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0404

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 92/149

10:00 a.m., December 11, 1992

M. Camdessus, Chairman

Executive Directors	Alternate Executive Directors
	A. A. Al-Tuwaijri
	B. R. Fuleihan, Temporary
	L. E. N. Fernando
	T. P. Thomas, Temporary
	Wei B.
	Chen, M. Temporary
	M. E. Hansen, Temporary
	S. B. Creane, Temporary
	F. Moss, Temporary
	B. Szombati, Temporary
E. A. Evans	A. M. Tetangco, Jr.
	I. Papadakis
	S. Vori, Temporary
	E. Quattrociocche, Temporary
I. Fridriksson	J. A. Solheim
H. Fukui	N. Tabata
	T. Kanada, Temporary
	K.-T. Hetrakul
D. Kaeser	K. Link
A. Kafka	J. C. Jaramillo
	G. Bindley-Taylor, Temporary
K. G. Kagalovsky	G. Y. Glazkov, Temporary
J.-P. Landau	I. Martel
	G. Torres
	O. Kabbaj
	B. S. Dlamini
	J. Dorrington
	J. W. van der Kaaij, Temporary
	R. Meron, Temporary
	Y.-M. T. Koissy
	B. Esdar
	Y. Y. Mohammed
D. E. Smee	G. F. Murphy
A. G. Zoccali	M. Estela

J. W. Lang, Acting Secretary
T. S. Walter, Assistant

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2. Cambodia - Overdue Financial Obligations - Review of Decisions on Complaints Under Rule K-1 and Rule S-1; Representative Rate for Cambodian Riel; Rate of Charge; Burden Sharing; Restitution of Gold; and Distribution of Profits from Sale of Gold . . . . . . Page 33
3. General Arrangements to Borrow (GAB) - Borrowing Agreement Between Saudi Arabia and Fund - Renewal . . Page 55
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<u>Also Present</u>

IBRD: S. B. Webb, Latin American and the Caribbean Regional Office. African Department: M. Touré, Counsellor and Director; C. Brachet. Central Asian Department: B. B. Aghevli, Deputy Director; J. R. Dodsworth, M. B. Rose, E. Spitaeller. External Relations Department: B. R. Brauning. Fiscal Affairs Department: J. R. Modi. Legal Department: W. E. Holder, Deputy General Counsel; J. L. Hagan, Jr., F. M. Zeidan. Policy Development and Review Department: T. Leddy, Deputy Director; G. R. Kincaid, Y. A. Metzgen, J. P. Pujol. Research Department: M. Mussa, Economic Counsellor and Director. Secretary's Department: A. Leipold. Treasurer's Department: D. Williams, Treasurer; G. Wittich, Deputy Treasurer; J. E. Blalock, W. J. Byrne, J. C. Corr, Z. Farhadian-Lorie, M. Fitzpatrick, D. Gupta, B. Keuppens, A. W. Lake, P. R. Menon, M. A. Wattleworth. Western Hemisphere Department: C. M. Loser, Deputy Director; S. Bayas, M. E. Bonangelino, R. A. Elson, E. S. Kreis, L. Perez, L. Schmitz, S. Shah, F. van Beek, G. Yadav. Personal Assistant to the Managing Director: R. Saunders. Special Advisor to the Managing Director: P. R. Narvekar. Advisors to Executive Directors: J. O. Aderibigbe, J. M. Abbott, M. B. Chatah, S. K. Fayyad, J. Jamnik, W. Laux, M. J. Mojarrad, M. Nakagawa, L. M. Piantini, A. Raza, B. A. Sarr. Assistants to Executive Directors: S. Al-Huseini, D. A. Barr, G. M. Blome, J. M. Burdiel, C. D. Cuong, Deng H., H. Dognin, A. Galicia, M. A. Hammoudi, V. Harris, K. M. Heinonen, O. A. Himani, K. J. Langdon, G. J. Matthews, S. McDougall, S. del C. Ogliati, J. K. Orleans-Lindsay, R. K. W. Powell, S. Rouai, P. Salles, N. Shimizu, F. A. Sorokos, L. Tase, R. Thorne, A. Viirg.

1. JAMAICA - EXTENDED ARRANGEMENT

The Executive Directors considered a staff paper on Jamaica's request for a three-year arrangement under the extended Fund facility in an amount equivalent to SDR 109.1 million (EBS/92/179, 11/13/92).

The staff representative from the Western Hemisphere Department made the following statement:

> This statement provides information on developments in Jamaica since the circulation of EBS/92/179. Preliminary information suggests that the overall public sector balance for the first half of the current fiscal year--April-September 1992--was about the same as estimated in the staff paper. As of mid-November 1992, the growth in currency issue was in line with the program target for end-December 1992, while the net domestic assets of the Bank of Jamaica had declined, resulting in a better external position than had been contemplated in the program. As of November 25, 1992, the net international reserves of the Bank of Jamaica were some US$90 million stronger than contemplated for end-December 1992.
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> The average monthly rate of inflation has fallen somewhat faster than programmed in 1992, from 4.2 percent in the January-July period to 1 percent in the August-October period. Interest rates have declined substantially in the past few months, and the yield on treasury bills and short-term certificates of deposit of the Bank of Jamaica is currently about 24 percent. Since June 1992, the value of the Jamaica dollar in the interbank market has been stable at about J$22 per U.S. dollar.
>
> By end-November 1992, the Government had eliminated 6,800 civil service posts under its Administrative Reform Program, compared with a targeted reduction of about 8,000 posts; it is expected that the remaining reduction will be carried out before end-1992. In the effort to shift the Bank of Jamaica's losses to central administration accounts, the Government has increased its sales of securities, which enabled the Bank of Jamaica to reduce the stock of its certificates of deposit from J$7.1 billion in July 1992 to J$3.1 billion at end-November 1992. Furthermore, as was planned, Parliament approved in November 1992 the Financial Institutions Act, as well as amendments to the Banking Act and the Bank of Jamaica Act. These actions are designed to improve the supervisory function of the Bank of Jamaica and increase the transparency of financial system operations.
>
> In the past two months, the Government of Jamaica has taken actions to liberalize further its foreign trade system. The heads of government of the Caribbean Common Market (CARICOM) reached agreement in October 1992 on a phased reduction of the level and

dispersion of the regional Common External Tariff over the next five years. As a result, the range of import tariff rates in Jamaica will be changed from 0-45 percent to 5-30 percent effective April 1, 1993, and to 5-20 percent effective January 1, 1997. Also, licensing requirements for a number of import and export items were removed in mid-November 1992.

Mr. Smee made the following statement:

Jamaica has had Fund programs almost continuously since 1978 and is one of the longest-standing users of Fund resources. Nevertheless, outstanding Fund credit to Jamaica has declined from 445 percent of quota as at end-May 1985 to 181 percent of quota as at end-September 1992. Moreover, a further reduction in Fund exposure in Jamaica is envisaged over the medium term, even including the purchases under the proposed extended arrangement.

Looking back, we can see that Executive Board discussions on Jamaica have, by necessity, had a predominantly short-term focus. This can be attributed both to the review process of stand-by arrangements and to the difficulties that Jamaica has had to overcome in recent years. This short-term focus has prevented an appreciation of the important long-term policy developments that have taken place in the Jamaican economy. I would thus like to provide some perspective on how far along the road of adjustment Jamaica has come and where my authorities intend to be in three years' time.

Over the years, Jamaica has implemented a strategy of progressively reducing fiscal imbalances. To this end, there have been ongoing efforts at fiscal consolidation, which have succeeded in bringing down the public sector borrowing requirement from 13 percent of GDP in 1988/89 to near balance in 1991/92. Jamaica has implemented comprehensive tax reforms, which have lowered marginal tax rates, broadened and increased the elasticity of the tax base, and simplified the tax system through the introduction of the General Consumption Tax (GCT).

On the expenditure side, my authorities have carried out a substantial streamlining of the public sector to improve its efficiency and administrative effectiveness, as well as to eliminate virtually all general subsidies. Furthermore, discipline is being maintained over the public sector wage bill, thus contributing to private sector wage moderation. Wage negotiations with the central government employees' union are taking place now, but the Government is committed to limiting any settlement in order to achieve the program's objectives.

With regard to the monetary system, Jamaica has pursued efforts to improve the effectiveness of monetary policy instruments and the efficiency of financial system operations. My authorities have been successful in increasing the reliance placed on indirect instruments in the conduct of monetary policy and have increased the use of open market operations. For some time now, interest rates have been determined by market forces and have thus been free of direct government control. In addition, progress has been made in improving the Bank of Jamaica's supervisory function, and a plan is being implemented to eliminate its losses.

Jamaica has also implemented major structural reforms. Progress has been made in strengthening the process of divesting assets, and in privatizing public holdings. Efforts have been directed toward improving management practices and the price structures of the remaining public enterprises. Notable achievements have been the elimination of the import monopoly of the Jamaica Commodity Trading Corporation (JCTC) and the upward price revisions designed to eliminate subsidies. Similarly, automatic cost pass-through mechanisms have been established for the electricity company, the water supply authority, and the state petroleum company.

