciated.

In the first four months of 1993, broad money grew at a 60 percent annual rate; bank lending grew at a 100 percent rate. It may be true that the economy is being remonetized, but all the evidence is that these rates of increase in broad money and the credit aggregates are too rapid to be consistent with the sort of price stability that is required to maintain the credibility of the exchange peg. If money growth has to be that fast to re-establish financial equilibrium, there must still be a great deal of financial distortion and disequilibria in the system. The distortion of temporary marginal reserve requirements on capital inflows would be a small price to pay for a better-paced and more secure adjustment path.

This review asks again for a waiver and modification of the performance criterion applying to the timing for congressional approval of the social security reforms. We understand fully both why this performance criterion was part of the arrangement, and why it has been necessary to request repeated waivers. Straightening out social security finances is a critical component of the Argentine financial reforms. We would urge the authorities to press forward and secure the required legislative approval as soon as possible. Perhaps Mr. Zoccali could give us a little more background about the prospect for early completion of this legislation, in particular since the fall election season will soon be upon us.

We are prepared to go along with this waiver, but more thought needs to be given to how the Fund handles program requirements that depend on successful passage of controversial reform legislation. The actions covered by such legislation are usually far too important to be left out of Fund conditionality, but the timetable for completion is usually too uncertain to fit well into the review schedules. If the Policy Development and Review Department has any constructive suggestions about how we might refine the way we handle such issues, we would be interested in hearing them.

Mr. Desruelle made the following statement:

Under the present extended arrangement, Argentina has implemented a highly successful strategy of macroeconomic stabilization and structural reform. The first pillar of this strategy is the strengthening and consolidation of public finances. The fiscal results are impressive. Both the primary surplus of the nonfinancial public sector and the overall surplus--including the BCRA--are in line with the program's objectives, despite some shortfalls in revenues. Expenditures have been reduced correspondingly and will be monitored further through a system of monthly budget allocations. The process of reform of the social security system, although lagging behind schedule, is today well advanced.

The second pillar of the economic strategy is the convertibility law, which links the Argentine currency to the dollar and ensures that the growth in base money follows the evolution of the foreign exchange reserves. This has contributed significantly to macroeconomic stabilization by anchoring price and wage expectations and, inter alia, prohibiting monetary financing of the public deficit.

The convertibility law meets today with two implementation challenges. The first--as in other Latin American countries--is that spontaneous capital inflows tend to push base money to higher, and sometimes undesirable, levels. It is thus welcome and appropriate that the authorities have decided, inter alia, to sterilize the monetary impact of the process of privatization of the state oil company. Further actions might be necessary in the future, perhaps in the field of public finance, if inflows of capital were to destabilize the overall macroeconomic strategy. That does not seem to be the case today. The second challenge is that, while the convertibility law constrains the growth of base money, it allows for expansion of broad money aggregates, and thus does not fully guarantee against inflationary pressures of a monetary origin. Indeed, broad money is presently growing at an annual rate of 60 percent, and has increased significantly in the last two years. According to the authorities, this can be seen as a normal process of remonetization of the economy, following the return of confidence in the Argentine currency. However, as mentioned by the staff, money growth is fueled by strong domestic credit expansion, and might thus be a dominant factor behind the surge in demand, the persistent inflation differential with the United States, the concomitant loss of competitiveness, and the current account deficit.

The staff tends to attribute this evolution to the reduction in reserve requirements that took place in 1992 and 1993, and suggests that this trend might have to be reversed by imposing marginal reserve requirements on both dollar and peso deposits.

The authorities do not seem to want to impede financial intermediation by the banking sector, and their priority appears to be to strengthen prudential regulation and supervision, from which they expect a more moderate rate of credit expansion as a side effect.

At this stage, it might be recognized that the overall liquidity of the economy has by no means reached a worrisome or unsustainable level. It is also true, as pointed out by Mr. Zoccali, that discouraging capital inflows might be counterproductive in a period in which the current account deficit is projected to grow, although for very good reasons--that is, the surge in domestic investment and the importation of capital goods. This can certainly justify the present stance of the authorities.

It is all the more important, however, that structural reform be allowed to proceed expeditiously and relentlessly. The exchange rate strategy has been extremely beneficial to the Argentine economy and, at the present juncture, it has been usefully complemented by tax and deregulation measures. As pointed out by the staff, those have offset to a significant degree the loss of competitiveness stemming from the real appreciation of the currency.

My authorities strongly support the present stance of the Argentine economic strategy. They are impressed by the breadth and pace of the reform process. They fully support the proposed decision.

Mr. Al-Jasser made the following statement:

I would like to join other Directors in congratulating the authorities on the impressive progress achieved in stabilizing and reforming the economy. Public finances have been strengthened, output continues to grow at a robust rate, and inflation is on a declining trend. Moreover, the substantial structural reforms already implemented have led to a more dynamic and open economy, which is much more capable of sustaining noninflationary growth.

These achievements are impressive enough to warrant guarding and extending them so as to achieve the desired sustainability. Thus, the challenges facing the authorities in 1993 and the medium term should be addressed on a timely basis.

Central to the authorities' adjustment program is the peg to the U.S. dollar and the full convertibility of the peso. Under such a fixed exchange rate regime, maintenance of balanced and sustainable growth is predicated on convergence of inflation toward the level prevailing in industrial countries and on improvements in productivity. However, despite the downward trend over the past two years, inflation in Argentina remains unfortunately well above that of industrial countries. The divergence in inflation rates led to an appreciation of the peso by some 30 percent in real terms over the past two years. Although the impact of the peso appreciation on competitiveness was partially offset by productivity gains and lower real wages in the industrial sector, as noted in Mr. Zoccali's statement, exports stagnated and the current account deficit widened. Admittedly, some of these developments have reflected other factors, such as weak international demand and a recovery in private investments financed by capital inflows. However, the fact remains that continued adherence to a fixed exchange rate regime requires adopting financial and structural policies that would provide for an increase in domestic savings and a reduction in inflation.

On the fiscal front, while achievement of the program targets for March 1993 is noteworthy, further consolidation of the fiscal accounts is needed, in particular as the exchange rate cannot be used to enhance competitiveness. The weakness in revenue in the first four months of the year, coupled with a reduction in a number of taxes in May, could lead to a shortfall in revenues estimated by the staff at about Arg$1.5 billion for the year. Moreover, the increase in subsidies is likely to put further pressure on the fiscal position. Accordingly, I share the staff's view that achievement of the programmed public savings for the year may require the implementation of additional revenue and expenditure measures. These could include, on the revenue side, a reduction in the tax breaks that were introduced in May 1993, in particular those relating to excise taxes on cosmetics and luxury goods, and increases in consumption taxes. This will not only strengthen the fiscal position, but also reduce demand pressures and credit demand by consumers, thus freeing credit to the small-business sector. On the expenditure side, a scaling back of subsidies, coupled with careful monitoring of expenditures, will also strengthen the fiscal position, while reducing distortions in the economy.

Regarding the social security system, I note that the ability of the system to raise national savings is contingent on the implementation of the authorities' proposed reforms. In this regard, while it is disappointing that the reform package has not yet been enacted, its passage by the lower house of Congress with minimal impact on its financial viability is a welcome development. In this connection, it is not clear what the effect is of guaranteeing the rate of returns of the pension fund of the BNRA on the system's finances. The staff's comment on this issue would be appreciated.

With regard to monetary policy, I fully endorse the staff's view that although there is still ample room for remonetization of the Argentine economy, the rapid expansion of bank credit has been contributing to the persistence of inflation. In fact, inflation has picked up in April-May 1993. While this was due in part to the impact of adverse weather on food prices, it was also a result of an intensification of demand pressures generated in part by capital inflows. The problem of capital inflows is a complex one, and further fiscal consolidation is one way of preventing an overheating of the economy that could be generated by such inflows. However, experience has shown that the fiscal adjustment needed to offset the inflationary impact of such flows may be very large. Therefore, and given the fixity of the exchange rate, a mix of monetary and fiscal policies would be the preferred avenue in this case. Thus, in addition to the fiscal measures discussed above, a restrained monetary policy is called for. For example, the authorities should seriously consider the staff's proposal of marginal reserve requirements as a way of restraining credit expansion and capital inflows. In this context, I welcome the authorities' decisions to sterilize the proceeds from the sale of YPF, as well as strengthen the risk-adjusted capital adequacy requirements and shift a larger share of the nonfinancial public sector deposits to the Central Bank.

Regarding structural rigidities in the labor market, the submission to Congress of legislation aimed at enhancing the flexibility of the labor market is indeed a welcome development. The impact of labor market reforms on inflation, which would improve competitiveness and efficiency, cannot be overstated.

My comments on the Argentine economy are not meant to imply any skepticism as to the viability of the program, but rather to highlight what I consider to be the pressing policy issues that need to be addressed, in order to consolidate the impressive progress achieved so far in Argentina. I support the proposed decision.

Mr. Schoenberg made the following statement:

There is probably no need for me to stress the considerable and admirable progress Argentina has made in stabilizing and restructuring its economy since 1989, leading to high growth rates and, in Mr. Zoccali's words, unlocking a large supply response and large inflows of private capital that had fled the country earlier. At the same time, however, Argentina has experienced a significant real exchange rate appreciation and a deterioration in the terms of trade and the external balance. Also, the rate of inflation was relatively high in 1992, which is astonishing in view of the exchange rate movements. Under these conditions, the staff recommends a reorientation of economic policy toward raising domestic saving, curbing inflation, and increasing the economy's flexibility. I basically agree with these recommendations.

The need to increase domestic savings and, in particular, public sector savings, is clearly demonstrated by the decline in the savings ratio from 22 percent of GNP in 1988 to some 15 percent of GNP in 1992 and, at the same time, an increasing propensity to invest. While I agree with the staff's view on the desirable key elements of a strategy to raise national savings, the staff's case could have been made even stronger and more convincing if information had been provided on the reasons for the dramatic decline in the private sector savings ratio. Does that development reflect basically a change in the time preference of savings and consumption, respectively, or do other factors, such as changes in the demographic structure or in institutional arrangements, also have roles to play?

I wonder to what extent private sector savings behavior might be affected by the planned reform of the pension system, which would imply a public sector expenditure reduction of about 1.5 percent of GDP. Does the projected increase in public sector savings correspond exactly with the increase in national savings?

I agree that the instruments proposed by the staff for further curbing inflation should have an inflation-dampening effect. Those instruments include the imposition of a marginal reserve requirement, strengthening the capital adequacy requirements, and the shift of a larger share of public sector deposits to the Central Bank. However, given the demand shift from the tradable to the nontradable sector in Argentina, and the corresponding increase in the relative prices of nontradable goods and services, the question is whether the steps proposed by the staff will be sufficient.

While I agree that adherence to the fixed exchange rate arrangement adopted by Argentina has served the country well, especially with respect to stabilizing expectations and creating confidence in the Government's policies, the question arises as to whether the present exchange regime can be upheld in view of continuing capital inflows, on the one hand, and a growing current account deficit, on the other. Certainly, even significant capital inflows can be sterilized for some time. In this context, we welcome the authorities' decision to sterilize the foreign resources generated from the privatization of state-owned companies like YPF, and to use the proceeds to build up international reserves.

Germany's experience with protracted massive capital inflows in the 1960s and 1970s shows that, eventually, such inflows, if they do not abate, will force either a nominal revaluation via a formal exchange rate adjustment, or a real revaluation via inflation. I would agree with Mr. Zoccali that "rather than being the cause of the real appreciation of the peso, the fixed nominal exchange rate has probably slowed the appreciation that would have taken place under a more flexible system."

Therefore, to the extent that strong capital inflows continue, find their way into consumption, and cannot be fully sterilized, thereby raising the prospect of a revaluation via inflation, the authorities should consider letting the exchange rate float at least temporarily, in order to allow it to find a new equilibrium level. If supported by continued tight monetary policies and effective steps to increase domestic savings, any nominal revaluation might be compatible with the objective of reducing the current account deficit. However, I recognize that the ongoing remonetization of the Argentine economy may absorb part of the capital inflows.

An important issue is how the capital inflows are being used. To the extent that foreign savings is channeled into investment and corresponding increases in imports of capital goods, the process is largely inflation neutral, and sustainable as far as the capacity to repay is concerned. Such a benign process could allow adherence to the fixed exchange rate arrangement. However, it would require both a quick reduction in the inflation rate and increased flexibility in the labor market, in order to retrieve some part of the loss in external competitiveness caused by the real effective exchange rate appreciation, as the staff points out. Even so, the staff's balance of payments projections, based on the assumption of increasing foreign demand for Argentine goods and no further deterioration in the country's competitive position, could be regarded as somewhat optimistic.

In this context, I wonder whether the staff has taken into account the welcome agreement reached recently between Argentina and its foreign creditor banks on a restructuring of the external debt, which will oblige Argentina to resume interest payments on its consolidated liabilities in autumn 1993, thereby further burdening the current account. Also, I wonder to what extent the staff has incorporated into its current account projections the trade-enhancing effects of greater regional economic integration, above all, from MERCUSOR, the Southern Cone free trade association.

We welcome the new central bank statute put into effect in the autumn of last year, providing independence to the Central Bank and committing it to the objective of price stability. The new statute also provides a high degree of autonomy to the members of the board. According to our information, however, definite confirmation of the appointment of the board members is still outstanding, rendering their autonomy more or less ineffective. I should like to ask Mr. Zoccali how long the state of suspense is expected to last.

We agree to the proposed decision, including the staff's proposal that the performance criterion applying to the timing for congressional approval of the social security reform be waived and modified. Like Mr. Dawson, this incident prompts me to repeat my earlier suggestion, namely, that in any case in which a performance criterion is subject to parliamentary action, on the one hand, and is deemed essential for the success of a Fund-supported program, on the other, contingency measures should be agreed upon between the staff and the authorities that would be implemented if the necessary parliamentary approval was not secured.

Mr. Keller made the following statement:

The Argentine authorities have earned much praise for the well-deserved success of their stabilization policy pursued under the 1992 extended arrangement. In particular, the adoption of a one-to-one parity between the peso and the dollar has provided a strong nominal anchor for the adjustment program. In order to gain the necessary credibility of the new policy, fiscal and monetary discipline was thus imposed on Argentine economic policy. As the staff paper points out, "with the public sector no longer a factor of monetary expansion, the demand for money is to be satisfied through the external accounts."