Foreign exchange liberalization figured prominently in Jamaica's most recent Fund-supported program. All restrictions on payments and transfers for current international transactions have been eliminated, and virtually all controls on capital transactions--including surrender requirements--have been removed. The value of the Jamaica dollar is now determined by a fully liberalized interbank market. With the tightening of financial policies and the reversal of speculative activity, the value of the Jamaica dollar has remained stable since June 1992.

With respect to trade liberalization, Jamaica's external trade is now essentially free of quantitative controls, and the licensing requirements that remain reflect mainly health and security concerns. My authorities have also been at the forefront in seeking support from other CARICOM governments for a substantial reduction in the average level and dispersion of regional import tariff rates. In addition, Jamaica continues to work toward improving the regulatory environment affecting international trade.

A positive performance has been recorded in the external accounts, with the current account deficit declining from 8 percent of GDP in 1988/89 to 5 percent in 1991/92, and with reasonable prospects of trimming the ratio to about 1 percent of GDP in the current fiscal year. This stronger current account performance, together with healthy net private capital inflows, should continue to allow further improvements in the Bank of Jamaica's net international reserves.

Despite all these accomplishments, the external debt burden continues to be large, with external interest payments alone accounting for 10-11 percent of GDP. This issue has been raised as a concern on a number of occasions in the Executive Board, as it inhibits the achievement of medium-term balance of payments viability and, thus, Jamaica's economic prospects. Although Jamaica is still one of the most indebted countries in the world, it has nevertheless generally serviced its debt in a timely manner. As such, Jamaica's management of its debt in recent years should be viewed as an important achievement.

While considerable progress has been made in past years, further reforms are necessary to place Jamaica firmly on the path of balanced, sustained growth. My authorities are committed to continuing adjustment so as to increase the economic and financial viability of Jamaica and thus ultimately to obviate the need for Fund-supported programs and exceptional balance of payments support.

It is in this context that my authorities have developed a medium-term strategy designed to consolidate the progress achieved thus far, to attain a viable external position, and to make further improvements in the structure of incentives for private investment as a basis for promoting sustained economic growth. This strategy focuses on raising domestic savings and investment and improving the efficiency of resource utilization through the implementation of restrained financial and incomes policies, supported by further structural reforms.

My authorities envisage a progressive improvement in the public sector balance to a surplus of 3.5 percent of GDP by 1995/96. Bank credit expansion will be restrained to achieve the objectives of price and exchange rate stability. Additional structural reforms will focus on fostering private sector activities through the privatization and liberalization of the trade and regulatory environment. Confidence arising from the pursuit of sound economic policies and a stable economic environment should help raise private sector savings and investment.

Jamaica's medium-term program seeks to achieve substantial improvements in the balance of payments, so as not to require recourse to exceptional financing from Paris Club creditors after the expiration of the proposed extended arrangement. On the basis of my authorities' policies and external prospects, the external current account deficit is projected to shift to a surplus by 1995/96. Given that Jamaica's small, open economy will continue to be vulnerable to external shocks, the program envisages a sizable buildup of international reserves.

My Jamaican authorities believe that their policies, as described in the letter of intent and further elaborated on in the technical memorandum of understanding, will achieve the objectives of their economic program over the next three years. My authorities would like to express their appreciation to the staff and management for their assistance and continued support.

Mr. Dorrington made the following statement:

When Jamaica was last discussed in this Board in April 1992 (EBM/92/55, 4/15/92), my predecessor expressed deep skepticism that the measures then promised would be delivered. I think I would have done the same had I been sitting here. Thus I hope that you will take it in the manner intended if I say that I am delighted that he was wrong, at least judged by the performance in the past eight months.

The impressive turnaround in the intervening months has, I think, justified Jamaica in making this request for an extended arrangement, although it is worth underlining that a stand-by arrangement is normally converted to an extended arrangement only when a reasonable track record has been built up. My support is also made easier by the fact that the total outstanding stock of Fund credit to Jamaica has declined substantially and is expected to continue to do so.

It is essential that the Jamaican authorities demonstrate that their work of the past months has marked the beginning of consistently good performance--a genuine change from the "stop-and-go" policies that have characterized much of their economic management in the five years following the 1988 hurricane. The speed with which the situation has improved serves to remind us that, with inappropriate policies, it could deteriorate again even quicker.

Furthermore, the sensitivity analysis summarized on page 13 of the staff paper demonstrates that even modest changes in exogenous factors--or, indeed, endogenous ones--could have serious impacts on the Jamaican balance of payments, and on the economy more generally. It is important that the authorities stand ready to react promptly to adverse shocks and do not react to any windfall gains that there might be as if they were permanent shifts. I certainly endorse the intention to build up reserves. On a similar theme, I welcome the fact that the program limits the use of domestic financing of the public sector in the event of a shortfall in external financing.

We can help the Jamaican authorities by ensuring that the ceilings and targets set for the extended arrangement are appropriately stringent, which they are, and by making it clear that we will keep a particularly close eye on performance relative to these targets.

The staff paper is very clear and concise, and my copy is covered with ticks; thus, I will limit myself to comments on a few issues. The first of these is privatization. On paper, the program looks rather exciting, with an extensive list of public bodies being prepared for divestiture, and the World Bank, among others, providing active support. I have some concern, however, that the initial impetus of this program may not be maintained. Can the staff say how far it expects the target dates for divestiture to be met for the entities listed in Annex III? For example, what progress has been made with the 12 entities specifically intended to be divested by the end of this month or earlier? Are things on course? I would also be interested to know whether plans are on track for the sale of Air Jamaica by next April; all too often, governments are tempted to hold on to such high-profile assets. Additionally, I would be interested to know more about the share of foreign investors emerging as prospective buyers.

Privatization receipts will obviously have an important influence on the overall fiscal position, and this is at the heart of the program. It will also be necessary to have strict management of the public sector wage bill. I note that the wage bill is programmed to increase in real terms in 1993/94 to allow for selected increases in civil service pay levels. This is not unreasonable, provided that adequate budgetary provision has been made; however, I note that this proposed increase offsets the real decrease in 1992/93. This is an area where it is worth cautioning against any resumption of stop-and-go policies. There is no point being tough one year if you more than reverse it the next time around. For the years beyond 1993/94, it is important to stick to the intention to limit the increase in the wage bill to the targeted rate of inflation.

On the revenue side, I have only two comments. The first is to warmly welcome the important tax reforms that have already occurred, including moves toward harmonizing and reducing taxes on imports. The second is to ask whether there are any lessons that other countries might learn from Jamaica's experiences with the introduction of the GCT.

Jamaica's program is predicated on a sharp rise in domestic savings. The feasibility of this depends on low inflation and positive real interest rates. This implies a tight monetary policy, as well as a tough fiscal stance. Monetary policy needs to reflect the longer-term desirability of a stable exchange rate, particularly so for Jamaica because of its strong direct link with the domestic price level. However, for the moment, a flexible exchange rate system remains appropriate in view of the openness and vulnerability of the economy, the low levels of foreign exchange reserves, and the need to maintain private sector confidence in the exchange system--the liberalization of which is still relatively recent. Nevertheless, movements in the exchange rate can be a valuable indicator of monetary conditions, and I wonder to what extent the authorities plan to make use of this fact.

As I have said, Jamaica's balance of payments will remain vulnerable. Nevertheless, I am encouraged to note the expectation that the balance of payments will be strong enough by September 1995 to eliminate the need for exceptional financing. I wonder how realistic this goal is. The measures to be taken by the Jamaican authorities are certainly all steps in the right direction. However, external viability will depend in part on strong growth in exports and import substitutes, which is, in turn, dependent on a recovery in investment--and that, in turn, depends upon the projected strong growth in total domestic savings. I am concerned that the latter assumption may be overoptimistic. Can the staff or Mr. Smee provide me with any reassurance that the savings increase is indeed realistic?

In conclusion, since our most recent discussion, the Jamaican authorities have demonstrated that they can set themselves ambitious targets and meet them. I am convinced that we may reasonably expect continued good performance under the extended arrangement. On that basis, I can approve the proposed decision.

Mr. Bindley-Taylor made the following statement:

Notwithstanding the slippages experienced in respect of some of the performance criteria for end-September and end-December 1991, the authorities must be commended for their efforts to keep the 1991/92 program on track. The deterioration in the finances of the public sector, which began in 1991, was firmly addressed at the beginning of 1992, resulting in the public sector borrowing requirement declining by 4.5 percentage points of GDP within the last quarter of fiscal year 1991/92. Moreover, in the first quarter of fiscal year 1992/93, the public sector registered a small surplus. These are all welcome developments.

Events in the monetary sector not only reflected fiscal imbalances during the year, but were also compounded by a combination of the rapid increase in bank liabilities to the private sector--which led to a substantial increase in private sector credit--rising inflation, and downward pressure on the exchange rate. In an effort to stabilize the exchange rate and contain inflation, interest rates on government paper and the legal reserve requirement rose to 50 percent while lending rates in the banking sector rose to in excess of 58 percent. The combined effect of this monetary tightening and the fiscal stance followed in the latter quarter of the year has resulted in relative stability in the exchange rate since June 1992. In addition, the reversal of speculative activity has also contributed to the lowering of average monthly inflation rates, a trend which began in 1991 and has continued in 1992.

In the area of structural reform, the elimination of the import monopoly of the JCTC, the establishment of cost pass-through mechanisms with respect to electricity and petroleum prices, and the introduction of the long-awaited GCT were all welcome developments in 1991. The full liberalization of the exchange rate market in September 1991, together with the elimination of almost all restrictions on both current and capital payments and transfers, was also a commendable achievement.

Unfortunately, during 1991, we saw once again the traditional tendency of the authorities to drift away from the discipline of the financial program relatively early in its life, only to have to follow through with excessively tough measures in the latter part of the program to keep it on track. This stop-and-go approach seems to have plagued almost all of Jamaica's programs, and we believe that it is an area of weakness that the authorities should address with dispatch if they are to achieve the objectives that they have set for themselves in the medium term.

We commend the Jamaican authorities for following their current approach of casting their economic policies in a medium-term framework with an emphasis on growth, rather than continuing with consecutive stand-by arrangements, in which the emphasis is placed on stabilization. Critical to the authorities' thrust toward economic development will be the maintenance of the relative stability of the exchange rate, the reduction of the domestic inflation rate to the level of its major trading partners, and the strengthening of the country's foreign reserve position. The necessary policies to achieve those aims would comprise a fiscal stance that generates a surplus in the overall public sector and credit policies that inhibit excessive growth in consumption while encouraging domestic private savings and investment.

We welcome also the effort to increase public sector savings from 7.8 percent of GDP in 1991/92 to 12 percent by 1995/96. This is to be accomplished by the recently introduced taxation measures, particularly the GCT. In addition, the bold move to reduce the number of public service jobs by 20 percent by end-1992, the positive financial impact of the automatic price adjustments of utility tariffs on public utilities, and the overall policy of wage and expenditure restraint will contribute to this outcome. The move to finally improve the transparency in the central bank accounts by transfering the quasi-fiscal expenditures of the Bank of Jamaica is commendable, and we urge its rapid but careful implementation.

Sound monetary policy is clearly necessary, and we endorse the authorities' approach to maintaining monetary restraint. However, we would prefer a faster pace in reducing the extraordinarily high level of the cash reserve requirement and replacing it by the issuance of short-term securities. This market for short-term securities will also prove useful in avoiding the traditional tendency to resort to central bank financing whenever public sector revenue falls short of immediate expenditure commitments.

The maintenance of positive real interest rates, the improved savings performance of the public sector, and the new open market operations of the Bank of Jamaica should contain inflation, stabilize the exchange rate, and allow adequate room for noninflationary expansion of credit to the private sector.

The staff once more reminds us of Jamaica's sensitivity to changes in the international prices of bauxite and petroleum, world interest rates, and tourist arrivals. In light of this, there can be little policy relaxation, and the authorities must stand ready to counter any sudden external shocks. In the absence of any large negative shocks, however, the balance of payments outlook is positive. The real depreciation of previous years is reflected in the improved performance of nonbauxite exports, and the most laudable objective over the medium term is the effort to relieve Jamaica of the need for exceptional financing by 1995. To accomplish this, a substantial reduction in indebtedness to official creditors is targeted to be accomplished between 1991/92 and 1995/96. We note that the success of this strategy is dependent upon expected disbursements from bilateral creditors over the period. We recall the substantial dislocations in past programs caused by shortfalls in expected external disbursement and urge creditors to be timely in their efforts at financial support. Over the period 1992/93-1995/96, external financing gaps will emerge, and we expect that these will be covered by multiyear reschedulings by creditors during the period of the program.

We commend the Jamaican authorities for their substantial achievements in structural reform over the past 4-5 years, and we welcome the continuation of this process in the future, particularly the privatization program and the authorities' intention to use the proceeds of divestment to reduce public sector debt obligations. Clearly, the reform efforts have had an impact on the standard of living of all segments of society, but even more so on the poor and the unemployed. We therefore welcome the efforts of the authorities to strengthen the social safety net over the program period.

The evidence shows that Jamaica is a prolonged user of Fund resources. Despite this fact, however, the Jamaican authorities have reduced their outstanding stock of Fund credit from approximately 445 percent of quota at end-May 1985 to 181 percent of quota at end-September 1992. In the context of the proposed extended arrangement, this level is expected to fall to approximately 126 percent of quota by end-1995. The authorities are clearly moving in the right direction, reducing both Fund exposure and their own reliance on Fund support. More important, despite its own financial difficulties, Jamaica has met its obligations to the Fund on a timely basis since 1987. We therefore fully support the authorities' request for an extended arrangement.

Mrs. Hansen made the following statement:

We are pleased to support Jamaica's request for an extended arrangement. Following the very regrettable fiscal slippages under the stand-by arrangement in 1991, we have now seen a period of considerable fiscal adjustment. This, combined with significant ongoing structural change, constitutes the track record that we had been looking for as a basis for an extended arrangement. We have every expectation that Jamaica will continue to perform well under this new arrangement; however, like previous speakers, I would like to emphasize the importance of careful monitoring and implementation.

As in the past, the determining factor in Jamaica's success under the extended arrangement will be its fiscal policy stance. To Jamaica's credit, it has made a number of structural improvements in the fiscal area, including the introduction of the GCT, greater automaticity in public sector pricing, and reductions in the size of the civil service, that should increase revenue collections and help limit government expenditures. We also welcome the increased transparency afforded by the shift of the Bank of Jamaica's losses to the government budget and the plan to eliminate them by the end of 1994/95. We believe that the increased use of open market operations will increase the Bank's effectiveness while avoiding some of the problems that have occurred in the past.

The effects of the stronger fiscal position are already being felt in a decline in the inflation rate and a strengthening of the Jamaica dollar. Still, Jamaica has some distance to go to establish a reasonable degree of price stability, which underlines the importance of a continued strengthening of the fiscal position compatible with a restrictive monetary stance. And, as the authorities are able to bring inflation performance more in line with that of the country's major trading partners, this will no doubt help establish a firmer basis for a stable Jamaica dollar.

With regard to exchange rate developments, we fully support the liberalization of Jamaica's exchange rate system. However, we have some doubts as to whether the system is working in a fully liberalized manner, as stated in the staff paper. Specifically, we understand that the exchange rate is holding remarkably steady at J$22.20 to the U.S. dollar, rather than showing the normal fluctuations that one would expect to see in a fully liberalized system, especially given the seasonal variations in the availability of foreign exchange in Jamaica. Fortunately, the gap between the exchange rates in the interbank market and those in the parallel market does not appear to be very large. Nevertheless, if there is a policy of trying to manage the exchange rate, it should be recognized and factored into the analysis. While it is true that there was a rather large real depreciation through July 1992, the recent fixity of the rate must imply some real appreciation, which would erode export competitiveness over time.

On other external issues, we are encouraged to see that Jamaica plans to use privatization receipts to reduce external indebtedness, that it is planning for a reduction in foreign grants, and that it does not plan to seek further exceptional financing beyond September 1995. We also would like to acknowledge Jamaica's leadership role in the recent CARICOM decision to lower the Common External Tariff and express the hope that Jamaica will carry this leadership into other areas of trade reform.

Overall, we are much encouraged by the progress that Jamaica has been making, and we hope that its performance under the stand-by arrangement will validate our belief that its economic management has been permanently strengthened.

Mrs. Martel made the following statement:

Since our most recent discussion in the Board, the progress made by the authorities has been very encouraging. The courageous measures taken under the revised program for the first semester of 1992 have borne their fruits and have led to improvements. Worth underlining are the results already achieved in the fiscal situation, the reduction in the inflation rate, and the stabilization of the exchange rate. Looking back, we can see that significant progress has also been made on structural reforms: the GCT has gone into effect, public prices have been raised substantially, the mechanisms for passing future price increases onto consumers have been made more automatic, import monopolies of the JCTC have for all intents and purposes been eliminated, and a major liberalization of the exchange system has been implemented.

Like previous speakers, nevertheless, I agree that, in light of their past policy performance, the authorities have to stick to their commitment. The Government's program now rightly aims at achieving sustained progress on the stabilization front through further improvements in public finances, and at stimulating investment and growth through the development of an efficient private sector.

I would like to confine myself to a few detailed comments on some issues. Fiscal policy is clearly the cornerstone of the program, and the targeted increase in the public sector surplus of up to 3 percent of GDP by 1994/95 goes in the right direction. Attaining this objective is indeed crucial to achieving macroeconomic stability, to improving the investment climate, and to speeding up the supply response to the reforms being undertaken at sectoral levels.

On tax revenue, I welcome the important reform already implemented--not that, even though the ratio of taxes to GDP of more than 30 percent seems rather high, there might not be room for further improvements in collecting taxes and reducing the exemptions on the value-added and property taxes.

Regarding expenditure, this could be an area where pressures might be higher than projected. I understand that the Government is in the process of renegotiating contracts concerning wages in the public sector. The program incorporates an increase in the wage bill in 1993/94 above the projected rate of inflation to allow for an upgrading of selected civil service pay levels and a rise in line with the targeted inflation rate of the subsequent two years. It also includes a social pact, in which wage restraint is to be mitigated by tax relief. In this regard, I was surprised by the magnitude of the cut in the personal income tax rate. It may well be a positive measure in the long run, but it may also prove to be a little premature to make such tax cuts, given the quite recent progress on the stabilization front.