Indeed, the fixed peso rate was crucial for the Argentine authorities to manage curbing inflation and consolidating the budget. Their extraordinary performance in tackling both expenditure and revenue collection is acknowledged. As a result, the economy has responded very favorably, and private funds flowing in massively have created a climate of renewed enthusiasm in the economy. Domestic consumption has picked up strongly, but it is fueling partly on its own a somewhat excessive consumer credit boom. Direct investment has responded somewhat, although much of the foreign capital inflow goes into financial assets, thus creating a buoyant stock market that allows for the successful completion of such large stock flotations as that stemming from the privatization of YPF. In this environment, however, domestic private savings have fallen short of expectations. The Government is experiencing some problems in reaching its fiscal targets, and delays have occurred in adopting the social security reforms that are an essential part of the program under the extended arrangement. There is thus some inconsistency in the program's strategy to raise domestic savings.

These developments may suggest that the buoyancy of the success of the Argentine strategy of stabilization is about to weaken the very bases on which it is built. Under the rules of currency substitution, capital brought into the country has to be changed into pesos. Up to now, it seems that it has not always been possible to sterilize all the excess inflows, considering the limited scope of the instruments available for monetary intervention, which have hitherto been used in rather contradictory ways. In sum, monetary aggregates have grown too much. It is doubtful whether it will be possible for the authorities to execute their laudable intention and to sterilize all the capital inflows they are collecting for the YPF privatization, in particular since much of the proceeds should go to pensioners who have probably a particularly high propensity to consume. This feeds inflation expectations, at a time when the developments in the real economy suggest that the short-term orientation of the economic subjects--and perhaps also their inflation mentality--might not yet be fully subdued.

The relatively strong inflationary pressures have led to an appreciation of the real effective exchange rate of about 30 percent against the U.S. dollar. This appreciation will erode competitiveness, even after allowing for some relative productivity gains owing to changes in taxation and deregulation, and the evolution of relative labor costs, as the staff points out. As a result, and owing to the buoyant domestic economy, the trade and the current account balances are showing a trend of increasing deficits. Of course, there is no immediate problem as long as inflows of foreign capital continue to finance these deficits, and even to generate a surplus in the overall balance.

However, much of the inflowing capital is speculative, footloose capital invested in short-term assets that probably reacts less to interest rate levels than to capital gains expectations. The present financial bonanza is thus basically volatile, and has the potential for another period of capital outflow. Expectations can change, and very suddenly. Having liberalized the external balances, the authorities could not do much to defend their foreign position and prevent an erosion of reserves. The present relatively high level of international reserves does not represent a guarantee against a possible crisis of confidence. Much depends on the Government's ability to enhance confidence convincingly.

I do not believe that, in the future, the increasingly contradictory development of the Argentine economy can be contained in a fixed exchange rate regime, simply by factors of productivity and labor market developments, or structural reforms alone, as the staff appears to argue. If the authorities do not wish to change their exchange rate policy, they will have to take urgently fiscal, monetary, or regulatory measures--or a combination of such measures--to reduce the incentives to capital inflows.

At any rate, it does not look prudent for the Argentine authorities to tolerate a trend of growing deficit on the current account balance and to rely on continued strong capital inflows to finance it. It also appears hazardous, while focusing on undoubtedly positive developments, to try to ignore the basic problems of real and financial developments.

I am also not convinced by the authorities' contention that the recent upsurge in inflation is attributable to adverse weather conditions, and that they did not consider it advisable to take additional steps to tighten fiscal policies--or other measures, such as a more restrictive monetary stance--because of the risk of throwing the economy into recession. Buying time might be a politically promising strategy in an election year, but usually it does not help economic stabilization in a longer-term perspective.

I would be grateful if the staff could comment further on the issue of the exchange rate regime providing an anchor for the Argentine stabilization program. What measures would the staff recommend the authorities take in the short term, if they are faced by strong market pressures to alter the exchange rate in order to protect the stabilization results? Would there be room for indirect measures that effectively alter the rate, while formally maintaining the one-to-one parity?

For the further success of the Argentine Government's policy, the provincial authorities also need to share the Government's goals and contribute to the Central Government's reform efforts in order to make them fully effective. There is evidence that the provinces have just begun to adjust, and still have a long way to go. The negotiations on fiscal matters between the Government and the provinces appear to proceed only slowly. For example, only a handful of the provinces seem to have followed the Government in abolishing capital turnover taxes and different agricultural levies.

I want to express the confidence of this chair in the Government's willingness and ability to pursue successfully its policy and to find a way ahead, as has been proven since the vigorous implementation of Argentina's adjustment efforts more than two years ago.

Mrs. Hetrakul made the following statement:

I join other speakers in commending the Argentine authorities for their successful efforts in regaining the vitality of the economy. I note that the authorities have achieved considerable progress in reducing the internal and external imbalances and improving economic growth. Substantial progress has also been made in the implementation of the privatization programs. The fact that almost all performance criteria for end-June 1993 were broadly observed attests to my conviction that the authorities are determined to continue with their economic program.

Notwithstanding these remarkable achievements, I am also of the opinion that inflation should remain a prime concern, because of its adverse influence on other components of the economy, as reflected in the deteriorating trend of savings, the heavy reliance on external funds for investment, and the erosion of competitiveness. In this connection, the intention to sterilize the proceeds from the privatization of the state oil company--amounting to about $2 billion--is in the right direction.

While last year's budgetary performance was satisfactory, the staff's estimate of the possibility of a revenue shortfall of around Arg$1.5 billion this year is a cause for concern. It is advisable, therefore, that the authorities consider strengthening revenue collections, as well as implementing additional measures on both the revenue and expenditure sides, including the reduction of subsidies, to raise domestic savings. I also hope that the program for reform of the social security system will be approved by the Senate soon, so that the resources can be collected without further delay.

Regarding monetary developments, I agree with the staff that overall credit should be tightened further. However, I would like to hear the staff's view on how to minimize the impact of increasing the reserve requirement, as it could raise interest rates and attract a larger inflow of external liquidity, and hence run counter to its primary objective. On achieving a better control over credit, I welcome the authorities' decision to raise risk-adjusted capital adequacy requirements and shift a larger share of the nonfinancial public sector deposits to the Central Bank. Such a transfer has been proven to be effective in re-establishing monetary stability in a country of my constituency. However, the recently introduced interest subsidies for small- and medium-sized enterprises should be phased out as soon as possible, as it introduces inefficiency into the system.

In the external sector, I note with concern that Argentina's current account will continue to experience a substantial deficit for some years. The medium-term outlook for the balance of payments, as presented by the staff, is highly optimistic, considering the recent world economic outlook projection on the world economy and world trade. The outcome clearly depends on the assumptions for export growth, income elasticity of imports, and a halting of the erosion of competitiveness. I notice that the peso has appreciated by about 30 percent since it was pegged to the U.S. dollar two years ago. I therefore urge the authorities to pay close attention to this development, so that the economy's competitiveness is not jeopardized. Better adherence to the market mechanism, changes in taxation, and an increase in labor market flexibility should contribute to maintaining the country's competitiveness. A prudent wage policy could reduce inflationary pressures and, at the same time, promote a satisfactory external performance.

I support the proposed decision.

Mr. Waterman made the following statement:

I would like to join others in complimenting the Argentine authorities on the sound policy actions of recent times and the greatly improved performance of the Argentine economy.

Without detracting in any way from those positive comments, I would like to make three related points on the papers bearing on Argentina's recent economic performance.

I appreciate the benefits that the authorities see in terms of the current exchange rate system, but it appears, nevertheless, that the real appreciation of the peso is generating pressures in other policy areas, as reflected in the introduction of subsidies and other forms of assistance for particular sectors. That assistance has been directed at the traded goods area of the economy, and in that sense may be less undesirable than some forms of assistance but, in a broader sense, the measures run the risk of undoing much of the good achieved through other reforms by adding to input costs for domestic producers economy-wide, and slowing the necessary pace of adjustment for firms benefiting from subsidies, as well as weakening the budgetary position. It is clear that, if the current exchange rate arrangements are to be maintained, Argentina will need to further reduce its rate of inflation.

Related to that, the rate of credit growth appears far too rapid, and that needs to be moderated. It is difficult making a judgment on a financial system with which one is not particularly familiar, but the staff's analysis of the situation, and the proposal to increase reserve requirements on both peso and dollar deposits, is quite persuasive.

The need for action on the monetary policy side would be moderated to the extent that early action was taken on further fiscal consolidation, including the early passage by Congress of the social security reform bill. The authorities have recognized the need for such consolidation to raise savings in Argentina, so that indebtedness can be reduced and the financing provided for an appropriate level of investment for the ongoing growth in the economy without becoming overly reliant on capital inflows. As the authorities have noted, strengthened tax administration will be a central step toward this goal, but pending that, I would argue pragmatically against the premature removal of existing taxes until this strengthening can assure sufficient revenue flows from other taxes.

These comments are nevertheless made in the light of the substantial progress made to date in Argentina. I can agree to the requested waivers.

The staff representative from the Western Hemisphere Department stated that several speakers had called attention to the differential evolution of consumer prices and wholesale prices. The main factor behind that was that the wholesale price index reflected the prices of tradable goods, the prices of which were being restrained by import competition, whereas the consumer price index reflected more the cost of services, in which excess demand pressures had been passed on more readily as increases in prices and wages. The main components in the consumer price index that had risen rapidly were education, health, and housing--all nontraded goods for which demand pressures had been readily translated into price increases.

Measures to sterilize capital inflows had been an issue of longstanding discussion between the staff and the authorities, the staff representative commented. The key question was whether domestic policy measures would be completely offset through the capital account. Also, the authorities regarded the rapid rates of growth of credit and money as a response to strong market demand, and thus not necessarily a cause of concern, given the level of monetization of the economy in a historical perspective. The staff had stressed that its concern was not the remonetization per se, but the speed at which it was proceeding.

The labor flexibility decree of March 1993 provided a greater incentive for decentralizing collective bargaining to the firm level, the staff representative explained. Collective contracts that covered more than one firm had to be approved by the Ministry of Labor, and the Ministry of Labor would apply the productivity guidelines strictly in approving or not approving those pacts. A pact negotiated at the firm level would be approved automatically, because there would be no question of the Ministry determining that the firm could not pay the agreed wage increase. The main labor market reforms remained to be done, however. Those reforms included increasing the flexibility to take on temporary workers--currently restricted in all collective contracts--and lowering the cost of dismissing temporary workers; at present, temporary workers had the right to two years' severance pay. The new regulations would make severance pay directly related to the length of service. Those reforms were by no means assured of political support at the present juncture, however.

Regarding the sterilization of the proceeds from the privatization of YPF, the staff representative continued, the Government intended to transfer resources to pensioners and provincial governments, but also to offset immediately the impact on aggregate demand by other operations. The staff welcomed the comments of Mr. Dawson that front-end sterilization was what would really be needed, perhaps in the form of the issuance of domestic paper simultaneously with the release of resources to pensioners and provinces, for example.

A question had been raised about the effect on the pension system's finances of the guarantees on the rate of return of the Banco de la Nacion's pension fund, the staff representative recalled. The direct impact on the public sector system was likely to be unimportant, unless the guarantees were called in--in which case they could be very important indeed. That was why, as a matter of principle, the Government and the staff believed that extending Government guarantees to such a potentially large area of financial savings was unwise. It would be preferable to leave the rate of return to market forces. The partial guarantee provided to the Banco de la Nacion's pension fund also might be perceived as giving the Banco de la Nacion an unfair advantage over all of the other private pension funds, and might well end up creating a monolithic private pension fund run by the Banco de la Nacion.

What had been behind the decline in savings since 1990 merited further analysis, the staff representative remarked. However, one factor might be the extreme economic instability, culminating in hyperinflation, that had characterized the period of the 1980s, and which had ended only about 1990. In circumstances of instability, economic agents might tend to have greater precautionary savings, as reflected in capital outflows. The return to more normal conditions might mean a permanent decline in savings, as the precautionary behavior of economic agents changed. Another factor might be the severe restrictions on imports and relative import prices that had prevailed during the period of hyperinflation and instability, which had caused import levels to be compressed for a long period of time below their historical trends. The pent-up demand for imports since then--in particular for consumer durables like automobiles--was reflected in higher imports and a corresponding decline in domestic savings. The decline in savings had gone on systematically in 1991, 1992, and--what was very likely--into 1993. The inverse of that decline in savings was a deteriorating current account balance, which was a matter of concern, and which explained the stress being placed on raising private savings at the current juncture.

The balance of payments projections in the past had included interest on an accrual basis, and for the future, because the debt situation had been regularized, the projections would be on a cash basis, the staff representative pointed out. From that perspective, there was no increase in terms of outlays, because interest payments were accruing as they fell due. Interest payments on post-Brady Plan debt had been taken into account in the projections.

The medium-term projections contained no specific assumptions of a deepening of trade through MERCOSUR, the staff representative observed. Trade deepening might indeed occur, especially if Brazil's economy began to expand, but the projections were based on the assumption of export growth in line with the growth of world market demand. Of course, any trade deepening would be expected to take place on both the import and the export sides, and therefore it probably would not change the net figures very much.

The extent to which possible monetary measures would affect the capital account, and whether or not monetary measures would be swamped by an offsetting move on the capital account, would depend on whether or not an increase in reserve requirements--or any other measures--fell relatively more strongly on loan rates--increasing them--or on savings rates--depressing them, the staff representative from the Western Hemisphere Department concluded. In any case, because of perceptions of country risk, it could not be assumed that, if interest rates rose, inflows of capital would grow commensurately. Therefore, the capital account might not respond in a way that swamped the effects of monetary measures.

The staff representative from the Policy Development and Review Department stated that the staff was reviewing ideas about how to handle structural measures requiring legislation in Fund-supported programs. The staff was still guided by the thought expressed in the summing up on structural adjustment in Fund-supported programs, namely, that conditionality should be attached to structural reform when the latter was seen as essential for the achievement of external viability. In the case of Argentina, the reform of the social security system and the legislation to implement it was seen as being fundamental in the medium term. In assessing whether or not to attach conditionality to a structural measure, the staff was guided by three qualifications: first, whether it was a crucial issue; second, whether it was a concrete action; and third, whether it could be monitored. In the case of Argentina, all those criteria would seem to be met.

Successive waivers of such a criterion tended to weaken a program and the credibility of Fund conditionality, the staff representative commented. It needed to be borne in mind that, often, the staff saw such a condition as difficult to implement, but the Government itself wished that it be included, in order to keep up the pressure for reform. Mr. Schoenberg had suggested that possible solution would be to design a contingency. When major reform measures were called for, however, such as the privatization of the pension system in the case of Argentina--which would not only increase private savings, but also deepen capital markets over the medium term--the question became more complicated. In the case of Argentina, the only alternative--which nonetheless would go only partly in the direction of doing the job--would be an increase in public sector savings. However, the alternative would not increase private savings or deepen capital markets. While contingencies could be looked at more closely, it needed to be borne in mind that it might be difficult to find a suitable replacement for an important, specific, measure of a structural nature that had been included as a criterion under a Fund-supported program.

The Chairman said that he would encourage the staff to identify suitable contingencies in cases in which that was possible.

The staff representative from the Western Hemisphere Department stated that the contingency approach that the staff was employing included the use of a series of waivers. The waivers themselves should not be interpreted as indicating that the program was not operating properly; rather, the waivers were evidence of a delay which, in and of itself, was not affecting the program. In fact, for purposes of the program in the following year, the authorities intended to operate as if the pension reform would be in place beginning January 1994.

Mr. Wei made the following statement:

The adoption of the convertibility law in 1991 has reinforced markedly the authorities' progress in implementing their bold economic reform and adjustment program aimed at restoring domestic and international credibility and sustaining economic growth.

The authorities are highly commended for their achievements of recent years. We note that inflation has been reduced to about 18 percent, measured by the consumer price index, while real GDP increased to about 9 percent during 1991-92. In addition, it is comforting to note that all the quantitative performance criteria for end-March 1993 under the extended arrangement were met.

Currently, the Argentine authorities are confronting two main impediments to their stabilization efforts, namely, high inflation and a relatively large external current account deficit, together with a stagnation of private exports and a decline in private savings. Aware of these weaknesses, the authorities continue to implement the medium-term program designed to raise domestic saving through improving the public finances, reforming the social security system, enhancing external competitiveness by reducing tax distortions, and strengthening labor market mobility.

Given the authorities' concern that a tightening of fiscal policy could shrink economic growth, and since the primary surplus of the nonfinancial public sector and the overall surplus are in line with projections, the authorities' fiscal policy is aimed at supporting investment and exports and reducing production costs. However, given that inflation remains high, the authorities must maintain a tight fiscal policy that is conducive to repressing the threatened inflation.

Like the staff, I note with concern that, based on the weakness in revenue observed in the first four months of 1993, there might be a shortfall of Arg$1.5 billion, because of a lower forecast for corporate income taxes and for social security contributions. Therefore, I caution the authorities that additional measures affecting both revenue and expenditure will be needed to achieve the 1993 fiscal targets, as well as continued expenditure restraint through careful expenditure management, as the staff pointed out correctly in the staff report.

With respect to monetary policy, we note with concern that broad money and bank lending were growing too fast in 1992, while interest rates were lowered substantially. The consecutive rapid credit expansion during the last two years resulting from the large capital inflows and the lowering of the reserve requirement has contributed to the persistence of inflation.

Regarding the reserve requirement and its effectiveness as an instrument of monetary control, we concur with the authorities' view that, since the demand for money in Argentina depends mainly on external accounts, any reduction in the reserve requirement would reduce the costs of financial institutions and improve their overall efficiency. In this respect, we are convinced that there are strong arguments for the authorities to improve the solvency of the financial system through more stringent capital adequacy requirements and the tightening of bank supervisory practices, as Mr. Zoccali observes. The other effect of raising the reserve requirement with the purpose of curbing credit expansion would be an increase in the lending rate, and thus, more capital inflows into the country--which would definitely fuel inflation. Therefore, the authorities should not rely too heavily on increasing reserve requirements in order to curb lending, especially given their aim of encouraging savings by narrowing the spreads between the deposit and lending rates. However, the authorities should be prepared to take further measures if the need arises.

On the external front, I observe with grave concern that Argentina's external account has remained vulnerable and is a possible threat to both external performance and credibility. The current account deficit is projected to widen to $8.5 billion in 1993, reflecting an increase in imports linked to the rapid expansion of domestic economic activity, while exports remain at relatively the same level as in previous years. On the capital account, the large capital inflows offset the current account deficit, resulting in a surplus in the overall balance of payments. This trend is expected to continue. On the curing of such imbalances, we again share Mr. Zoccali's view that, rather than prematurely discouraging capital inflows through administrative or monetary means, the major policy challenge facing the economy today is to increase domestic savings, thereby reducing the economy's reliance on external financing.

Regarding exchange rate policy, we remain concerned that the sharp appreciation of Argentina's real effective exchange rate since the adoption of the unitary peg to the U.S. dollar in March 1991 has caused a deterioration in Argentina's external competitiveness in the short run. However, Argentina's exchange rate arrangement is conducive to the eventual elimination of inflation and to the enhancement of domestic efficiency in the long run. Therefore, we endorse the authorities' decision to embark on the scheduled reform measures in the social security and privatization area, to increase labor market flexibility and deregulation, and to open up the economy to the rest of the world, as a means of offsetting in a timely manner the erosion of competitiveness.

I support the proposed decision.

Mr. Mohammed made the following statement:

Argentina has made impressive progress since it began its program of economic reform and stabilization in 1991. Compared with the decline in real GDP of 2-2/3 percent on average during 1988-90, real GDP growth averaged 9 percent a year during 1991 and 1992. The yearly average inflation in consumer prices dropped from over 2,200 percent in 1988-90 to 18 percent in 1992. At the same time, Argentina made important progress in restoring credit-worthiness, strengthening public finances, liberalizing trade, streamlining the tax system, and privatizing public enterprises. Considering the worldwide economic slowdown, it is noteworthy that the continued economic upswing in the first four months of 1993 has led to an upward revision of projected GDP growth for 1993 to 6 1/2 percent, from a program projection of 4 percent.

We agree with Mr. Zoccali that, in assessing Argentina's future prospects, three issues deserve special attention: relative prices and competitiveness, monetary policy and capital inflows, and domestic versus foreign savings.

With regard to relative prices and competitiveness, let me first commend the staff for having gone beyond the standard indices in its assessment of the overall competitiveness of the Argentine economy. Although alternative indicators of competitiveness have confirmed the general pattern of appreciation indicated by the standard index, they did suggest that up to 50 percent of the post-convertibility erosion in competitiveness may have been offset by structural measures. Indications of favorable effects on the prices of nontradables due to increased competition and higher investment are quite welcome, and it is hoped that further structural improvements and productivity gains will go a long way toward improving the competitiveness situation.

While developments in the external account should be monitored closely, I do not believe that the projected outturn of no improvement in 1993 relative to 1992 should be a cause for alarm. It is true that the projected deficit in 1993 exceeds the program target by some $3 billion; however, it is also true that private capital inflows are now projected to exceed their programmed level by nearly $4 billion. So long as these inflows reflect a favorable response by investors to efficient investment opportunities, I see developments in the current account as quite normal, and certainly not as a consequence of unsound policies. The fact that consumption is now slackening is quite reassuring in this regard.

On monetary policy, we are in agreement with the authorities' view regarding the qualifications associated with further steps to tighten overall credit conditions. Apart from their adverse implications for investment and growth, higher interest rates can only be expected to lead to even larger capital inflows, other things being equal, and would indeed thus tend to complicate further the task of macroeconomic management.

We agree with Mr. Zoccali about the importance that should be--and is being--attached to increasing domestic savings. The contribution that the social security reform is expected to make toward that end is quite significant. We note that despite its intensive efforts, the Government has not yet been able to secure the needed legislative approval of the said reform. In these circumstances, we find the delay understandable, and we would support the proposed waiver. We support the proposed decision.

Mr. Dorrington made the following statement:

This chair continues to view Argentina's progress with stabilization and structural reform as one of Latin America's success stories. The authorities have chosen a tough discipline to form the centerpiece of their policies. While this has served them well so far, as Mr. Zoccali notes, it is clear that the authorities now face real risks to its credibility, and that they will need to respond to them with the strength and determination that they have exhibited in the past. This will have to be coupled with continued efforts to maintain the hitherto impressive consensus behind the reform, although I do not underestimate the difficulty of this now that the crisis is perceived to be over, and the elections imminent.

This chair continues to believe that the fiscal targets are insufficiently ambitious. That view is reinforced by current indicators of both demand pressures and the current account, and by the recent analysis in the March 1993 Staff Papers and in the papers to be discussed in the Board next week of the best response to capital inflows when these are the result of domestic conditions.

Mr. Kabbaj made the following statement:

I generally concur with the analysis and thrust of the staff report, and I can support the proposed decision. Since 1991, Argentina has made impressive progress in stabilizing its economy and pursuing its reform agenda. Particularly noteworthy have been the marked strengthening of public finances, the overall process of liberalization, and the steps taken to invigorate private initiative. Nevertheless, as other Directors have noted, the economy is still faced with a number of challenges, including the need to bear down on inflation through the implementation of tight macroeconomic policies, the fostering of domestic savings, and the achievement of rapid productivity gains. These elements are indispensable to the continued successful adherence to the fixed exchange rate regime and the maintenance of external competitiveness.

Mr. Zoccali says that the recent turnaround of the external position should not be viewed as signaling a permanent trend, nor should it be attributable to unsound policies. To the extent that the external imbalance is financed by autonomous private flows in response to the progress that Argentina has made with structural transformation, and to the extent that these flows serve to enhance the economy's future supply potential, there would appear to be no immediate cause for concern. Of course, this should not detract in any way from the authorities' plan to increase domestic savings and bring about gradual equilibrium in the current account balance over time. In this regard, we welcome the assurance by Mr. Zoccali that the satisfactory implementation of the reform of the social security system, which is a key element in the authorities' strategy to raise national savings over the medium term, is well in hand.

While we welcome the authorities' actions to sterilize the injection into the economy of resources generated through the sale of YPF, and to strengthen risk-adjusted capital adequacy requirements, in order to discourage capital inflows, the question arises as to whether or not the authorities should pursue their aims through additional administrative or monetary means. We would encourage the authorities to monitor liquidity creation closely. Although the monetization of the economy is still below its historical level, to the extent that the rapid expansion in bank credit arising from a reduction in reserve requirements has prevented inflation from declining more quickly, the situation warrants close attention.

Regarding the recent trends in productivity and unit wage costs, the authorities recognize that rapid efficiency gains can offset significantly the impact of currency appreciation. Developments in this area, as noted in the staff report, are certainly encouraging. The opening up of the economy is clearly having a favorable effect on productivity growth, while the flow of investment into the nontradables sectors can be expected to bring about a reduction in relative prices in these sectors. The proposed reform of labor legislation should facilitate a further increase in labor mobility and provide greater scope for improved competitiveness. These favorable trends need to be sustained and strengthened, to ensure the sustainability of the convertibility regime.

Mr. Lvin made the following statement:

Recent developments in Argentina provide us with new and convincing evidence that the vicious circle of destabilization and inflation can be broken. Two main instruments of Argentina's success--monetary stabilization and broad deregulation--once more proved their efficiency when supported by a national commitment to the reform. The authorities applied those instruments firmly in pursuing a comprehensive economic program, and they achieved remarkable and very commendable results.

The most visible and noticeable feature of the reform in Argentina is the great influx of foreign capital. Net private inflows started up immediately after the convertibility law was adopted in March 1991, and they reached $2.8 billion in 1991 and $13.7 billion in 1992. Projections on the 1993 estimates showed a slowing down of this process, and the net inflow is expected to amount to $10.8 billion. However, these figures are much greater than the programmed $6.8 billion. Although the main part of this money should be attributed to the repatriation of previous capital flight, it is the most important sign of confidence in the authorities' policy. Since the currency board mechanism has been introduced, these inflows have become the only source of inflation. Indeed, consumer prices--as well as wages--have increased substantially, and thereby undermined the international competitiveness of the Argentine economy. We share this concern, but as the repatriation of capital meets its own natural limits, and as interest rate differentials are decreasing, the capital account will become more balanced. I hope that a cautious wage policy, modified tax system, and enhanced tax administration will help the authorities to restrain further growth of domestic demand and improve the competitiveness of Argentina's exports. This task seems to be of particular importance in light of the trade balance deficit and a worsening of the terms of Argentine trade.

The scale of deregulation that has been undertaken during the last two years in Argentina is enormous. Foreign trade regulations shifted from a regime of protectionism--for many decades--to a very liberal one. In order to comply with new foreign competition and to make labor relations more flexible, the labor legislation has been modified and national sectoral wage bargaining is being steadily replaced by direct bargaining between employers and employees. I welcome the authorities' liberal approach in reforming these areas.

Relations between the provinces and the Central Government seem to be a very important issue, and have a great bearing on the authorities' ability to pursue their tax measures. Urgent measures have to be undertaken to reach a settlement of these relations, to redefine tax and budget responsibility, to reduce employment in the provincial governments, and to address rising federal financial transfers to the provinces. Mr. Zoccali mentions a new federal fiscal pact to be discussed in 1994. We urge the authorities to push ahead with this project.

Notwithstanding my broad agreement with the staff appraisal, there are some systemic issues that I would like clarified and explained.

First, as noted on page 17 of the background paper on recent economic developments, the convertibility law is based on the full backing of the monetary base by international reserves. At the same time, the new Central Bank Law allows the Central Government to borrow from the Central Bank, and establishes a ceiling on these loans at one third of base money (one fifth in the transitional period). How could this provision affect the implied backing of the peso?

Second, the importance of strengthening domestic savings is strongly stressed by the staff. The reform of the pension system could provide a permanent and stable basis for private, market-oriented savings. The Chilean experience discussed by the Board last week, and noted positively by Mr. Zoccali, demonstrates the excellent performance of a fully privatized pension fund system. At the same time, the state-managed "pay-as-you-go" pension system in Argentina has proved to be highly inefficient, while it has created huge arrears in pension payments--about $6 billion. In this context, what was the purpose, when reforming this system, in privatizing only half of it, and in retaining state administration of the basic pension schemes? In this regard, we fully share the staff's concern about the clause on the special treatment of the pension fund administered by the Banco de la Nacion, included in the draft law by the legislature. The staff's explanations would be appreciated.

Ms. Langdon made the following statement:

Like other speakers, we continue to be impressed by the commitment of the authorities and the performance of the Argentine economy under the extended arrangement. While we regret that the necessary parliamentary approval for the social security reform has not yet been received, we can accept the proposed waiver. The repeated waiving of the criterion, however, has certainly diminished the criterion's effectiveness in aiding the Government in passing the reform.

Although the performance of the economy to date has been more than satisfactory, there are a few disquieting developments of late. Broadly speaking, there appears to be a risk that some of the authorities' policies, as well as some of the staff's policy recommendations, are oriented more toward alleviating symptoms than addressing the fundamental causes.

We are less concerned about the widening of the current account deficit, as we view it as a reflection of domestic demand and the real appreciation of the currency. With the impressive increase in investment over the last few years, we take comfort in the fact that the increase in imports of intermediate goods and equipment should translate into higher export capacity in the years ahead.