I appreciate very much the commitment of the authorities to monitor revenue and expenditure flows closely, and to stand ready to adjust as necessary the expenditure level being planned to achieve the performance targets for the public sector. I would appreciate some comments from the staff on possible areas for maneuver should slippages occur on the wage side. Needless to say, I was pleased to note the intention of the authorities to tackle forcefully the serious problem of the central bank losses, as well as the specific measures and timetable developed for their elimination.

On monetary policy, I agree with the need for a strict stance, given the authorities' objectives on inflation and the balance of payments. I would note briefly that the short-term interest rates on government paper have recently dropped substantially, from 45 percent to 25 percent. Such a decline in interest rates may be linked to the lowering of inflationary expectations, which is good, but it may also be linked to an increase in money supply, which could, on the contrary, have adverse effects in the medium term. I am quite satisfied to read in the recent staff statement that the first solution proposed appears to be the one that has materialized. Inflationary expectations do not seem out of line, and the adjustment process appears to be squarely on the right path.

Turning to structural policies, I welcome the additional steps that the Government intends to take. Decreasing the size and scope of the public sector, improving resource allocation through trade system reform, and encouraging private investment through the reform of the regulatory framework for business are very positive developments, rightly supported by a private sector development adjustment loan from the World Bank.

I noted with satisfaction that, taking into account the high level of debt of this country, the privatization proceeds would be used to reduce the stock of debt.

Finally, I agree with the authorities on the actions taken to address the needs of the most economically disadvantaged groups of the population, and on the measures designed to increase environmental protection. With these comments, I support the proposed decision.

The staff representative from the Western Hemisphere Department said that the recent wage developments in the public sector of the Jamaican economy should be seen in the context of the decline in the ratio of the government wage bill to GDP, which had plummeted in 1991/92 to 4.9 percent and was projected to drop further in the current fiscal year. In those circumstances, the authorities had programmed a moderate--and temporary--increase in that ratio for 1993/94, in order to enable the public sector to attract and retain qualified personnel. Nevertheless, as the Government was well aware of the importance of incomes policy for maintaining cost competitiveness and supporting its efforts to adjust the budget, it envisaged that the ratio of the wage bill to GDP would continue to decline during the rest of the program period, reaching 4.4 percent in 1995/96.

On the revenue side, the staff representative continued, one lesson that other countries could learn from Jamaica's experience in introducing its GCT was that it was important to educate tax collectors and payers about the tax administration in order to establish a successful value-added tax program. Because the Jamaican authorities had not rushed through the preparatory phase, the loss of revenue that had been expected to follow from the introduction of the GCT had not developed; in fact, receipts from the

GCT had been 7 percent higher than projected for the first six months of 1992/93.

Together with the information contained in the staff paper, the update provided in the December 9, 1992 staff statement indicated that the authorities' monetary policy was on track, the staff representative commented. Real interest rates were positive, and the inflation rate had fallen somewhat faster than programmed. The stock of money was larger than had been projected, but that could be explained in part by the increase in market confidence and the improvement in incentives for the private sector to hold money. The decline in central bank credit in recent months was a further indication of the pursuit of a tight credit policy, and it would appear that the increase in the stock of money did not seriously threaten the success of the monetary program.

The authorities had been working closely with the World Bank, the Inter-American Development Bank, and prospective private sector participants to iron out the administrative details of the privatization program, the staff representative remarked. It was envisaged that foreign ownership of the public entities earmarked for privatization would be permitted.

To date, the privatization program had stayed broadly on track, the staff representative continued. The Government had divested itself of some of the public enterprises that, as Annex III of the staff paper indicated, had been scheduled for privatization by end-1992. Although, for various reasons, the privatization of other enterprises on that list had been postponed, some entities that the authorities had not expected to sell until the 1993/94 fiscal year had been privatized ahead of schedule.

The scheduled privatization of Air Jamaica was also on track, the staff representative added. Various sale prices were being quoted in the ongoing discussions between the Government and prospective buyers, as the net worth of the airline--which the authorities considered to be positive--had not yet been agreed on.

The goal of raising domestic savings, which would enable the authorities to service their external debt on a timely basis, was at the heart of Jamaica's program, the staff representative stated. Although the task would not be easy, the staff felt that the continued firm implementation of the macroeconomic policies and structural reform could be expected to increase both private and public sector savings.

The authorities were strongly committed to maintaining as the cornerstone of their medium-term economic program the exchange system, which had been liberalized in 1991, and a stable environment for market-determined exchange rate, the staff representative from the Western Hemisphere Department considered. The stability exhibited by the exchange rate in recent months reflected the market participants' growing confidence in the economy, as well as the resulting increase in the supply of foreign exchange. In fact, the Bank of Jamaica was overperforming with respect to its target for international reserves; as noted by some Directors, there was no evidence of a large or growing disparity between the legal and illegal market rates. Furthermore, in their discussions with the staff on those issues, no mention had been made by representatives of the private sector of any accumulation of arrears.

Mr. Esdar said that he agreed with the general thrust of the policy recommendations in the staff paper. As he had little to add to the statements of those speakers who had addressed the crucial areas of reform and stressed the need to implement the agreed program vigorously, he wished to focus on one particular point, which, in his view, deserved more emphasis than it had been given in the staff paper.

Jamaica had been a prolonged user of Fund resources for more than a decade without having reached balance of payments viability, Mr. Esdar remarked. Since 1982, three of its seven Fund-supported programs had not been completed successfully. Others had been revitalized only through the use of waivers. In the case of Jamaica, therefore, the question arose of whether the problems at hand were temporary ones that, in keeping with the Articles of Agreement, could be supported by Fund resources.

According to the staff paper, the authorities expected to achieve external viability by the end of the proposed extended arrangement, Mr. Esdar noted. However, such announcements or projections had also been made on the occasion of previous agreements; as could be seen, they had proved to be too optimistic. For example, the staff had concluded at the inception of the 1985 stand-by arrangement that Jamaica would move toward a more viable external position once an appropriate balance between adjustment and financing had been struck. In those circumstances, he wondered whether the staff could explain why it believed that Jamaica would have more success with its current program than with earlier ones.

Given the country's situation, Mr. Esdar continued, he would have expected that the justification for presenting another follow-up arrangement to the Board would have been discussed in detail, with special attention paid to the length of the Fund's involvement in Jamaica and the Board's frequently repeated commitment to avoid situations involving prolonged use of Fund resources. He supported and welcomed the intention of the Jamaican authorities to progress with their adjustment efforts and overcome their structural problems; considering the length of the Fund's involvement in Jamaica, however, he wondered whether a monitoring arrangement would not have been a more appropriate solution--and more in line with the Fund's financial mandate. Perhaps the staff could indicate why it felt that further Fund involvement was justified despite the problem of prolonged use.

Nevertheless, the Fund's financial involvement in Jamaica would be reduced significantly during the program period, Mr. Esdar commented. Therefore, despite all his reservations, he could support the proposed decision if the staff could provide a reasonable argument in support of the new program.

Mr. Fridriksson said that, as previous speakers--including, in particular, Mr. Esdar--had mentioned, Jamaica had been a prolonged user of Fund resources, as was demonstrated by the fact that the arrangement under discussion was the eighth to come before the Board since 1981. In addition, Jamaica had drawn three times in the past five years under the compensatory and contingency financing facility and its predecessor, the compensatory financing facility.

In the summing up of the most recent review of conditionality in Fund-supported programs (at EBM/91/96, 7/19/91), it had been stated that access for prolonged users should be guided by the need to reduce their outstanding use of Fund resources over time, Mr. Fridriksson recalled. Fund support for prolonged users would be considered on a case-by-case basis, in light of a comprehensive review of past programs, as well as of factors behind past program slippages. Those assessments would be included in staff papers on requests for Fund arrangements. It had also been agreed that, in cases in which progress toward external viability had been slow, continued Fund financing might require strong policy justification, including a front-loading of policy measures, and would need to take clear account of the prospects for external viability.

Although the paper currently under discussion shed some light on developments during the 1980s--and even more on developments under the most recent stand-by arrangement--it was debatable whether it met the prescription of the summing up to which he had referred, Mr. Fridriksson considered. In view of that conclusion, an even stronger program aimed at an earlier attainment of external viability might have been expected. Such a program would also have been justified in view of Jamaica's large external debt and debt service, and its vulnerability to external shocks.

Nevertheless, Mr. Fridriksson noted, the level of Jamaica's obligations to the Fund had been falling and would continue to fall during the program period. Moreover, Jamaica's performance had improved during the latter part of the most recent stand-by arrangement, thus creating a basis for the proposed extended arrangement, which seemed to be appropriately balanced.

He could support the proposed decision, Mr. Fridriksson concluded. At the same time, and with particular reference to Jamaica's history, the importance of the full implementation of the program by the Jamaican authorities should be emphasized. The authorities would also have to be ready to strengthen their efforts should the external environment turn out to be worse than currently projected, as that was essential for continuing the country's relations with the Fund and securing the operations on the external side that were necessary to close the financing gap. Like other speakers, he would like to think that a permanent change had taken place in economic policy performance in Jamaica.

Mr. Kanada made the following statement:

Although Jamaica has repeatedly implemented programs under arrangements with the Fund for about the past 17 years, there seems to have been little progress made, other than in the reduction of fiscal deficits. We understand that the unsatisfactory performance that has been repeated under previous arrangements can be attributed partly to exogenous factors, such as hurricane damage and weaknesses in the prices of Jamaica's main export commodities; however, it is regrettable that the program deviations in the second half of 1991 resulted from the weakening of financial policies during a major liberalization of Jamaica's exchange policy.