However, we view the introduction of subsidies on domestically produced goods and interest subsidies to small- and medium-sized firms as worrying policy responses to the current account deficit. Apart from their budgetary impact, these measures, by introducing distortions, represent some backsliding in the substantial progress made in trade liberalization. Such actions risk sending disturbing signals to firms, and may encourage them to continue counting on a change of the rules rather than cost-reducing measures to improve their international competitiveness.

Like some other speakers, we are puzzled by the staff's recommendation that marginal reserve requirements be imposed as a means of dealing with strong capital inflows and the expansion of domestic credit. We are not sure that raising reserve requirements would be effective, nor do we feel that it is appropriate, as it may well interfere with financial intermediation, as Mr. Zoccali notes. The staff paper on capital inflows that is scheduled to be discussed by the Board in a seminar next week concludes that there is little evidence to show that impediments to capital inflows are effective. This suggests that the staff should have provided a much stronger justification for what must be considered only a "third-best" option.

The preferred route to dealing with sustained capital inflows when a nominal appreciation of the exchange rate is not an option is to pursue more vigorously fiscal austerity at the federal and provincial levels and to advance structural reforms, in particular with regard to enhancing labor market flexibility. We welcome the measures taken by the authorities in this direction.

Given the buoyancy of income growth, however, we are somewhat disturbed by the apparent weakness displayed by government revenues so far in 1993. There has been a significant amount of tinkering with taxes, tariffs, and subsidies, and we would note that a stable, cohesive system could be of great benefit to improving revenue collections and tax administration.

The authorities have a strong anchor to their reform program in the quasi-currency board arrangement, but they and the staff do not seem to want to let it operate fully. If that is the case, then perhaps this is an appropriate time to consider how to move to a more flexible exchange rate system, rather than introducing distortions.

Mr. Posthumus made the following statement:

Argentina's macroeconomic and reform policies have been very successful in the past few years, and I would like to praise the authorities for their adjustments. However, several economic indicators now give serious warning signals. Inflation has not come down sufficiently, and it is not clear whether it is on a downward path at this time. International competitiveness has deteriorated substantially. The current account outcome is worse than expected, owing to lower domestic savings. The deficit is smoothly financed by capital inflows, but the share of foreign direct investment--excluding privatization proceeds--in these inflows is low, and the rise in the investment ratio lags behind projections. Domestic credit increased by 43 percent last year, and will continue to grow sharply this year. Continued adherence to the fixed exchange rate regime requires orienting policies at this stage squarely on raising savings and curbing inflation, as well as increasing the economy's flexibility, as the staff rightly states in the appraisal. It is therefore surprising that the staff, in this same appraisal, is so reticent in advising further measures to raise savings and curb inflation. It seems that the sustainability of the exchange rate regime, and therefore the program as such, may be questioned--and indeed, was questioned today--if the authorities do not facilitate and strengthen its operation as much as possible. Or perhaps it is the staff's opinion that there is not that much urgency--or possibility--in taking such measures?

The scope for monetary policy is limited under a currency board arrangement. Monetary policy cannot be used to reduce inflation by increasing short-term interest rates and thus reducing credit expansion; ultimately, of course, the currency board arrangement itself corrects an imbalance caused by high inflation. In this respect, I wonder why the staff advises the authorities to increase reserve requirements of the banking system, a measure that is not commensurate with this arrangement. Other measures aimed at reducing inflation and demand must therefore be taken. In the case of Argentina, this means that domestic savings should be raised through increasing the fiscal surplus and through accelerating other reforms, such as those of social security and the pension system. The authorities' statement that they did not consider it advisable to take additional steps to tighten fiscal policies because of the risk of throwing the economy into recession is therefore also surprising. This reminds me of the experiences in the exchange rate mechanism (ERM) in September 1992, when all too often monetary actions that were required to maintain exchange rate stability--other than intervention--were not taken, out of concern for the possible effects of interest rate increases on domestic demand.

Mr. Kural made the following statement:

Argentina's stabilization and structural reform efforts have improved as a result of the shift in policies since the introduction of the convertibility law in March 1991. These immediate major improvements, together with Argentina's debt and debt-service reduction operations, have permitted continuous pursuit of structural adjustment in the years since then. Recent years have seen renewed output growth in various segments of the economy, a strengthening of the public finances, liberalization of the economy and an acceleration of privatization.

There remain two potential major obstacles to the implementation of Argentina's program in the medium term. The first is the difficulty of creating a surplus of savings over investment while still maintaining sufficient investments to sustain output growth. The second is the need to maintain confidence in order to stabilize the capital account and reduce the current account deficit.

The *policy reorientation* needed now will have to answer two principal concerns. First, policies will have to include restrictive macroeconomic measures aimed at reducing excess demand and consumption, but without at the same time discouraging the much-needed private investment. Second, policies must be sufficiently credible to avoid the resurgence of inflationary pressures and the country's vulnerability to a sudden outflow of capital. It is now essential to identify where cuts and savings can be made in the public sector. It is known that efforts to strengthen competition, improve efficiency, and increase productivity through the removal of state intervention in the markets have been under way for several years. No doubt this is related to the inability of the state to improve the collection of fiscal revenues from the tax system. In order to meet the program's public sector savings target, it is vitally important to further enhance revenue-raising measures through improvements in tax administration. Given the size of the public deficit and the constraints on further expenditure cuts, the task of increasing national savings now depends on reforming the social security system.

The attainment of anti-inflationary growth targets will require more harmonious fiscal and monetary policy stances in the medium term: at present, the effectiveness of monetary policy is being undermined by certain shortfalls in fiscal management and capital inflows. For this reason, I join the staff in urging the imposition of marginal reserve requirements to help slow domestic credit expansion and capital inflows. The mobilization of savings requires maintaining the pace of reform in both the public and private sectors. An appropriate balance between public and private investments will be important for future growth. Business confidence would benefit from the establishment of a clear legal framework with stable rules favoring private business and controlling the key economic factors. Macroeconomic stability and policy credibility are therefore the keys to obtaining a strong investment response.

The Argentine economy must now choose between two strategic options. The first of these consists of optimistic reliance on capital inflows coming from the privatization of state companies, short-term investment, and consumption. The authorities seem to have committed themselves to this option, for which they are building an institutional framework. Clearly, the preference for sending resources abroad rather than investing them at home was at work before the debt crisis erupted, and was also largely responsible for the absence of recovery afterwards. I consider the authorities' choice of this option undesirable in the medium term, because the prospects for continued inflows are uncertain: these are "disguised" capital movements responding to the liberalized financial system and to the exchange rate regime. The second--and, to my thinking, preferable--option would be to find ways of increasing domestic savings. The reform of the social security system is a major element in the Government's strategy to encourage domestic savings. The latest version of the social security reform is the most promising policy means toward this objective.

The success of the program will depend mainly on the attainment within a specified time period of well balanced public finances. In order to keep the growth rate of the economy from falling as a result of this policy implementation, priority should be given to the measures for increasing production in the nontraded goods sector. At the same time, care must be taken to avoid harming investments when implementing measures to limit demand pressures, further increase labor mobility, and make employment conditions more responsive to market developments, with the aim of increasing Argentina's competitiveness under the fixed exchange rate arrangement.

We support the proposed decision.

Mr. Papadakis made the following statement:

Argentina has made impressive progress in the last two years in both macroeconomic stabilization and the consolidation of structural reforms, thus laying the foundations for renewed growth in the framework of a more stable, transparent, market-based environment. After years of disinvestment, private sector confidence has been restored, responding to tax and trade reforms, privatization, liberalization of real and financial markets, as well as to the sharp fall of inflation to record-low levels, the result of financial policies geared to supporting currency convertibility.

The fixed dollar link has had a crucial role in the drive toward stabilization. Unlike some previous speakers, I do not think that, at the present juncture, it would be to Argentina's benefit to change its monetary orientation or float its exchange rate. Inflation has just been driven to single-digit figures, following protracted strong efforts to establish and strengthen the credibility of the monetary anchor, while restoring the economy's fundamentals. As long as there remains room for further improving the fundamentals, and as long as the authorities' commitment to do so remains credible, the desired improvement in relative external competitiveness should be sought primarily through these means. The viability of the fixed dollar strategy will continue to depend on the pace of increase in domestic costs and prices relative to that of world dollar prices. Following some notable further improvements recently, low domestic inflation now needs to be secured. Financial policies in the period directly ahead will thus be even more crucial than in the recent past. We welcome the authorities' commitment to sterilize the external inflows coming from privatization. We wonder, however, whether this alone would be sufficient to anchor inflation to low levels. A major contribution should be sought from stronger fiscal adjustment. There are ways, such as those proposed by the staff, of minimizing the risk of recession from a tighter fiscal policy. Also, such a risk should be weighed against the risk of ending up with an even worse outcome, should a relaxation of fiscal policy lead to a loss of confidence in the peso and a reversal of capital flows. A correction then would require a much stronger adjustment compared with the one that the staff proposes now, with a view to addressing the situation at an early stage.

Even if a reversal of capital flows was caused by exogenous factors, the temptation to counterbalance these by relaxing domestic policies should be resisted at all costs. Argentina's economy has now come very close to a "swift landing" scenario, in which supply and demand will have moved permanently into better equilibrium, interest rate differentials will have narrowed, and capital flows will have tapered off by themselves. It is crucial, therefore, to ensure that market confidence is maintained without a need for sharp changes in interest rates, which could affect investment adversely. A key factor remains the ability to generate sufficient public savings, in order to keep interest rates down in a healthy manner, while improving the distribution of overall expenditure. As pointed out in the background paper on recent economic developments, about two thirds of the increased use of external saving in the last two years reflected increased consumption, and only one third reflected increased investment. Foreign saving to finance investment was only sufficient because of the sharp decline in the relative price of capital goods. It is highly improbable that such a sharp decline will continue.

There seem to be downside risks on the revenue side of the budget. To some extent, these are inevitable, given that a series of much-needed tax reforms and measures to reduce production costs have been introduced in a relatively short period of time. Nevertheless, in view of the revenue shortfalls projected by the staff for the current year, corrective measures on both revenues and expenditures would be advisable in order to minimize the extent of the shortfall. Even in the absence of large revenue shortfalls, a prospect of higher public and total domestic savings would further enhance the credibility of the policy mix.

In the area of monetary policy, it would be prudent to use reserve requirements more with a view to their monetary than to their structural effects, at least at the present juncture. Average reserve ratios will probably tend to decline gradually, as the effects of financial liberalization work their way through the system. Any further reduction now of compulsory reserve requirements would be rather premature. In fact, in the face of the 60 percent annual rate of growth of broad money, the 100 percent annual increase in bank lending capacity, and the sharp reduction in interbank rates in the first months of the year, the authorities should consider the temporary imposition of a marginal reserve requirement, as suggested by the staff.

At the previous Board discussion last March, our chair, like others, expressed the hope that the prospects for congressional approval of the social security reform would not fade as the election day approached. It is disappointing that the reform has encountered further delays. We also stressed last March that, in the process of passing the relevant legislation, it would be important to avoid any watering down of the proposed provisions in a way that could imply higher costs to the system or the government budget. The background paper on recent economic developments points out that the latest version of the reform would only lead to notable savings for the public sector, if all individuals aged under 50 at the start of the reform were to leave the state system. It is unclear whether, and to what extent, they will actually find it attractive to do so. There are other potentially cost-increasing elements as well; it is encouraging that the executive branch has been committed to remove some of these before the start-up of the new system. As for the waiver itself, I am reassured from Mr. Zoccali's statement and the supplement to the staff report that Senate approval can be expected soon. I can therefore go along in agreeing to the waiver. It should be stressed, however, that, with this new extension, the deadline for the passage of this particular piece of legislation has now become critical, since the reforms are supposed to be implemented starting January 1994.

With respect to labor market flexibility, an important further step will be achieved when the authorities finally succeed in passing through the Congress the proposed new piece of labor legislation. Its provisions will improve competitiveness through further productivity and efficiency gains, thus contributing to the fight against inflation and toward permanent success of the adopted monetary regime. A more flexible labor market will also improve the prospects for profitability, cash flow, and the internal savings of firms. There will thus be less need for resorting to subsidies and tax exemptions that can only contain production costs temporarily, in an artificial and very inefficient way.

My remarks are meant only as points of constructive criticism, for the fact remains that the strength of the program to begin with, and its overall satisfactory implementation so far, have brought about impressive macroeconomic results, thus allowing Argentina to secure the required official external enhancement resources, to normalize its relations with commercial creditors, and to bring the economy back on the track of sustainable, noninflationary growth.

Mr. Solheim made the following statement:

Like previous speakers, I want to commend the authorities for the strong performance under the program, and for having reestablished Argentina's creditworthiness. Furthermore, as pointed out by Mr. Zoccali, the recent reform effort, coupled with the support of the international community, has afforded Argentina a unique opportunity to unlock its potentially large supply response.

While the recent, overall good track record of Argentina may provide good grounds for optimism, I am becoming increasingly concerned about certain aspects of economic development. The continued weakening of international competitiveness and the widening current account deficit may ultimately create major economic imbalances and render it difficult to maintain credibility in international capital markets. The authorities should therefore be prepared to undertake additional restrictive measures to avoid the emerging overheating of the economy.

As underscored by many speakers today, as well as during the last Board discussions on Argentina, a critical task is to bring the rate of inflation firmly under control, so as to prevent a further erosion of competitiveness. In this context, I am in broad agreement with the staff recommendations that, under the fixed exchange regime system, the authorities should orient policies more aggressively toward raising savings and tightening credit policies. In this context, the recently introduced interest rate subsidies for small- and medium-sized enterprises should be reconsidered. In light of the recent weaknesses in revenue, could the staff comment on the impact of these subsidies on the public finances?

A further widening of the current account imbalances could jeopardize Argentina's solvency and credibility. In this context, a key element is to raise national savings over the medium term through the social security system. Therefore, it is disappointing to see that the approval of the reform of the social security system--a structural benchmark for the two previous reviews--is not yet achieved, and a waiver is needed once again.

Despite the fairly impressive overall performance of the Argentine economy, I am concerned that unsustainable economic imbalances may be building up if they are not appropriately addressed by a more restrictive economic policy stance. The summary of discussions may give the impression that the authorities attach somewhat less importance to a more restrictive stance of economic policy than advocated by the staff. In my view, the authorities would be well advised to follow the recommendations of the staff. I support the proposed decision.

Mr. Koissy made the following statement:

Like other speakers, I commend the Argentine authorities for the significant progress made over the past two years in stabilizing the economy.

In 1992, GDP growth continued to be robust, inflation, as measured by the consumer price index, was relatively moderate, and public finances have strengthened further. Moreover, the overall balance of payments improved markedly, with the gross official reserves representing at end-1992 ten months of imports. Prospects for 1993 and beyond appear favorable.

Although this performance indicates that the authorities are implementing with determination their program of adjustment supported by the Fund, it is a fact that additional efforts would need to be made so as to ensure increased flexibility in the labor market and enhanced competitiveness of the economy. Since I am in broad agreement with the staff appraisal and policy recommendations, I will limit myself to a few points relating to the fiscal and the monetary sectors.

With respect to the fiscal sector, we agree with the authorities that a further tightening of fiscal policies would be recessionary at this juncture. However, given the low level of domestic saving, and in the event that the fiscal outlook deteriorates further, we would urge the authorities to exercise firm control over expenditure and implement the revenue measures that have been envisaged in the 1993 budget, so as to comply with the program's fiscal objectives. In this connection, we note that the staff is anticipating a shortfall in projected revenue for 1993. Could the staff indicate whether recent developments confirm that assessment?

With regard to the monetary sector, we note that both the increase in capital inflows and the lowering of the reserve requirements seem to have contributed to a rapid expansion in domestic credit to the private sector. While we have some sympathy for the suggestion made by the staff to impose a marginal reserve requirement on local and foreign currency deposits as a way to curb credit in the short run, we also share the authorities' concern about the overall impact of tight credit on investment and growth. This is all the more important, as the process of remonetization is still in its infancy, and private sector indebtedness is relatively small. In this regard, we welcome the authorities' recent measures aimed at supporting the investment process and the restructuring of the economy, while selectively discouraging the growth of consumer credit.

We support the proposed decision.

Ms. Patel made the following statement:

As a result of the laudable adjustment efforts made by the authorities, Argentina's economic performance continued to improve noticeably. Significant progress was achieved in increasing markedly the rate of economic growth, reducing inflation, improving the fiscal stance, and strengthening the overall balance of payments position. The tight fiscal and monetary stances adopted by the authorities have enabled them to secure a better than projected performance in all the quantitative targets set for the first quarter of 1993. We therefore have no major difficulty in endorsing the authorities' request for a waiver for the nonobservance of the end-June performance criterion and for its modification.

As can be seen from Mr. Zoccali's statement, the authorities remain strongly committed to pursuing further financial and structural reforms, thus building on the progress achieved thus far. The major challenge confronting the authorities now seems to be how to consolidate the gains already made in the fiscal area--by improving domestic savings and investment in order to secure sustained economic growth.

The disturbing fact is that domestic savings, in particular by the private sector, has been declining for three consecutive years, and the expansion in domestic investment has relied increasingly on external savings. We are therefore encouraged by the authorities' determination in implementing a series of measures aimed at raising national savings over the medium term. In this regard, particular emphasis should be given to the timely implementation of the envisaged social security reform and to the faster improvement of labor productivity. Conferring the necessary priority on boosting national savings will not only assist the authorities in securing the required levels of domestic investment and growth in the future, but will also--and most important--reduce the country's dependence on external savings.

The authorities have made impressive progress toward reducing the rate of inflation rate over the past three years. However, because inflationary pressures are not yet totally subdued, the authorities should continue to attach to this problem the attention it deserves. In particular, further strengthening of the fiscal stance seems to be required in order to avoid overburdening monetary policy in the fight against inflation. In this respect, the decision taken by the authorities to sterilize the monetary impact of capital inflows as a result of the privatization of YPF is therefore most welcome.

We support the proposed decision.

The staff representative from the Western Hemisphere Department stated that the economic performance of Chile was similar to that of Argentina, as both had experienced strong growth and a relatively good inflation outturn. Interestingly, Chile also maintained a 30 percent marginal reserve requirement on all types of capital inflows, whether direct borrowing or through the banking system. The argument could be made that such a policy had helped the Chilean authorities to maintain better control of aggregate demand and a manageable current account deficit--with a ratio to GDP that was moderate--despite the fact that the economic fundamentals for Chile were among the strongest of the countries of the region, and therefore the country could be considered as attractive to capital inflows. The case of Chile showed that marginal reserve requirements could play a positive role in dealing with capital inflows. The role for monetary policy in Argentina might be fairly limited, and the principal emphasis would therefore need to be on the fiscal side. Orienting policies squarely on controlling inflation meant that the authorities would have to err on the side of strengthening the fiscal stance, especially if inflation was not reduced quickly to international levels. While expansionary monetary measures, such as the reduction in reserve requirements that had been taking place, were probably counterproductive, contractionary monetary measures could make a marginal contribution, however, in the staff's view.

Under the Central Bank Law, the backing for the currency was not only foreign reserves, the staff representative pointed out. Up to 30 percent of the backing under the law could consist of Argentine Government securities denominated in foreign exchange. Therefore, if the Government were to issue domestic paper in foreign exchange, that paper would be counted as part of the backing for the currency.

Only one half of the social security system--workers' contributions--was to be privatized because the authorities were moving away from a pay-as-you-go system to a capitalized system, the staff representative from the Western Hemisphere Department concluded. All of the existing pensioners in the system had accumulated rights which the Government intended would be phased out only over a period of 30 years or more. In the meantime, the government system needed to deal with the accumulated pension rights of people who were retiring at the current juncture, and who would have accumulated capitalized rights under a privatized system. If the system were to have been fully privatized, the Government would have had to have taxed back a good proportion in order to cover the deficit of the remaining system. In Chile, where the pension system had been fully privatized, the Government had continued to run deficits of 3 percent of GDP or more in order to cover its own remaining obligations under the old system.

The staff representative from the Policy Development and Review Department referred to the June 1993 issue of Staff Papers, which contained a paper by Carlos Rodrigues, entitled "Money and Credit under Currency Substitution." That paper discussed the appropriateness of raising legal reserve requirements on capital inflows under certain conditions in order to limit the expansion of credit.

Mr. Zoccali stated that he wished to thank his colleagues for their interest in and continued support for Argentina's adjustment effort. He would convey their comments faithfully to his authorities.

The authorities did not view the electoral calendar as having the potential to alter their fundamental stance to consolidate orderly market conditions and private sector confidence, Mr. Zoccali continued. That sentiment had been expressed very clearly to management and staff on the occasion of President Menem's visit to the United States two weeks before, and he would reiterate that sentiment.

The reform of the social security system, as well as labor reform, which had been pointed to as being crucial, were also commitments of the authorities, Mr. Zoccali observed. Those reforms would be important not only in order to raise domestic savings over the medium term, but also to improve competitiveness. While the timing of those reforms might be in question, their eventual implementation was not in doubt, and indeed, the authorities would spare no effort in seeing that they were implemented. That notwithstanding, it needed to be borne in mind that the necessary procedures that had been set in motion under Argentina's system of parliamentary democracy--which had been established with much pain and effort--needed to be respected.

The program had fiscal contingencies built into it, Mr. Zoccali noted. Even though there had been a delay in the implementation of fiscal measures, that delay was not expected to affect the fiscal program targets adversely.

Regarding the issue of external competitiveness, it might be observed that while structural reform was taking place in Argentina, it was not instantaneous, Mr. Zoccali pointed out. The implementation of structural reforms in Argentina had lagged somewhat behind the reforms in other strong performers in the region, such as Chile and Mexico. The increase in capital investment was contributing to strong import demand, which would contribute to productivity and facilitate future improvements in competitiveness. Also, the importance of the current weak world economic situation should not be underestimated in assessing the deterioration in Argentina's external competitiveness. The terms of trade for Argentina had declined to the lowest level of the century, and MERCOSUR was not expected to exert any favorable effects on the balance of payments or on trade performance. Import demand in important trading partners had been extremely depressed in important trading partners, and at the same time, the pickup in domestic aggregate demand in Argentina had been only 18 percent over the preceding two years. That notwithstanding, export values in Argentina had increased slightly, and export volumes had risen in both 1992 and 1993.

The process of domestic reform to foster the growth of trade on the basis of comparative advantage was not immune from the realities of an increasingly restrictive multilateral trading system, Mr. Zoccali stressed. For that reason, his authorities shared the concerns expressed by a number of speakers about the conclusion of the Uruguay Round, and they hoped that the Round would go beyond an agreement only on manufactures.

There were sufficient methodological caveats regarding the indices of competitiveness provided in the background paper on recent economic developments, Mr. Zoccali commented. The general unavailability of reliable data did not detract from the usefulness of a greater integration of macroeconomic and microeconomic analysis in refining assessments of exchange rate misalignments, however, and in that connection, care needed to be taken that assessments of exchange rate overvaluation were presented in an appropriate way in documents intended for wide circulation--in particular, for circulation outside of the Fund.

Regarding the expansion of bank credit, his authorities continued to be concerned about the wide spread between deposit and lending rates, Mr. Zoccali continued. Such a wide spread was a manifestation of an undesirable degree of inefficiency in financial intermediation. His authorities were open to suggestions about how capital inflows could be sterilized in a way that would not distort financial intermediation, but there did not appear to be any easy answers. While marginal reserve requirements could certainly slow the expansion of domestic credit, they could also influence lending rates and attract additional capital flows, a point to which Mrs. Hetrakul has also called attention. The authorities had resisted sterilizing capital inflows because of their recent experience of dealing with a very high quasi-fiscal deficit--almost 6 percentage points of GDP--but no options for dealing with capital inflows were closed.

The convertibility law did limit to a certain extent the functions of the Central Bank, Mr. Zoccali concluded. The law did not permit Central Bank financing either to the Government or to the private sector. Candidates for the Board of the Central Bank would be chosen in the succeeding few months. The Board would devote itself to supervision of banks and strengthening capital adequacy requirements.

The Chairman made the following summing up:

Executive Directors agreed with the thrust of the appraisal in the staff report for the 1993 Article IV consultation with Argentina.

Directors commended the authorities for the substantial progress that they had made, under the stand-by and extended arrangements with the Fund, in strengthening the public finances, liberalizing the economy, privatizing public enterprises, and re-establishing relations with external and domestic creditors. Those developments had contributed to confidence and to the strong economic expansion of the last two years. Directors emphasized that priority should now urgently be given to raising domestic saving, and thereby improving control over aggregate demand in order to help lower inflation to a rate consistent with the fixed exchange rate regime, improve the current account position, and reduce the reliance on capital inflows in financing investment. Successful action in those areas would help safeguard the economy's growth prospects. Directors also urged the authorities to continue to press ahead with structural reforms that would enhance the economy's flexibility, including labor market reforms.

Directors observed that the strengthening of the public finances and of public saving from current levels should now play a critical role in government strategy. To that effect, further improvements in tax administration--especially in the area of social security taxes--and continued expenditure restraint were essential. Directors urged the authorities to stand ready to implement measures that would strengthen the revenue base and to tighten outlays if shortfalls in public revenue continued.

Directors were disappointed by the further delay in approving the reform of the social security system, and they encouraged the authorities in their efforts to seek early Senate approval of the reform, given the key role that this reform played in the Government's program to raise domestic saving over the medium term. They also shared the authorities' concern about the proposed guarantees for the pension fund of the state bank, the Banco de la Nacion.

Many Directors believed that monetary policy was too easy. They urged the authorities to curb the overly rapid pace of expansion of credit. In that connection, a number of Directors expressed support for the imposition of marginal reserve requirements on foreign currency and peso deposits. Directors welcomed the authorities' commitment to sterilize the resources to be injected into the economy from the privatization of the state oil enterprise, YPF, and they noted that firm implementation of such an approach would help prevent an intensification of inflationary pressures and reassure financial markets. They also supported the authorities' plans to strengthen risk-adjusted capital adequacy requirements for banks and shift a larger share of nonfinancial public sector deposits to the Central Bank.

Directors expressed concern about the appreciation of the real effective exchange rate of the peso since the entry into effect of the convertibility law, but noted that deregulation measures, the behavior of wages, and tax changes had offset some of the loss of international competitiveness. They stressed that continued increases in prices in excess of those prevailing in the industrial countries would erode the breathing space that had been gained by these means, with adverse consequences for investment, growth, and balance of payments viability. At the same time, a number of Directors noted the positive effects of the current exchange regime on monetary and fiscal discipline and in dampening wage demands, and they stressed the importance of maintaining its credibility. In that context, Directors emphasized that measures to reduce rigidities in the economy were also essential, in particular a reform of labor legislation to facilitate labor mobility and promote more flexible employment conditions. Several Directors urged the authorities to avoid the recourse to subsidies and preferential interest rates in response to exchange rate appreciation. Directors also thought that it was important to implement promptly the reform of the health insurance system so as to improve the delivery of services and reduce labor costs, and to encourage further reforms in the provincial finances.

It was expected that the next Article IV consultation with Argentina would be held on the standard 12-month cycle.

The Executive Directors approved the following decision:

1. Argentina has consulted with the Fund in accordance with paragraph 4(d) of the extended arrangement for Argentina (EBS/92/46, Sup. 1), as amended, and paragraph 3 of the letter of December 10, 1992 from the President of the Central Bank and the Minister of Economy and Public Works and Services of the Argentine Republic, in order to review the implementation of the economic program and to establish the frequency of further program reviews for the remainder of 1993.

2. The letter dated June 11, 1993 from the Minister of Economy and Public Works and Services shall be annexed to the extended arrangement.

3. Paragraphs 4(c) and 4(d) of the extended arrangement shall read as follows:

> "(c) after September 30, 1993, if Argentina has not implemented satisfactorily the reform of the social security system; or

(d) after August 31, 1993 and November 30, 1993, until reviews of the implementation of the economic program for 1993, including the implementation of the policy intentions specified in the letter dated June 11, 1993, are completed; or".

4. The Fund decides that the review contemplated in paragraph 4(d) of the extended arrangement for Argentina, as amended, is completed, and that notwithstanding paragraphs 4(a) with respect to the nonavailability of data for end-June 1993 performance criteria and 4(c) on the satisfactory implementation of the reform of the social security system not later than June 30, 1993, Argentina may proceed to make purchases under the arrangement up to the equivalent of SDR 1,426.20 million until September 1, 1993.

Decision No. 10419-(93/99), adopted
July 14, 1993

5. VIET NAM - OVERDUE FINANCIAL OBLIGATIONS - REVIEW FOLLOWING DECLARATION OF INELIGIBILITY

The Executive Directors considered a staff paper on the further review of Viet Nam's overdue financial obligations to the Fund following the declaration of its ineligibility to use the general resources of the Fund effective January 15, 1985 (EBS/93/110, 7/7/93).

The staff representative from the Treasurer's Department stated that the payment of Trust Fund interest that was mentioned in the staff paper was completed late in the preceding week, which brought the arrears to SDR 100.2 million, and the payments made since January 15, 1993--the time of the last review of Viet Nam's arrears--to SDR 2.6 million. The authorities were in the process of acquiring about another SDR 1 million for payment of other obligations. The staff expected that transaction to be completed by the following day.