It is welcome that, as of end-March 1992, all of the performance criteria were observed under the revised stand-by arrangement, which was approved by the Executive Board in April 1992. However, at end-June 1992, a technical waiver for the performance criterion on net domestic assets of the Bank of Jamaica was granted on a lapse of time basis. In this connection, it is hard to say that Jamaica accomplished the program's targets.

Before assessing these points, let me touch on some specific aspects of the economy. Regarding fiscal policy, it is welcome that measures were taken to strengthen the revenue, such as establishing a chain of tax increases, expanding the tax base, strengthening tax administration, and improving the automatic cost pass-through mechanism. On the expenditure side--which constitutes one of the most important factors for attaining the fiscal targets--it is imperative to strengthen the monitoring of expenditures, as a temporary increase in 1992/93 has been projected, reflecting the shifting of losses by the Bank of Jamaica to the government budget and the cost of civil service reform.

On monetary policy, considering that the repeated nonobservance of performance criteria was caused by the weakening of financial policies, it is imperative to implement a tight financial policy under the medium-term program, in order to stabilize the exchange rate--which, as indicated in the staff paper, is a critical element in the medium-term strategy--and to reduce the rate of inflation.

On the external front, an increase in exports is considered to be an important factor in the development of the economy. It is projected that the value of all exports will increase at an average annual rate of about 10 percent in U.S. dollar terms. The staff paper projects that, in particular, nonbauxite exports will grow strongly. In this connection, I would like to ask the staff to clarify which concrete industries in the nonbauxite sectors are expected to experience export growth.

Finally, I would like to emphasize the need for industrial diversification in order to achieve economic development. In this regard, this chair is not fully convinced that, in light of the unsatisfactory performance that has been repeated under Jamaica's previous programs and its prolonged use of Fund resources, there has been enough emphasis placed on industrial diversification.

Despite these aforementioned negative factors, it is welcome that efforts have been made to get the program back on track by taking corrective measures in the fiscal area, and that the accumulated external arrears were eliminated as of end-March 1992. Considering the heavy external debt burden on Jamaica, international assistance will also be necessary to regain external viability on a medium-term basis.

In light of these circumstances, we can go along with the draft decision on the condition that Jamaica's economic performance is monitored carefully, and that a steady effort is made in the area of diversification under the extended arrangement. Finally, I would like to stress the need to reconsider the extension of the Fund's aid on a medium-term basis to such prolonged users of resources as Jamaica.

Mr. van der Kaaij said that, during the past few years, Jamaica had implemented major structural reforms. Progress had also been made in macroeconomic stabilization, and the slippages that had occurred in 1991 had been corrected under the guidance of the Fund, thus laying the groundwork for the extended arrangement that had been proposed.

His chair could support the request for an extended arrangement, Mr. van der Kaaij stated. However, it should be noted that Jamaica's external position remained fragile: at the end of the program period, the debt-service ratio would still be about 20 percent; moreover, the staff's balance of payments scenario showed that Jamaica's external position was particularly sensitive to changes in the underlying assumptions. The staff had came to the frank conclusion that the best assurance of Jamaica's capacity to repay the Fund was the country's own commitment to do so. In those circumstances, a close monitoring of the program would be necessary, as previous speakers had noted.

With those uncertainties in mind, he wished to make a few points, Mr. van der Kaaij remarked. With respect to inflation, the target set under the program was somewhat disappointing. After a sharp reduction to 6.5 percent during the first year of the extended arrangement, the inflation rate had been programmed to remain at that level thereafter rather than be reduced further. He wondered why a more ambitious inflation target had not been set. Also, after 1992/1993, broad money growth would be targeted to keep pace with nominal GDP growth, which implied a rather accommodative monetary policy.

The authorities seemed satisfied with reducing the inflation rate to 6.5 percent. which was a level comparable to that of Jamaica's major trading partners, Mr. van der Kaaij observed. However, it could turn out to be very difficult to stabilize inflation at that level, as an inflationary spiral could still easily be triggered by adverse terms of trade developments.

In the area of monetary policy, a major objective of the program was to eliminate the losses incurred by the Bank of Jamaica, Mr. van der Kaaij commented. The replacement of certificates of deposit by treasury bills was an important feature of that process. The result would be a more transparent situation, in which the central bank's conduct of monetary policy would not be hindered by considerations of its financial position. The costs of the open market operations--which could be huge--would rightly be borne by the Central Government. In order to reduce those costs, it would be necessary to scale down the stock of treasury bills; however, that would have an expansionary effect on liquidity, which would have to be offset. He wondered what instruments were already available or could be created for that purpose.

On exchange rate policy, the authorities' commitment to implementing financial policies that would promote exchange rate stability was welcome, Mr. van der Kaaij considered. At the same time, they were committed to maintaining a flexible exchange rate. He hoped that the exchange rate regime would not turn out to be too flexible; a small open economy like Jamaica's had much to gain from maintaining a stable exchange rate.

As the staff, Mr. Smee, and other speakers had pointed out, Jamaica had been using Fund resources for a long time, Mr. van der Kaaij noted. It would be a great success if the proposed extended arrangement were to be the last in that long line of Fund arrangements. The program, if implemented fully, could achieve that goal.

Ms. Vori made the following statement:

> Jamaica's situation as a prolonged user of Fund resources requires careful consideration. The Fund's involvement with this country has extended for some 18 years, with three extended arrangements and nine stand-by arrangements granted. Given the revolving, temporary nature of Fund assistance, the request for a new extended arrangement in these circumstances becomes a matter of principle. Already, on preceding occasions, this chair expressed its concern that the kind of support being sought from the Fund was incapable of dealing effectively with the difficulties of Jamaica. It was also suggested that an extended and more structurally-oriented arrangement would prove more appropriate for serving the country's needs. At this point, therefore, any proposal of Fund assistance must be accompanied by the consideration of a strong scenario for bringing the Fund's involvement with Jamaica to an end. Jamaica's external viability must be restored so that the need for exceptional financing will

not arise after the end of the program. Also, approval of the extended arrangement should be contingent on the restoration of a good track record by the authorities.

The program under consideration seems to satisfy both these requirements. On the one hand, the authorities have already taken important steps to consolidate the fiscal imbalance; bring down the inflation rate; liberalize prices, interest rates, and the foreign exchange market; and implement structural reforms. On the other, the program envisages a reduction in Fund exposure over the medium term and a substantial improvement in the balance of payments, such that exceptional financing will not be required after the expiration of the proposed arrangement.

I will comment on some potential weaknesses in the program and ask for information, focusing, in particular, on fiscal and incomes policies, the central bank losses, and structural reforms. Implementation of a restrained fiscal policy is essential for sustained improvement in Jamaica's economic performance. In this respect, the authorities' efforts to achieve and maintain a surplus in the public sector balance must be praised. The proposed ceilings on the stock of the short-term external debt of the public sector will play an important role in preventing the substitution of external for internal financing--a practice that could have negative consequences in the presence of exchange rate instability.

The program, however, envisages a recourse to domestic financing in the event of a shortfall of external financing, albeit within a percentage limit of this gap. Given the large fluctuations in the gap between monthly revenues and expenditures, this could prove dangerous for maintaining the inflation target and exchange rate stability. Instead, the program should consider a curbing of current expenditures, which are projected to rise from 28 percent of GDP in 1991/92 to almost 34 percent by 1995.

Coming to the revenue side, I wonder whether it is wise to grant a reduction of personal income taxes while introducing the GCT, as this could impinge on the effectiveness of collection procedures. I understand that such a reduction is part of the deal that the authorities are seeking in their wage negotiations with the central government employees' union; however, although discipline can be imposed on the public sector wage bill, it should not be expected that this will be immediately reflected in private sector wage moderation. In order to secure an appropriate revenue flow and maintain the necessary competitiveness of the export sector, a more prudent approach would seem advisable.

With regard to incomes policy, the program envisages that a sizable shedding of civil servants will be completed by the end of the year. It is claimed that selective pay increases can be granted out of the saving on the wage bill deriving from the reduction in the number of employees; however, expenditures on wages and salaries are actually forecast to rise from 4.3 percent to 4.7 percent of GDP, thus implying a standard of pay increase that may also endanger the achievement of wage moderation in the private sector.

In the monetary field, the plan for eliminating the Bank of Jamaica's losses by transferring them to the central administration accounts will increase transparency and lead to the restoration of the financial soundness of the central bank. Current action by the Jamaican authorities has already enabled the Bank to reduce the stock of its certificates of deposit by J$4 billion--equivalent to 7 percent of GDP--over the past four months. As a consequence--and because of a bunching of the interest payment obligations of the Bank of Jamaica--the staff paper indicates that the surplus planned for the public sector this year might not be attained. I would like the staff to comment on the additional burden that this adjustment imposes on the public sector balance in terms of financing, as well as on its impact on financial and exchange rate stability.

This chair welcomes the structural reform effort aimed at liberalizing pricing mechanisms, eliminating subsidies, and reducing further the extent of the Government's participation in the economy. The plan to use the proceeds from divestment to reduce public sector indebtedness is also appropriate, given the large debt/GDP ratio. Comments from the staff would be appreciated as to whether the automatic public sector pricing mechanism has been extended to cover most of the public entities, and as to the impact of price liberalization on inflation and exchange rate developments.