Mr. Ismael made the following statement:

This is the seventeenth, and it is to be hoped the last, review of Viet Nam's arrears to the Fund. The authorities welcome the White House press release of July 2, 1993, regarding United States policy toward Viet Nam, in which it is stated that President Clinton has "decided to end our opposition to the efforts of other nations to clear Vietnam's arrears in the IMF." They also welcome the subsequent statement by the staff to the Executive Board on July 9, 1993 that "international consensus has been reached on the resumption of lending to Viet Nam by international financial institutions...a mission will be sent later this month to negotiate a stand-by arrangement, which could be followed by an ESAF-type arrangement and...major donors are also being consulted on the modalities of settling Viet Nam's arrears to the Fund."

The authorities stand ready to receive and cooperate with the mission as soon as possible, and in the best possible way. They call on the French authorities to finalize as soon as possible the setting-up of a support group of donor countries to provide the bridge financing needed to clear Viet Nam's arrears to the Fund.

Viet Nam has not only been able to honor its commitment to keep its outstanding arrears to the Fund at the end-1988 level of SDR 101.2 million, but has even been able to have this amount reduced to SDR 99.9 million as of May 19, 1993.

Since then, as further proof of Viet Nam's seriousness in meeting its financial obligations to the Fund, three payments have been made: SDR 254,404 due on May 24, 1993; SDR 106,971 due on June 30, 1993; and SDR 975,000 due in early August 1993, but paid in advance on July 13, 1993. With these payments, Viet Nam's arrears to the Fund have been reduced to SDR 98,963,897 as of today.

The authorities deeply regret that the first-mentioned payment was blocked by a U.S. bank in New York because of the imposition by the U.S. authorities of restrictions on current payments and transfers to Viet Nam.

The authorities would have been reassured were the Fund to have advised them that concrete steps had been taken to obtain a waiver for the release of the blocked payment. Instead, they received two consecutive communications from the Fund urging them to make a make-up payment for the blocked payment.

Besides the concern of the authorities about how the blocked payment can be released, their additional concern is what guarantees would be available to prevent a recurrence of similar blockages in the future.

It is the opinion of the authorities that the draft decision does not reflect appropriately the aforementioned developments. However, they leave the finalization of the decision entirely in the hands of the Executive Board, trusting that the Board will act in an objective and just manner.

The Managing Director made the following statement:

Since 1989, the Vietnamese authorities have cooperated with the Fund by implementing structural reforms and macroeconomic stabilization policies and by stabilizing overdue obligations to the Fund at their end-1988 level.

Despite unexpected difficulties, including the collapse of CMEA trade, the Vietnamese economy has been performing remarkably well; the rate of growth is about 7-8 percent per year while inflation has been reduced to single digits. However, continued efforts are required to sustain progress toward macroeconomic stability and to complete the transformation of the economy to a fully market-based system.

Several countries have indicated their readiness to participate in an international effort to assist Viet Nam to clear its overdue obligations to the Fund. We all welcome President Clinton's very recent announcement--which Mr. Dawson may want to say more about today--that the United States had decided not to oppose such an effort on the part of others and I hope that it will expedite the efforts of Viet Nam and the international community to facilitate the clearance of Viet Nam's overdue obligations.

The Fund, of course, will play its part in this process. A Fund mission stands ready to visit Hanoi shortly to hold discussions on a comprehensive adjustment program that could qualify for Fund support under a stand-by arrangement once arrears have been cleared. We will also be working closely with members of the Support Group on the steps toward arrears clearance.

Finally, let me mention that a few weeks ago I informed the Vietnamese authorities that I have accepted their invitation to visit Viet Nam later year, probably after the Annual Meetings. I trust that by that time Viet Nam will have settled its arrears and adopted a Fund-supported economic adjustment program or be well on its way toward those objectives. I am confident that with willingness on all sides, we can look forward to a speedy normalization of Viet Nam's relations with the Fund and to Viet Nam's full reintegration into the international financial community.

Mr. Landau made the following statement:

Since the review of Viet Nam's arrears of January 1993, and in spite of the persistence of very difficult constraints, Viet Nam has continued to make progress under the two key criteria of the framework of our strengthened cooperative strategy. Viet Nam's commitment to pay its obligations to the Fund as they fall due has been fulfilled. Furthermore, I fully concur with the staff that Viet Nam's "strong economic performance of 1992 has continued, in most respects, in the first half of 1993." I would like to elaborate briefly on each aspect of this renewed and remarkable performance, before turning to the favorable perspectives that can now be explored by the Fund, and to the specific decision we have to take.

Regarding payments to the Fund, the staff paper correctly recalls that, since 1988, the level of Viet Nam's arrears has diminished by SDR 0.9 million. It is also clear that Viet Nam has transferred all amounts falling due since our last review. The slight increase in arrears since the beginning of this year only reflects exchange restrictions imposed by another member country, as Mr. Ismael has stressed. Through the sale of SDRs to Viet Nam, my authorities have participated, in the framework of a two-way arrangement with the Fund, in the solution found for the most recent maturities of obligations falling due. We appreciate the staff's indication that a solution is in view for the blocked amount, and we encourage the staff to pursue its efforts at finding a more permanent solution to the problem in the perspective of the settlement of forthcoming obligations.

Regarding economic developments it is noteworthy that Viet Nam's economic growth is now only slightly below the robust 8 percent rate of growth registered last year, and that its inflation rate has again declined sharply--to 8 percent--from the already encouraging 15-20 percent of 1992. Those achievements are certainly not small given the constraints on Viet Nam's external relations and the increasingly acute bottlenecks affecting the domestic infrastructure.

Progress has also been made in the definition and implementation of structural reforms. I refer here to the decrease in public sector employment--by 8 percent since 1991--to the initialization of the corporatization of public firms, to the recent adoption of the Land Law by the National Assembly, and to the consideration being given to tax rationalization.

Recently, both the budgetary and monetary policies seem to have adopted a more expansive stance, although it should be stressed that real interest rates remain positive, that no recourse appears to have been made to bank financing of the budget, and that the differential between the official and the parallel exchange rates has remained small and stable. I understand that the authorities are fully aware of the drawbacks of conducting an overly stimulative financial policy over the medium term.

It is thus clear that the time is right for the Fund to exert fully its influence--in the sense of stability, reform, and sustainable growth--in Viet Nam's economy. It is also clear that, especially since July 2, all the conditions have been met for this to happen in a consensual manner. I welcome the Managing Director's intention to send a mission to Hanoi in the next few days. This mission should aim at defining with the Vietnamese authorities a program that would allow Viet Nam to have access to Fund resources. Such access could be in the framework of a stand-by arrangement, the systemic transformation facility, or a combination of both. In any case, I concur with Mr. Ismael that this should be only a first step, and that access to Fund resources should aim at preparing for the ESAF successor, which will be indispensable in the medium term given Viet Nam's status as a low-income country and its need for structural reforms.

My authorities would strongly support such a course of action. There are advantages in proceeding as quickly as possible in this endeavor.

It is my authorities' intention fully to assume their responsibilities as President of the Viet Nam Support Group in the process that should lead to the clearance of arrears prior to the consideration of any program by the Board. My authorities intend to organize a meeting of the Support Group as soon as the staff is in a position to provide a precise assessment of Viet Nam's financing needs, and at the latest, on the occasion of the 1993 Annual Meeting. We fully expect that an agreement on a Fund-financed program will trigger without delay substantial financial assistance from other multilateral institutions, as well as the much-needed consolidation of public debt in the framework of the Paris Club.

In these circumstances, I have no major problem with the spirit of the proposed decision. However, like Mr. Ismael, I believe that its wording can be improved better to reflect the stance that it is to be hoped that the Board could take today.

In that regard, the second paragraph of the decision should incorporate the more positive and, given Viet Nam's past performance over the medium term, justified assessment that was contained in the Board's decision of January 1993. Also, the last sentence of the third paragraph could be somewhat more precise in describing in a factual manner the next steps that the Board could take. Given the favorable prospects for the clearance of arrears, we could certainly do without the fourth paragraph, which refers to the now unlikely persistence of arrears six months from now. It adds nothing to the Board's power to take up the matter at its convenience, if needed. In due course, I would like to submit the precise amendments I would propose to those paragraphs.

I hope that there can be a broad consensus today to give the staff a clear mandate to enter into negotiations with the authorities on a full-fledged Fund-supported program with Viet Nam. This would be the logical conclusion of a five-year process in which Viet Nam has demonstrated remarkable perseverance. This would help establish the proper conditions for the consolidation and enlargement of the gains obtained so far at this crucial juncture for Viet Nam's economy. This would also highlight the principle of equality of treatment, to which the Fund is so rightly attached. Finally, it would pave the way for a welcome new success in our strengthened cooperative strategy.

Mr. Fukui made the following statement:

I commend the Vietnamese authorities for the successful implementation of economic adjustment policies, which has resulted in a remarkable economic performance, including the recovery of growth and a reduction in inflation.

However, recent developments raise some concerns. The stance of macroeconomic policy has been expansionary, as is pointed out in the staff paper. I am concerned that the continuation of the present stance will lead to a resurgence of inflation, and will consequently undermine the achievements gained so far. In addition, attention should be paid to the recent decline in gross international reserves resulting from those expansionary policies. I would like to emphasize that the authorities should renew the stringent adjustment efforts made last year and adopt tighter financial policies in the period ahead.

I generally endorse the staff's assessment of specific economic policies. The authorities should adhere to a tight fiscal policy stance. Currently, the overall fiscal deficit is largely financed by foreign resources, but these foreign resources are sometimes volatile. It is therefore urgent that the authorities restore fiscal discipline. In view of this, the authorities should make every effort to finance capital expenditures, as well as current expenditures, with their own resources. We agree that there is a need for a rapid increase in capital expenditure, but it is necessary to avoid overreliance on foreign resources for this. We welcome the public salary reform, but we hope that it will not prove to be a burden for the budget by being combined with the retrenchment effort.

On the revenue side, several proposals are being considered to streamline the tax system. Although I do not have sufficient information on the contents of these proposals yet, I believe that this approach is in the right direction.

On monetary policy, I would like to express my concern about the recent expansion of domestic credit, which rose by 65 percent during the year ending April 1993. The rate of domestic credit expansion should be reduced sharply through tighter limits on the State Bank's refinancing facilities and on its lending to commercial banks. In addition, I would urge the authorities to maintain interest rates at positive levels in real terms. At the same time, we support the refinancing scheme to support small-scale projects in certain areas, as mentioned in the staff paper.

Structural reforms need to be accelerated in virtually all areas. I continue to be concerned about the slow progress of state enterprise restructuring. This reform is a central element of the structural reforms and will be an impetus to accelerating the recovery of growth. I would advise the authorities to create a strategy or timetable as a matter of urgency. In addition, interbank markets in both foreign and local currencies should be introduced as soon as possible. Technical assistance is very much needed for all of this, and Japan is willing to extend the necessary assistance for this purpose.

Regarding Viet Nam's arrears to the Fund, Viet Nam has made payments equivalent to most of the obligations falling due since the last review of the country's overdue financial obligations on January 15, 1993. It is encouraging that the authorities have continued to make payments on a timely basis, and I believe that the authorities meet the criteria for cooperation with the Fund.

The authorities have implemented successfully a comprehensive strategy of macroeconomic and structural adjustment, and have continued to make payments to the Fund. In view of this, my authorities wish to support Viet Nam's endeavor to return to the international financial community, and they hope that an international framework for that purpose will be established as soon as possible.

I welcome the recent developments concerning an international consensus on assistance to Viet Nam. On this occasion, a consensus to welcome and support the return of Viet Nam to the international financial community should be confirmed. I hope that the Fund will work speedily and successfully with the Vietnamese authorities with a view to agreeing on a program that will allow Viet Nam to have access to Fund resources once the arrears have been cleared.

My authorities intend to cooperate with the Fund on assistance to Viet Nam. We are willing to examine all possible measures to cooperate with the Fund, including measures to clear Viet Nam's arrears.

My authorities are ready to play a major role in the support group, and will also call upon other countries to participate in this international cooperative effort.

I support the decision, but I look forward to considering any suggestions for changes to it from the French chair.

Mr. Waterman made the following statement:

We welcome Viet Nam's continuing efforts to meet obligations to the Fund as they fall due at a time when the authorities have been faced with extremely difficult circumstances. Clearly, Viet Nam has attempted to meet all such obligations since the last review. As the staff paper notes, since end-1988, payments from Viet Nam have been sufficient not only to meet all new obligations to the Fund, but also to reduce the stock of arrears.

That the most recent payment of Trust Fund special charges was blocked because of restrictions on current payments and transfers imposed by the U.S. authorities should hardly be counted against the Vietnamese authorities. In any event, I understand that the authorities are currently involved in discussions with Fund staff on ways in which Viet Nam might be able to make these payments.

Viet Nam's economic performance has also continued to be quite impressive. Real GDP growth remains strong, and inflation, although high, has now fallen to a rate that is approaching that of trading partners. This improved performance has been reflected in a stabilization of the exchange rate and an increase in both foreign direct investment and concessional assistance. The fact that imports grew by about 30 percent in the first half of 1993 is evidence of the extent to which imports may have been compressed by the absence of such inflows. There is little doubt that the reform process in Viet Nam could have been enhanced substantially had the Fund been permitted to play its normal role earlier in the reform process.

The apparent slippage in economic policy over the last few months, while yet to have a substantial adverse impact on the economy, nevertheless highlights the need for a focus on the implementation of appropriate macroeconomic policies. This could be facilitated by the early establishment of a Fund-supported program of economic reform. I would support the staff's intention to negotiate a program that could be supported by a stand-by arrangement, and also to begin negotiations on a program under the ESAF. Given Viet Nam's need for extensive concessional financing, we should try to move toward an ESAF program as soon as possible. A stand-by arrangement could fill the gap while ESAF negotiations are taking place.

Of course, Viet Nam's arrears to the Fund must be cleared before such action is possible, and here, the emerging international consensus that would permit the clearance of Viet Nam's arrears is welcome, even if it is well overdue. My Australian authorities strongly support the initiative to create a 'Friends of Viet Nam' support group, and have already announced that they will contribute toward the clearance of Viet Nam's arrears to the Fund. We therefore warmly welcome Mr. Landau's proposal for an early meeting of a support group.

Mr. Fernando made the following statement:

We are impressed by the consistency with which Viet Nam has demonstrated its cooperation with the Fund despite the political obstacles in the international environment that complicated the country's economic performance. We are particularly satisfied that the level of arrears outstanding to the Fund has declined 1990 to 1992; what is more important, we note that arrears to Fund as measured against all external variables--as given in 1 in the Appendix--have declined. This strongly underlies healthy improvement in the creditworthiness of Viet Nam. Considering that now, no further repurchases of principal can accrue, and that the total arrears are only 57 percent of quota, conditions are propitious for an early normalization of relations with the Fund. This puts Viet Nam in a very favorable position to receive substantial front-loaded access to the Fund's resources when a program is agreed, provided, of course, that the balance of payments need is established.

The economic program that we anticipate would cover the structural features and objectives that would underpin the proposed access of Viet Nam to Fund credit. With respect to the question of safeguards for Fund resources, we are prepared to give full credit to Viet Nam, partly because of the strength of its commitment to good policies so far, as well as the potential support from other external sources, notably the World Bank--with which it is current. The confidence of foreign investors in Viet Nam is also on a rising curve, which reinforces these sentiments. While I would like to factor in the claims of Viet Nam for consideration under the systemic transformation facility, it is pertinent to ask what kind of facility we have in mind for Viet Nam when conditions for an arrangement are fulfilled. Mr. Ismael, and indeed this chair, mentioned the possibility of a stand-by arrangement to begin with, followed by a program under the ESAF. Viet Nam is a very poor country, and finance charges connected with a stand-by arrangement should not add to the problems of Viet Nam. I would hope that an ESAF arrangement could be the appropriate vehicle, with a stabilization focus, and with access and conditionality tailored to capture, where relevant, the operational features of the systemic transformation facility.

Turning to economic policies, we have noted the strong growth prospects for 1993 and the very commendable progress so far on inflation. In these respects, the authorities have delivered more than they promised, and this is very welcome. We have a right to ask the authorities to continue the good performance, but we would also like to bear in mind the costs of disinflation. Real interest rates continue to be high, and infrastructure improvements and productive private investment can be less than optimal, and can even be distorted--a point that is particularly important for Viet Nam, which has to continue on the path of systemic transformation, from the legacy of central planning to a market economy.

That said, we recognize that direct controls over credit and domestic liquidity have played an important role in the inflation outcome so far. The recent rapid expansion of credit and domestic liquidity thus sends a warning signal of potentially higher inflation. We entirely agree with the staff that the authorities should restrain financial policies, in particular to play down inflation expectations. In this context, we would like to know whether the State Bank has obtained full control of the design and implementation of monetary policy, and to what extent progress has been made in making monetary policy independent of the financial demands of state enterprises. There may well be important institutional shortcomings in this area, and perhaps the staff could provide an update on this.

Regarding fiscal policy, we commend the authorities for eschewing bank financing to cover the deficit, and we are prepared to see a higher deficit to the extent allowed by external support, and provided that it is devoted to well-conceived and production-raising investment. We stand ready to review the amendments proposed for the draft decision.

Mr. Lanciotti made the following statement:

I concur with the staff's assessment that Viet Nam's stance of cooperation with the Fund is to be judged positively. There is a clear will on the part of the Vietnamese authorities to make every effort to solve promptly their arrears problem, and their payments performance testifies to that. As this chair emphasized on previous occasions, such a performance is to be assessed not only in comparison with what other countries in arrears do, but also in the light of the extremely tight financial constraints that Viet Nam faces. In this connection, I welcome the indication that a broad consensus is emerging toward providing external financial assistance to the country.

The time has come for the Fund to provide to the Vietnamese authorities the much-needed assistance in formulating a comprehensive and coherent adjustment program. I particularly welcome the explicit mention of this in today's decision. The "appropriate conditions" that the Board regarded as a necessary prerequisite for the Fund's involvement in Viet Nam are now met, and I am looking forward to an early discussion of a program for the country itself.

The economy of Viet Nam is performing well, and many better than expected results have been achieved, most notably in reducing the inflation rate. However, the staff warns that the stance of the policies adopted is too expansionary, and may lead to macroeconomic instability. I share these concerns, and I urge the authorities to regain a firm hold of fiscal and monetary policies. At the same time, I would stress once again the crucial importance of a clear legal framework for providing economic agents with the most favorable environment to conduct their business.

I welcome the constructive attitude of the Vietnamese Government in trying to solve the arrears problem. I support the proposed decision. I am also willing to consider the modifications to be proposed by Mr. Landau.

Mr. Dawson made the following statement:

I would like to confirm that the United States has decided to end its opposition to the efforts of other members to clear Viet Nam's arrears to the Fund. The President has taken this step in order to encourage further progress by the Vietnamese in accounting for America's prisoners of war and soldiers missing in action.

With respect to the staff's assessment of the economic situation in Viet Nam, it seems clear that Viet Nam's reform effort appears to have lost momentum and needs to be reinvigorated. According to the staff, during 1993, Viet Nam's economy has continued to grow strongly, and inflation has declined further to single-digit levels. Despite these positive indicators, the substantial relaxation of monetary and fiscal policies that has taken place thus far in 1993 threatens to erode the significant steps Viet Nam made toward macroeconomic stability during 1992.

In this regard, we concur with the staff that "the present stance of financial policies casts doubt on the sustainability of macroeconomic stability in the period ahead." We strongly agree that a tightening of monetary and fiscal policy is called for in the very near term, and we would note that this will be particularly important if Viet Nam wishes to seek a stand-by arrangement at some point, as it has indicated.

We also see little evidence of progress on much-needed structural reforms. While the staff has outlined a few measures that have been implemented in recent months, there seems to have been no progress on issues 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. These are just some of the structural reforms that need priority attention if Viet Nam wishes to be in a position to utilize resources under the ESAF or ESAF successor in the months ahead.

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 will require not only a tightening of fiscal and monetary policies, but also a much more vigorous program of structural reforms, in particular those that will enhance the development of the private sector.

With regard to Viet Nam's arrears to the Fund, the authorities appear to have made a good faith effort to keep current on their payments thus far in 1993. In this connection, my authorities are aware that a recent payment by Viet Nam was blocked by a U.S. commercial bank, as noted in the staff paper. We would suggest that, at this juncture, Viet Nam apply for a license requesting this payment to be unblocked.

We have no objection to the proposed decision contained in the staff paper.

Mr. Wei made the following statement:

On the occasion of this review, I continue to welcome the Vietnamese authorities' timely payment of their obligations falling due to the Fund, and their efforts to make additional payments to reduce their arrears since the Board's last discussion on Viet Nam. Such active cooperation from the Vietnamese authorities should continue to be appreciated by the Fund membership which, in return, should also strengthen its efforts to help Viet Nam clear its overdue financial obligations to the Fund. In particular, the support group is encouraged to move ahead more quickly once the obstacles to its efforts are broadly overcome. In addition, it is good to note that the Vietnamese economy continued to perform quite well in the first half of 1993. External conditions recently also seem to be better for Viet Nam. This moment will be historically significant to Viet Nam's future development. It is to be hoped that the Board will soon have a chance to discuss Viet Nam's request for the use of the Fund's resources. In this respect, I share Mr. Fernando's view that, as Viet Nam is a very poor country and in urgent need of concessional assistance, it is better for Viet Nam to receive Fund assistance under the systemic transformation facility, which would serve as a bridge to an ESAF arrangement.

That being said, the staff correctly reminds us nevertheless of the two criteria for judging the extent to which a member with protracted arrears is cooperating with the Fund. As on previous occasions, I have been broadly satisfied with Viet Nam's payments performance and with many of the previous wise reforms and policy choices; the importance of the latter in sustaining a good payments performance cannot be overemphasized. In this regard, the recent policy developments in Viet Nam arouse serious concerns for us. The recent expansionary fiscal and monetary policies, as described in the paper, will jeopardize the health of the economy, and could be very risky for the ongoing reform process. I would therefore urge the authorities to do whatever they can to return quickly to a prudent stance of fiscal and financial policies. At the same time, the pace of structural reforms should be quickened. As the staff mentioned in the paper, the overall deficit was expected to widen to about 6 percent of GDP, which could be financed largely by foreign resources. This is an interesting point; perhaps the staff could elaborate a bit more on this source of financing.

I can support the proposed decision. However, I am ready to review the decision with the amendments to be proposed by Mr. Landau.

Mr. Jiménez de Lucio made the following statement:

We would like to associate ourselves with previous speakers in commending the Vietnamese authorities for their continued progress toward achieving macroeconomic stabilization. It is encouraging to note that over the past year and a half, inflation has declined significantly, while at the same time economic growth has remained at a high level.

Notwithstanding the considerable progress to date, substantial additional efforts are required to ensure macroeconomic stability. A cautious monetary and fiscal policy stance should be adopted, and basic structural reforms need to be implemented. A well-functioning market-based economy requires an appropriate legal and regulatory framework, a modern financial system, and a strong private sector. Undertaking the structural reforms needed to meet these requirements is a major task that could greatly benefit from foreign expertise and capital. In this regard, support from the international community would make a real contribution to Viet Nam's efforts to raise the future welfare of its people.

It is heartening to note that the Vietnamese authorities continue to make payments on a timely basis to meet their obligations falling due to the Fund. Considering the stabilization and structural adjustment program that is currently being implemented and the payments record since end-1988, we fully agree with our colleagues that Viet Nam is cooperating with the Fund. We look forward to an early clearance of arrears to the Fund and to the adoption of an adjustment program that could be supported by Fund resources. We support the proposed decision, but we are ready to consider the modifications that Mr. Landau will propose.

Mr. Esdar made the following statement:

> I join those speakers who commended the Vietnamese authorities for the success of their economic transformation process and their progress in structural adjustment that has been achieved so far. My authorities welcome the fact that the necessary consensus is developing to support Viet Nam in its efforts to regularize its relations with its bilateral and multilateral creditors, as a precondition for a full reintegration in the international community. My authorities are prepared to support this process by providing bilateral project financing and technical advice. For this purpose, Germany has made since 1990 official development assistance commitments of DM 85 million. However, we have no financial instruments to enable us to contribute directly to the settlement of arrears vis-à-vis the Fund.
>
> I support the intention to start program negotiations as soon as possible. In that regard, while we welcome the strong economic performance in the first half of 1993, I agree with the staff that financial policies will need to be tightened in order to avoid a resurgence of inflation. Budget deficits in the range of 6 percent of GDP, and broad monetary growth rates of 41 percent, are clearly not sustainable over the medium term.
>
> I would encourage the authorities to strengthen their structural policy efforts, especially concerning state enterprise restructuring and the planned substantial reduction of public sector employment. I would expect that far-reaching structural reforms aimed at a quick transition to a market-oriented economy will be one key element of a Fund-supported adjustment program.
>
> In general, I can endorse Mr. Fukui's detailed suggestions about the program, but perhaps with less emphasis on credit schemes for small-scale enterprises. We support the proposed decision as it stands, but we are ready to consider any amendments that might be suggested.

Mr. Dorrington stated that he agreed with the spirit of the Chairman's opening statement, which he also welcomed very much. He had an open mind with regard to the type of Fund support that might be appropriate in the case of Viet Nam. He had heard some Directors asking for a kind of arrangement with conditionality of the type incorporated in systemic transformation facility arrangement, and with a concessional rate of charge, such as that under the enhanced structural adjustment facility. Since such a concatenation of elements did not yet exist in any of the Fund's facilities, he could not support it. Like Mr. Esdar, he supported the proposed decision, but would be willing to consider any amendments to it.

Mr. Ferrillo made the following statement:

In January 1992, this chair called for a rapid normalization of relations between the international financial community and Viet Nam. We had recognized at that time the paramount importance for Viet Nam of gaining access to external resources in order to accelerate the pace of macroeconomic stabilization and structural adjustment.

Today, we are glad to further review Viet Nam's overdue financial obligations to the Fund following the recent positive developments in the creditor community. According to the criteria for determining the extent to which a member with protracted arrears is cooperating with the Fund, Viet Nam's performance is, in general, satisfactory.

Regarding the first criterion--payments to the Fund--Viet Nam's performance has been more than sufficient. We also welcome the Vietnamese authorities' reiteration that they consider the clearance of arrears to the Fund as a top priority. Indeed, this commitment has been demonstrated by the further reduction of arrears to the Fund since the last review.

Concerning the adoption of appropriate economic adjustment policies, we commend the Vietnamese authorities' continued efforts to implement a comprehensive set of policies aimed at sustainable economic growth, financial stability, and balance of payments viability. However, we join other speakers in urging the Vietnamese authorities to maintain their strong track record of performance. Indeed, we share the staff's concerns that the present stance of financial policies could contribute to a resurgence of inflation.

The expected clearance of Viet Nam's protracted arrears will allow the Fund and the Vietnamese authorities to embark on a comprehensive adjustment program that could be supported in the framework of Fund arrangements.

We would be pleased to support a proposed decision that reflects more fairly the recent positive developments, as Messrs. Ismael and Landau mentioned.

Mr. Murphy made the following statement:

Like many other speakers today, I welcome the continuing progress of the Vietnamese authorities in addressing their payments obligations to the Fund, and in carrying out other actions to restructure the economy of Viet Nam. I also welcome the decision of the U.S. authorities, which opens the way for dealing more decisively with arrears. The statements from our Japanese and French colleagues both have their merits, the first in offering a clear and thoroughgoing critique of financial and economic policies, and the second in showing the way ahead. I associate my remarks with those of Mr. Fukui, in particular with respect to his reference to the need for tighter monetary and fiscal policies.

I will be happy to review amendments to the draft decision to be proposed by Mr. Landau, provided that they maintain an appropriate exhortation regarding tighter financial policies. I urge all concerned to press forward with the proposed efforts to expedite dealing with overdue arrears in the months ahead.

Mr. Fridriksson made the following statement:

Given this chair's previous comments on Viet Nam, it should come as no surprise that I warmly welcome the Managing Director's opening statement, and the fact that Viet Nam should finally be able to normalize its relations with the Fund.

The Vietnamese authorities continue to demonstrate their willingness to cooperate with the Fund and to clear the existing arrears, and they are working firmly toward the goal of achieving full normalization of external financial relations. The Vietnamese authorities have managed, with little external assistance, to meet the two basic criteria of cooperation with the Fund. Their payments performance, as well as the economic policies that have been pursued, have to be regarded as sufficient, and to deserve more forthcoming international support than has been the case so far.

The fact that Viet Nam has been able to make substantial progress with very limited access to external financing, and without the constructive encouragement provided by a Fund-supported conditional program, indicates that under such a program, with full normalization of external financial relations, Viet Nam may perform very well indeed.

I share the staff's assessment of the economic situation and the policy stance in paragraph 3 of the staff paper. I note the risks posed by the recent expansionary monetary and fiscal stance, and I encourage the authorities to take the appropriate corrective measures.

I strongly endorse the plans to send a Fund mission to Hanoi as soon as possible to negotiate an upper credit tranche arrangement. I agree with Mr. Esdar on what should be the main priorities in such an arrangement.