With these comments, I support the proposed decision.

Mr. Al-Tuwaijri said that he agreed with the thrust of the recommendations in the staff appraisal. The Jamaican economy was a small and open one that depended heavily on foreign exchange earnings from tourism and exports of bauxite and alumina. Moreover, Jamaica was one of the most indebted countries in the world and one of the most prolonged users of Fund resources. However, it was heartening to see the considerable progress that the authorities had achieved in reducing economic imbalances through wide-ranging reforms, including the liberalization of the exchange system, the introduction of a value-added tax, and the institution of public sector pricing mechanisms that allowed for full cost recovery. Those efforts had helped to increase private sector confidence and improve the prospects for sustained economic growth over the medium term.

Notwithstanding the achievements that had been attained so far, further reforms were necessary to put Jamaica on the path of balanced and sustained growth, Mr. Al-Tuwaijri considered. In that regard, the authorities' commitment--as emphasized in both the staff paper and Mr. Smee's opening statement--to undertake further adjustment measures was welcome.

To build on the success achieved so far, Mr. Al-Tuwaijri continued, the Government had introduced a medium-term adjustment program, for which it was seeking the Fund's support under an extended arrangement. The program was designed to consolidate the recent progress made in stabilization policies, with a view to achieving a viable external position and making further improvements in the incentive structure for private investment that could serve as a basis for promoting economic growth. If implemented fully, the program would raise the rate of growth of real GDP and reduce the rate of inflation to a level comparable to that of Jamaica's major trading partners.

The program envisaged an increase in the overall public sector balance from zero in 1991/92 to a surplus of 3.5 percent of GDP in 1995/96, Mr. Al-Tuwaijri noted. That increase would be achieved through a combination of expenditure constraints and revenue increases, including better tax administration and greater reliance on broad-based, indirect tax instruments. Although the Government's intended efforts in that area were welcome, it was important to ensure that procedures for the collection of revenues by the public utilities and the JCTC were strictly enforced. Furthermore, a close monitoring of public expenditure would be essential to attain the targeted public sector surplus. In that regard, he welcomed the implementation in June 1992 of the World Bank-supported Administrative Reform Program, which would reduce the size of the civil service by 20 percent by end-1992.

Finally, the envisaged reform of the financial system and the steps taken to strengthen bank supervision were welcome, Mr. Al-Tuwaijri remarked. In addition, he concurred with the staff's assertion that the maintenance of the existing exchange rate system was a critical element of the Government's medium-term strategy, as it should improve the overall efficiency of resource allocation and strengthen Jamaica's ability to deal with external shocks. He supported the proposed decision.

Mr. Moss made the following statement:

> Let me first of all welcome Jamaica's request for an extended arrangement, which follows the six stand-by arrangements agreed with the Fund since 1984. Such a multiyear framework will allow the Government to focus better on the country's medium-term economic strategy, as well as enable it to concentrate more on structural objectives. One of the objectives must surely be to reduce the Government's sometimes inefficient participation in the economy. Of course, this arrangement will perpetuate for three more years Jamaica's standing as a prolonged user of Fund resources. However, I do not consider this to be too worrying

because--as Mr. Smee points out in his opening statement--the Fund's exposure to Jamaica will continue to decline over the course of the arrangement.

In light of what has been said already, I intend to focus my remarks on medium-term issues. However, before turning to these, I would like to point out two risk factors affecting the attainment of the inflation target for March 1994 of 6.5 percent on an annual basis. First, the welcome introduction and strengthening of cost pass-through mechanisms in the public enterprise sector might have an unexpected cost-push effect on the economy, especially if this enhanced possibility for revenue raising were to be used to pay for wage increases in the public enterprise sector. I know that the intention is to continue exercising wage restraint in the public enterprise sector; however, the prospect of a real increase in the wage bill of the Central Government next year, notwithstanding the sizable reduction in the size of the civil service, might have an unwarranted demonstration effect, as Ms. Vori has just highlighted.

A second risk factor concerns the sensitivity of Jamaica's balance of payments to external shocks and the ensuing effects on the exchange rate. This might lead to surprises in terms of an inflationary upsurge--certainly not of the size experienced in 1991, given the presence of tight financial policies, but maybe enough to slow down the anticipated rate of decline of inflation. In my intervention on Jamaica's request for its previous stand-by arrangement, I had developed a similar kind of reasoning, which, unfortunately, turned out to be more than true.

As regards the medium term, I would like to touch on three issues, all of them related to the balance of payments outlook. First, I note from Table 3 on page 21 of the staff paper that Jamaica's public sector will again resort to foreign financing in 1993, notwithstanding the large external debt stock and the slightly negative overall public sector borrowing requirement. I also note that, as explained on page 11 of the paper, Table 3 does not contain any figures for divestment proceeds from April 1993 onward "because of the tentative nature of the estimates of these proceeds for future years." Is the staff intentionally building in a safety valve here? If this is the case, would it not have been better to have such proceeds reflected in either an early reduction of the external debt stock or a further buildup of foreign reserves ? After all, the letter of intent mentions that the Government plans to step up the pace of the privatization process, and the staff paper mentions that the authorities are seeking assistance from the World Bank to this end. Some staff comments on this would be welcome.

The reference to a possible further buildup of foreign reserves brings me to my second remark. In view of the vulnerability of Jamaica's balance of payments to external shocks, on the one hand, and of the objective of eliminating further reliance on exceptional financing after March 1996, on the other hand, the aim of reaching a gross international reserve position of about ten weeks of nonbauxite imports might not be ambitious enough. Given the stated intention of the authorities to promote exchange rate stability in order to create an environment conducive to private investment, an accelerated accumulation of international reserves might sooner lay the basis for a return to a more stable exchange rate regime for the Jamaica dollar. Incidentally, I emphasize the word "regime" here, not the stability of the rate as such, which was the issue underscored in Mrs. Hansen's intervention. In any event, the starting position for enhanced action in the area of building up reserves seems to be favorable, with the November 1992 international reserve level some US$90 million stronger than contemplated.

My third comment has to do with creating the proper environment for private investment to thrive. The staff paper leaves me with the impression that the authorities still attach considerable importance to reserving a direct role for them in that process, as is evidenced, for instance, by the fact that central government investment is projected to rise over the program period. The need for further trade reform and liberalization, as well as the usefulness of a speedy enactment of the Fair Competition Act and other measures aimed at stimulating private investment indirectly, should not be underestimated. As to the trade liberalization issue, I learned from an April 1992 World Bank report on the Caribbean region that the regional import tariff structure entails a substantial effective rate of protection. I would like to hear from the staff whether the revised customs tariff, which, as mentioned in the staff's opening statement, was agreed upon in October 1992, will entail a sizable lowering of the effective rate of protection.

With these observations, I would like to encourage the Jamaican authorities to continue their policies aimed at increasing the efficiency of the economy, which will reduce the need for recourse to external savings to finance domestic investment and growth.

Mr. Evans said that he was pleased to see the extended arrangement that had been proposed for Jamaica. As Mr. Clark had argued in the Board on previous occasions, that kind of arrangement was what was required.

Speakers had expressed concern about Jamaica's prolonged use of Fund resources, Mr. Evans recalled. However, as Mr. Clark had noted, six of Jamaica's seven arrangements in the past decade had been stand-by arrangements, which had not incorporated fully the type of policies that were needed to deal with the country's problems. Therefore, he was pleased to see that an extended arrangement had been proposed that would encourage the appropriate concentration on structural policies.

He was also pleased to see the approach that had been taken with respect to access, as the Fund's exposure to Jamaica would continue to decline throughout the program period, Mr. Evans added. One might have thought that the combination of the policies included in the program and the approach taken toward access would have satisfied Mr. Esdar; apparently, however, that was not the case.

In the fiscal area, the cut in the income tax rate seemed to be acceptable, Mr. Evans considered. To combine a reduction in income taxes with the introduction of a general consumption tax was a classic approach to tax reform; therefore, he did not share the concerns that other speakers had expressed on that issue. It was also very appropriate to take those actions in conjunction with the negotiations on wages.

With respect to Jamaica's exchange rate performance, Mr. Evans commented, a reading of the staff paper had prompted him to wonder, along with Mrs. Hansen, whether the exchange rate could really be market determined. In that context, it would be helpful if the staff could remind the Board of the definition of Jamaica's representative rate; if the market were actually producing that rate, Jamaica had something that it could teach Europe.

Mr. Glazkov said that he broadly agreed with the staff appraisal and could support the proposed decision. As Mr. Smee had pointed out in his opening statement, and as other Directors had noted, the process of adjustment in Jamaica had been a very long one, and Jamaica had been an extremely prolonged user of Fund resources, which might raise some doubts about the appropriateness of approving another three-year Fund-supported program for the country. However, it appeared that some progress had been made in the past year in Jamaica's adjustment effort, and that further progress could be expected in 1993. The conclusion that Jamaica should be able to avoid the need for exceptional financing after September 1995 was both welcome and reassuring with respect to its capacity to repay the Fund. The reduction in the total of Jamaica's borrowing from the Fund over the program period was also welcome.

With respect to the details of the program, Mr. Glazkov continued, he had been struck by the very large quarterly variations in the performance criteria on the changes in the net domestic assets of the Bank of Jamaica, the overall public sector financing requirement, and the financing requirement of the Central Government, which were set out in Tables 5 through 7, respectively, of Annex II. To judge from those tables, it would seem that, at least in quantitative terms, fiscal and monetary policy adjustment was somewhat back-loaded in the first year of the program. He understood that, in terms of the profile of disbursements of project assistance and associated spending, as well as of the seasonal demand for private sector credit, there were good reasons for that back-loading; however, in the early months of the program, the authorities should be careful to avoid a surge in inflationary expectations, as that could undercut the inflation target for the year.

Also, on monetary policy, it was regrettable that the authorities were not planning to eliminate the losses of the Bank of Jamaica until end-1994/95, Mr. Glazkov remarked. That was a cause for particular concern if, as the staff appraisal implied, the existence of those losses would constrain the Bank of Jamaica in the pursuit of its monetary policy objectives. Similarly, he regretted that, although the authorities were moving toward more indirect means of monetary control, the reduction in the liquid asset requirement from its present level of 50 percent to the target of 17 percent would not begin until 1994/95. In both cases, it would be preferable if the adjustments could come much earlier in the program period.

In conclusion, he welcomed the progress that Jamaica had made so far, Mr. Glazkov stated. However, he wished also to sound a note of caution in light of the slippages in performance that Jamaica had experienced under previous Fund-supported programs. In particular, there had been a tendency for cycles of inflation and currency depreciation to develop. In order for the authorities to avoid those cycles, rigorous adherence to the stabilization program and continued efforts on structural reforms would be necessary. If the authorities could stick to the targets set out in the program, they could achieve a great deal.

Mr. Torres said that, clearly, the Jamaican authorities had put on the table the kind of positive track record that some Directors had called for at the time of the most recent Article IV consultation as a precondition for a formal request for an extended arrangement. The Jamaican economy had attained the minimum conditions of stability needed to start a program supported by an extended arrangement. The combination of the achievement of public sector equilibrium and the granting of Fund support might help Jamaica to bolster even further private sector confidence and strengthen the structural measures already taken.

The program that the authorities had presented looked feasible and coherent, Mr. Torres considered. As expressed in the letter of intent, raising the levels of domestic savings and investment was one of its principal goals. It was also noted in the letter that Jamaica's reliance on external savings and grant receipts was projected to decline during the program period. In those circumstances, the only way to achieve that goal was to restrain substantially public sector expenditures while improving the revenue side, so as to accumulate an effective amount of public savings.

In that connection, two points should be emphasized, Mr. Torres continued. First, in the short run, private savings usually reacted with a longer lag to macroeconomic adjustments. Therefore, it could be expected that, in the very short run, the primary burden of raising the level of savings would have to be shouldered by the public sector. With that premise in mind--and notwithstanding the measures and assumptions already taken into account in the projections--the authorities should be aware of their important responsibility in the matter.

Second, Mr. Torres observed, the policies that, as described in the staff paper, were aimed at achieving the inflation and balance of payments objectives also hinted at the necessity of closely monitoring real and nominal interest rates, with a view to avoiding any reverse effects on domestic investment that could develop.

Finally, his chair recognized the extraordinary efforts that the Jamaican authorities had made following the significant economic deviations in past years, Mr. Torres remarked. Moreover, his chair was pleased with the authorities' comprehensive intentions. Jamaica's policy stance clearly reflected its goal of consolidating the gains of past adjustment efforts in order to achieve eventual economic growth. Accordingly, he could endorse the staff's suggestion to grant Jamaica the Fund's support under an extended arrangement.

The staff representative from the Western Hemisphere Department said that, as some speakers had suggested, the envisaged reduction in the personal income tax rate should be viewed in the context of the authorities' efforts to restrain wages under the social pact. With the GCT in place, and in light of the existing high ratio of tax revenue to GDP in Jamaica, it would be possible to reduce income taxes while maintaining overall wage restraint. Expenditures could be cut to compensate for the decline in revenue that would ensue.

The Government had not yet decided on an appropriate pace of inflation reduction for the latter half of the program period, the staff representative continued. Aware of the harmful effects that inflation could have on the social fiber of the country, the authorities aimed to reduce the rate of inflation to the level projected for Jamaica's partner countries during that period. Therefore, if the inflation rates of partner countries were to fall at a faster than expected pace, the authorities would re-evaluate their own inflation targets.

With respect to monetary policy instruments, the staff representative observed, the Bank of Jamaica had relied more heavily on open market operations and the liquid asset requirement than on the discount rate, partly because of the absence of an efficient domestic capital market in Jamaica. However, as was noted in the staff paper, the impending passage of the Securities Market Act would help to spur the growth of a capital market in Jamaica; that development, in conjunction with the recent increased use of commercial paper by the private sector, would allow the Bank to use the discount rate more freely in conducting monetary policy.

It should be noted, the staff representative added, that any shifting of the Bank of Jamaica's losses to central administration accounts through reductions in the stock of certificates of deposit would not have inflationary repercussions, as those reductions would be financed only through public sector surpluses.

In the external sector, the staff representative noted, the planned reduction in the levels and dispersion of the regional Common External Tariff would effectively lower the level of protection afforded to domestic producers. Because of the accompanying reduction in the number of exemptions for importers and the improvements in compliance that the lower rates would encourage, it was expected that revenues would not be adversely affected by those changes.

Remarkably, Jamaica's external debt had not only remained fairly stable in nominal terms in recent years but had even declined slightly, the staff representative stated. Moreover, in light of the projected continuing fall in external debt, it was envisaged that the net nonfinancial public sector borrowing requirement--even including the payments on the Bank of Jamaica's losses as part of that requirement--would decline and turn negative over the program period.

In that connection, the staff representative commented, the authorities had wisely chosen to use the proceeds from the privatization of public entities to reduce the still sizable stock of external debt. However, it had been decided not to include the revenues from such transactions in the medium-term program, given the impossibility of predicting the timing of those sales or the amounts involved.

In those circumstances, the staff representative explained, the Government could have attempted to boost the level of domestic savings by accelerating the pace of adjustment, with a view to building up its international reserves more quickly. However, the speed with which the authorities had chosen to build up their reserves seemed to be appropriate, given that any shortcomings in implementing a more ambitious strategy could weaken the credibility of the medium-term program.

With respect to the use of Fund resources by Jamaica, the staff representative considered, the request for support under an extended arrangement could be justified on several grounds. First, as several speakers had emphasized, the Fund's exposure in that country had been declining considerably in recent years. Second, the authorities had carried out programs that had enabled them to reduce financial and economic imbalances substantially while undertaking fundamental structural reforms. Third, they were about to embark on a strong, credible medium-term adjustment program, under which the Fund's exposure would be reduced even further. Fourth, through its involvement with Jamaica, the Fund had an important catalytic role to play in channeling financial resources from donors and creditors.

Moreover, the staff representative continued, the design of the extended arrangement had been modified to prevent some of the slippages that had occurred in the implementation of previous Fund-supported programs. For example, an additional restriction had been imposed on the use of domestic credit in the event of a shortfall in external financing. Also, it would be possible to make greater use of short-term financing to smooth out large fluctuations in the fiscal balances.

Another important factor in support of Jamaica's proposed use of Fund resources was its current level of political cohesiveness, the staff representative considered. The Government, the private sector, and the labor unions were working as social partners to generate economic development that would be more equitable and promote social harmony.

Finally, the staff representative from the Western Hemisphere Department recalled, the waivers that had been sought in the preceding Fund-supported arrangement had been needed more on technical grounds than because of any lapses of policy implementation.

The staff representative from the Policy Development and Review Department said that it was undeniable that Jamaica had been a frequent user of Fund resources over the past decade. Moreover, as some speakers had emphasized, not all of the performance criteria in the country's Fund-supported programs had been met during that period. However, the general economic situation had clearly improved significantly over that decade. Ten years previously, it had been very difficult to see the light at the end of the tunnel; because of the considerable progress that had subsequently been made, however, it was possible to contemplate a situation in which, having successfully implemented reforms over the medium term, Jamaica would no longer require the use of Fund resources.

Given the progress that had been achieved--and in line with the Fund's guidelines for determining the level of access that prolonged users should have to its resources--the staff felt that an extended arrangement, rather than a Fund-monitored program, would be more appropriate for Jamaica, the staff representative from the Policy Development and Review Department remarked. As had been noted, the Fund still had a role to play in galvanizing support from other multilateral institutions, such as the World Bank, and from bilateral creditors in order to help alleviate the country's heavy debt burden. Moreover, even with approval of the authorities' request for an arrangement, the Fund's exposure in Jamaica was projected to decline over the medium term.

Mr. Esdar said that, first, with respect to the Fund's catalytic role, it would not be satisfactory to allow other institutions to determine how the Fund should interpret its Articles of Agreement. As always, the Fund should make its decisions in light of its mandate to provide resources in support of temporary balance of payments problems.

Second, as Mr. Fridriksson had noted, the summing up of the Board's most recent discussion on conditionality had provided clear guidelines for determining the amount of access that prolonged users should have to Fund resources, Mr. Esdar remarked. The current discussion would have been facilitated if the paper prepared by the staff had contained an analysis along the lines proposed in that summing up.