I also wish to welcome the indication provided by Mr. Landau that a support group meeting will be convened at the earliest possible opportunity, and not later than during the Annual

Meetings. Some of the countries that I represent will consider possible participation in the support group.

I can support the decision as proposed, but I look forward to hearing Mr. Landau's proposed amendments.

Mr. Posthumus stated that he welcomed the fact that the final obstacle had been removed to the clearance of Viet Nam's arrears to the Fund with the help of a support group. He thought that the Netherlands authorities would be prepared in principle to participate in such a group if an agreement on an economic program with the Fund materialized. He supported the decision proposed by the staff, and would be willing to consider the amendments to it to be elaborated by Mr. Landau.

Mr. Lvin made the following statement:

The continued constructive cooperation of the Vietnamese authorities with the Fund, together with economic adjustment policies, have made clearer the progress made in settling Viet Nam's overdue financial obligations to the Fund. However, the improvement in external viability in the immediate future is less certain, as it is highly dependent on the availability of external donor assistance. I fully agree with Mr. Ismael that the international constraints on Viet Nam's economy should be removed, and that the country should not continue to be hampered by uncertainty with regard to the timeliness and completeness of international support for its endeavors.

At the same time, this is a two-way street. The recent relaxation of financial policies and delays in implementation of the structural reforms might hinder gaining macroeconomic equilibrium, and thus, indirectly, make more difficult the access to international financial resources.

With that in mind, this chair would urge the authorities to make additional efforts to repay the overdue obligations. Last year, the ratio of debt service to exports stood at about 22 percent, while arrears to the Fund were equal to 5.8 percent of exports. During the first half of 1993, export earnings grew way above projections, at a pace of 17 percent. There is thus every reason to believe that the country is in a position to make additional repayments, reducing the outstanding obligations to the Fund. The present time is exactly the right time for such an undertaking.

The counterargument might be made that, with the decline in international reserves, there is little space to rechannel export revenues toward debt repayments. That is true, but, in the light of the recent relaxation of the fiscal stance, it is necessary in any case to tighten monetary and credit policies. In this regard, some indirect measures aimed at compressing imports might be appropriate. They would complement the efforts required on the domestic front, and prevent macroeconomic imbalances and the reigniting of inflation.

In order for these measures not to hinder economic growth, additional efforts are required to accelerate structural reforms. More attention should be paid to the planned reform of public sector salaries. Monetization of remuneration now paid in kind and increases in public sector salaries should be balanced carefully with an overall reduction in public sector employment. At the same time, the reform should not be narrowed to a mere reduction of employment in the public administration; rather, it should be designed as a broad transformation and migration of jobs into the private sector. This has obviously not been the case so far, as public sector employment has been reduced by only 8 percent since the beginning of 1991. Moreover, it is regrettable that commercial bank loans to state-owned enterprises continued to rise at a rapid pace, indicating that the Government is retaining its involvement in productive activities. The reaction to the poor performance of the privatized companies is even more worrisome: these companies are being returned to the state, and thus continue to exert pressure on the public finances. Priority should be given to forcing privatization and carrying out the reform of enterprises with the help of the market mechanism, rather than through direct state support. It is commendable that pilot corporatization projects have been initiated with the technical assistance of the World Bank. Nevertheless, at this stage of economic reform in Viet Nam, it is time to move away from the pilot privatization programs and toward privatization on a large scale, and quickly.

More pronounced progress in these policy areas would bolster significantly the authorities' commitment to continue to reduce the level of overdue financial obligations, thus making the final elimination of the arrears, with international cooperation, more predictable. I endorse the draft decision.

The staff representative from the Central Asia Department stated that the staff would do its part to ensure that the meeting of the support group to which Mr. Landau had alluded would take place in the anticipated time frame. In particular, the staff would attempt to collect more up-to-date information on Viet Nam's financing requirements in the interim.

A number of Directors, while noting a list of positive developments, had expressed concerns about economic policy in the first half of 1993, the staff representative recalled. During the staff mission to Viet Nam in June 1993, the authorities had reaffirmed their strong intention to bring the policy back to the kind of path that had been welcomed by the Executive Board at the time of the Article IV consultation discussions in January 1993. In the forthcoming mission, the staff would emphasize the concerns about current economic policies that had been expressed by Executive Directors in the course of the meeting.

The staff believed that a stand-by arrangement in the upper credit tranches, rather than a drawing under the systemic transformation facility, would be the appropriate way to assist Viet Nam in the first instance, the staff representative explained. A stand-by arrangement would allow the rescheduling of official debt in the context of the Paris Club that would be required for bilateral donors to increase their assistance to Viet Nam. A drawing under the systemic transformation facility, to which upper credit tranche conditionality would not necessarily be attached, would not serve that purpose. The staff was aware of the benefits in moving to an ESAF arrangement as soon as possible, and in that light, the staff had already begun preliminary discussions with the World Bank regarding the time frame for preparation of the policy framework paper, which would serve as the basis for the Fund's negotiations with the authorities on an ESAF arrangement.

The authorities intended to finance externally the rather large deficit, which was budgeted to approach 6 percent of GDP in 1993, the staff representative commented. External financing to Viet Nam, while at a limited level, had continued to flow. Also, there had been a substantial infusion of lending from Japan at the end of 1992 that had not been utilized by the authorities, and which had been allocated to finance part of the expected deficit during the course of 1993. That said, there were, nevertheless, questions about the appropriateness and sustainability of dependence on foreign financing to that extent in the medium term, a point which the authorities recognized as well.

Viet Nam had made great strides in 1991-92 in the area of constraining credit to state-owned enterprises and operating an appropriate monetary policy, the staff representative from the Central Asia Department concluded. However, given the large increase in the rate of expansion of credit to state-owned enterprises in the first half of 1993, the staff was concerned that a step backward may have been taken. The staff would stress that policy issue in its discussions with the authorities in the forthcoming mission.

Mr. Fernando commented that he would agree with the staff that the Board had in mind the countries of Indochina in designing the systemic transformation facility. That notwithstanding, he would also agree that the parameters for determining the applicability of the systemic transformation facility to the countries of Indochina might be different from those of other countries. He wondered whether it might be possible to consider an ESAF arrangement for Viet Nam rather than a stand-by arrangement. In particular, he wondered whether the requirements for a rescheduling of debt could not also be satisfied on the basis of an ESAF arrangement.

The staff representative from the Central Asia Department stated that it would take some time to negotiate an ESAF arrangement. The staff would be able to start the work with the World Bank on the policy framework paper soon, with a view to completing it by early spring 1994. That paper would require a comprehensive review of structural and macroeconomic adjustment policies. The staff would need to be cautious about not rushing that process. A thorough and convincing policy framework paper would serve as a good basis for the staff's negotiations with the authorities on an ESAF-type program. Rather than aiming for a program under the ESAF that might take a long time to design, the staff believed it best to approach a stand-by arrangement, and deal initially with the immediate issue of macroeconomic stability that Mr. Dawson had emphasized.

Mr. Ismael stated that the concerns of Directors about the slippages in fiscal and monetary policy were well taken. He could see the rationale and appropriateness of beginning with a stand-by arrangement, considering the conditions of Viet Nam. The objective of the stand-by arrangement would be to create the means to discharge Viet Nam's arrears to the Fund and other creditors. He was grateful for the Board's advice, and for its support in favor of leaving the door wide open in order to put decisively behind it the problem--of almost ten years' duration--of Viet Nam's arrears.

The Executive Directors then considered the proposed decision. They adopted Paragraph 1 of the decision without any amendments.

Mr. Landau, addressing Paragraph 2 of the draft decision, stated that the wording of the paragraph was less positive than the wording in the Board's decision on the review of Viet Nam's overdue financial obligations to the Fund of January 1993. He proposed replacing the wording of the current paragraph with that in Paragraph 2 of the Board decision of January 1993.

Mr. Dawson commented that, while the proposed wording of the paragraph might be a bit austere, to simply repeat the declaration from Paragraph 2 in the decision of the preceding January would fail to take into account the fact that there had been slippages in macroeconomic policy, a point to which a number of speakers--including Messrs. Ismael and Esdar--had drawn attention. Also, Paragraph 2 in the decision of January 1993 had referred to the continuing active cooperation of the authorities with respect to the adoption and implementation of a comprehensive program of macroeconomic and structural adjustment, which was pitching it a bit strong. The paragraph also should stress the need for the authorities to accelerate the pace of macroeconomic reform, as well as of structural reform.

Mr. Landau said that Mr. Dawson's second point was well taken. To take that into account, he would suggest that a sentence be added to Paragraph 2 of the decision of January 1993 to the effect that the Fund stressed the need to accelerate the pace of structural reforms and to pursue tight financial policies.

The Chairman suggested that the formulation provided by Mr. Landau be modified to reflect the need for the authorities to tighten financial policies.

Mr. Posthumus said that he could agree to the change proposed by the Chairman. At the same time, he wondered why the sentence could not refer to the need for the authorities to tighten both monetary and fiscal policies.

The Chairman agreed that the sentence should reflect both, as Mr. Posthumus had noted.

Commenting on Paragraph 3 of the draft decision, the Chairman observed that the text was perhaps too standardized. To take more fully into account the progress Viet Nam had made in its relations with the Fund, he would suggest that the first sentence of the paragraph read as follows:

> The Fund welcomes the payments made by Viet Nam since the last review, and welcomes the intention of Viet Nam to give the highest priority to the full settlement of its arrears to the Fund.

The Executive Directors agreed to the Chairman's formulation of the first sentence of Paragraph 3.

Mr. Landau observed that the last sentence of Paragraph 3 did not fully reflect the evolution of events in Viet Nam, or the intention expressed in the Chairman's statement and by the staff regarding the future relationship with the country. He would accordingly suggest that the last sentence in the current draft be replaced with the following one:

> The Fund will thus now expeditiously start discussions with Viet Nam to agree on a program that would, once the arrears have been cleared, allow for Viet Nam to have access to Fund resources.

Mr. Dawson commented that he was not certain what "expeditiously" was intended to mean in the case at hand. The word might imply haste, which would be both inappropriate and unrealistic. Moreover, the Board was very conscious of the steps that Viet Nam would need to take in order to qualify for access to Fund resources, the likely timetable was well known, and the Board would be attaching a degree of urgency to the issue that seemed unnecessary. Perhaps a word other than "expeditiously" could be found. He also believed that the concept of negotiations with the staff on a program, rather than an agreement per se on a program, should be incorporated in the sentence.

The Chairman suggested that the words "as soon as possible" replace the word "expeditiously," and the sentence be redrafted as follows:

> The Fund will begin discussions with Viet Nam with a view to agreeing as soon as possible on a program that would, once the arrears have been cleared, allow for Viet Nam to have access to Fund resources.

Mr. Landau stated that, while he was not especially attached to the word "expeditiously", it was clear that the issue of Viet Nam's arrears would have to be settled within the succeeding three months, because the support group would not be successful without an agreed program with the Fund. His authorities would like the wording of the sentence to reflect the need for speed. In that connection, "as soon as possible" was a bit vague.

Mr. Fridriksson suggested that the sentence should reflect the fact that the Fund stood ready to start negotiations with Viet Nam on a program. A sense of immediacy would be provided in that way.

Mr. Landau said that the Fund had also stood ready to begin negotiations in January 1993; he did not wish to return to the formula that had been adopted in January, as the picture was now much more encouraging. In fact, a Fund staff mission was scheduled to depart for Hanoi in the following few days.

The Chairman suggested that the sentence read as follows:

> The Fund will promptly begin discussions with the Vietnamese authorities with a view to agreeing as soon as possible on a program that would, once arrears have been cleared, allow it to have access to Fund resources.

The Executive Directors supported the Chairman's proposal.

Mr. Landau, addressing Paragraph 4 in the draft decision, said that to specify a review of the decision on Viet Nam's arrears again in six months might undermine the credibility of the current stage of the procedures to clear Viet Nam's arrears. It was agreed that, if the procedures were to succeed, the arrears would have been settled within six months. The Board always had the opportunity to review the matter if, by chance or bad luck, the arrears were not settled. He would propose deleting Paragraph 4, accordingly.

Mr. Dawson said that he did not have any problem with such a deletion. However, he wondered whether not mentioning a deadline for the next review was in keeping with the Board's intensified cooperative approach for dealing with overdue financial obligations. At the same time, to include a reference to a review deadline would seem to suggest that the Board did not fully believe what it had included in the preceding paragraph--namely, that the arrears would be settled in a short time.

The Deputy General Counsel commented that, in the case of Peru, which was similar to that of Viet Nam, the review clause had specified that, unless the arrears were cleared, the Board would review the matter again before a given date.

The Chairman remarked that it was clear that the Board could always resort to a review of the arrears in the event that the arrears were not cleared. There was no need, therefore, to mention in the decision a particular date as a deadline for the review.

The Executive Directors agreed to delete Paragraph 4 in the draft decision. They then adopted the following decision:

1. The Fund has reviewed further the matter of Viet Nam's overdue financial obligations to the Fund in the light of the facts and developments described in EBS/93/110 (7/7/93).

2. The Fund welcomes the continuing active cooperation of the Vietnamese authorities with respect to the adoption and implementation of a comprehensive program of macroeconomic and structural adjustment. In this context, the Fund welcomes the considerable progress made by Viet Nam toward macroeconomic stabilization and urges the authorities to continue to pursue comprehensive economic adjustment policies aimed at sustaining economic growth and achieving financial stability and balance of payments viability. In this regard, the Fund stresses the need to accelerate the pace of structural reforms and to tighten monetary and fiscal policies.

3. The Fund welcomes the payments made by Viet Nam since the last review, and welcomes the intention of Viet Nam to give the highest priority to the full settlement of its arrears to the Fund. The Fund welcomes the indications by the membership of their support for the implementation of the collaborative approach needed to facilitate a speedy and successful clearance of Viet Nam's overdue obligations to the Fund. The Fund will promptly begin discussions with the Vietnamese authorities with a view to agreeing as soon as possible on a program that would, once arrears have been cleared, allow it to have access to Fund resources.

Decision No. 10420-(93/99), adopted
July 14, 1993

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/93/98 (7/14/93) and EBM/93/99 (7/14/93).

6. LEBANON - ACCEPTANCE OF OBLIGATIONS OF ARTICLE VIII, SECTIONS 2, 3, AND 4

The Fund notes with satisfaction that, with effect from July 1, 1993, Lebanon has accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Articles of Agreement. (EBD/93/119, 7/9/93)

Decision No. 10421-(93/99), adopted
July 14, 1993

APPROVED: November 29, 1993

LEO VAN HOUTVEN
Secretary