Third, as Mr. Evans had suggested, the Fund might have erred in the past by approving a series of stand-by arrangements with Jamaica, given that those programs had not placed sufficient emphasis on the attainment of medium-term viability, Mr. Esdar suggested. Perhaps if a longer-term focus had been adopted, Jamaica's current request for the use of Fund resources would not have been necessary.

The Chairman said that the staff and management would heed Mr. Esdar's second point in the preparation of future papers on requests for the use of Fund resources by prolonged users.

Mr. Smee remarked that there was no getting around the fact that Jamaica had been and was a prolonged user of Fund resources. Certainly, the situation in May 1985--with outstanding Fund credit equivalent to 445 percent of quota--had been far beyond anything that one would want to envisage. However, Jamaica's recent history provided one of the best examples of how the Fund could successfully support a country's adjustment efforts. The Jamaican authorities had suffered setbacks from time to time--some of them related to policy slippages, and some of them caused by external factors over which they had little or no control, such as commodities, terms of trade, and natural disasters. Nevertheless, four years after the onslaught of Hurricane Gilbert, which had wiped out approximately 25 percent of the country's GDP, Jamaica was able to graduate to a medium-term Fund-supported program because of the policies that its Government had implemented under a series of stand-by arrangements with the Fund.

Hurricane Gilbert had left the Jamaican economy in a very debilitated state in 1988/89, Mr. Smee recalled. Despite that poor starting position, however, few, if any, other Fund members had made as much progress over the ensuing three years as had Jamaica. The public sector borrowing requirement had improved from a deficit of 13 percent of GDP in 1988/89 to near balance in 1991/92 and was projected to move to a surplus of 3 1/2 percent of GDP within three more years. Also, the current account deficit, which had stood at 8 percent of GDP in 1988/89, was expected to narrow to approximately 1 percent of GDP in 1992/93 before turning into a surplus of 1.2 percent in 1995/96. The reduction of the public sector borrowing requirement had been more impressive than the upturn in the current account because domestic savings were increasingly being mobilized to finance domestic investment--which was exactly what was needed in Jamaica. The dramatic improvement in the net savings position should help to create a more equitable balance between the private and public sectors of the Jamaican economy, as well as between the internal and external sources of its financing.

By dint of their tremendous efforts, the Jamaican authorities had turned the economy around, Mr. Smee considered. Nevertheless, he would certainly bring to the attention of his authorities not only the broad support demonstrated by the Directors for their policies, but also the emphasis that Directors had placed on the need for a careful monitoring of their performance over the period of the arrangement. The Government would have to continue to demonstrate its resolve in confronting problems head-on in order to keep the program on track. Ambitious targets had been set under the arrangement, but, as Mr. Dorrington had said, the authorities had demonstrated over the past three years their ability to meet such targets.

The Executive Board then took the following decision:

1. The Government of Jamaica has requested an extended arrangement for a period of three years beginning December 11, 1992.

2. The Fund approves the extended arrangement set forth in EBS/92/179, Supplement 1.

3. The Fund waives the limitation in Article V, Section 3(b)(iii).

Decision No. 10228-(92/149), adopted December 11, 1992

2. CAMBODIA - OVERDUE FINANCIAL OBLIGATIONS - REVIEW OF DECISIONS ON COMPLAINTS UNDER RULE K-1 AND RULE S-1; REPRESENTATIVE RATE FOR CAMBODIAN RIEL; RATE OF CHARGE; BURDEN SHARING; RESTITUTION OF GOLD; AND DISTRIBUTION OF PROFITS FROM SALE OF GOLD

The Executive Directors considered staff papers on the review of decisions to limit Cambodia's use of the Fund's general resources and suspend its use of SDRs (EBS/92/188, 11/24/92), and on operational aspects of the Fund's financial relations with Cambodia (EBS/92/193, 11/30/92).

The staff representative from the Central Asia Department said that, since the issuance of EBS/92/188, there had been a number of political and economic developments with regard to Cambodia. On the political side, the Security Council of the United Nations (UN) had adopted a resolution on November 30, 1992 reaffirming an implementation timetable for the peace process that would lead to elections for a constituent assembly by April or May 1993. Those elections, however, would be conducted only in those areas to which the United Nations Transitional Authority in Cambodia (UNTAC) personnel had full and free access as of January 31, 1993. As Directors were aware, the UNTAC had been denied access to the zones that were controlled by the Party for Democratic Kampuchea (PDK), which had also refused to comply with the planned cantonment and demobilization of its military forces. As a result, the cantonment of the forces of other factions in Cambodia had been delayed, and the UN had in its resolution called for sanctions, including an embargo on all exports to the zones controlled by the PDK.

While there had been several recent reports of cease-fire violations by the PDK forces, the staff representative continued, those had so far appeared to be localized, and the overall response of the PDK to the sanctions was still uncertain. Outside the PDK zones, the UN had reported that good progress was being made in deploying UNTAC personnel, implementing voter registration, and repatriating Cambodian refugees from Thailand.

As regards economic developments, the authorities had implemented the policy actions on which understandings had been reached with the staff in October 1992, the staff representative noted. As described in EBS/92/188, measures had been taken to raise customs revenues, increase petroleum taxation, and raise domestic interest rates. The official exchange rate had remained unchanged since October 1992, but, as a result of an appreciation of the parallel market rate in November 1992, the spread between the two rates had been within the targeted 5 percent differential. Provisional data indicated that monetary growth was decelerating in the fourth quarter of 1992, owing to a decline in government bank financing during October and November of that year.

During the past two weeks, the staff representative from the Central Asia Department remarked, a staff team had been assisting the authorities in Phnom Penh with the formulation of the 1993 budget, which would be presented to the National Assembly in January. A major issue in respect of the budget would be the level of defense expenditure and the impact of the delays in the cantonment and demobilization process referred to earlier. In that connection, the staff had been discussing contingency fiscal measures to cover any overruns in military spending.

Mr. Fukui said that the staff's clarification of the recent events in Cambodia was welcome. In view of the fragile situation, it was absolutely necessary to keep a close eye on developments in that country.

Continuing, Mr. Fukui made the following statement:

> I welcome this opportunity to discuss Cambodia at the Board for virtually the first time since 1978, when the Board decided to suspend the use of Fund credit by Cambodia. I also wholeheartedly welcome the fact that this Board has started the process of reviewing its previous decision and supporting the painstaking adjustment efforts that the authorities are making to build a new economic system based on market principles.
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> This process began formally when Fund management expressed its judgment in October 1992 (at EBM/92/127, 10/21/92) that a governmental structure with which the Fund could work existed in Cambodia. I appreciate the efforts made by management and staff to formulate a future course of action aimed at normalizing the Fund's relations with Cambodia in an expeditious manner.

We have before us today a proposed decision that states that the Fund will informally monitor Cambodia's arrears in the context of the strengthened arrears strategy. I strongly endorse this decision; the normalization of Cambodia's relations with the Fund should take place as soon as possible under this strategy.

I also welcome the fact that, in the few months that have elapsed since formal communications between the Fund and Cambodia have been re-established, considerable progress has been made in the area of cooperation between the Fund and the authorities. The Cambodian authorities are cooperating with the Fund by providing economic information, by reopening accounts in the National Bank of Cambodia as their financial window for transactions with the Fund, and by proposing a representative rate for the Cambodian riel. They have also expressed their willingness to resume Article IV and Article XIV consultation discussions with the Fund next month.

The authorities' cooperation with the Fund is even more visible on the policy side. It is encouraging to know from the staff paper that the country has enjoyed robust economic growth of more than 6 percent per year during the past two years. It is particularly welcome that this strong growth has resumed after a sharp slowdown in output in 1989-90, which was due mainly to external shocks, such as the total suspension of foreign aid from the former Soviet Union and other Council for Mutual Economic Assistance (CMEA) countries.

Nevertheless, Cambodia's economic situation is very fragile and precarious. I am particularly concerned that the continued widening of the domestic imbalances is fueling the risk of inflation and weakening the currency. The cause of the imbalances is, of course, the weak fiscal situation. In light of this economic situation, I welcome the authorities' policy package, which was endorsed by the staff during its October 1992 mission. I do not wish to elaborate on the details of this policy package, which are clearly explained in the staff paper; I believe, however, that the measures are appropriate. It is also encouraging to know that most of the elements in the policy package have already been implemented.

It is a matter of concern, however, that in terms of macroeconomic policy, the prospects for military outlays are very uncertain, given that the present political and military situation in Cambodia depends on the actions of one of the military forces. I strongly hope that, in this difficult situation, the authorities will continue to make every possible effort--including, if necessary, the implementation of additional fiscal measures--in order to adhere strictly to the indicative targets for economic performance agreed on with the Fund.

Against this background, we strongly hope that a full-fledged Fund-supported program, to be supported by the use of Fund resources, will be worked out and implemented as a matter of urgency. Also, intensive technical assistance from the Fund and the World Bank in virtually all areas of economic policy management is needed. It is encouraging that certain steps have already been taken in this connection. I strongly hope that the staff will be able to formulate a stand-by arrangement when it visits Phnom Penh next month.

In this connection, the clearance of Cambodia's arrears to the Fund is a necessary condition for normalizing its relations with, and receiving financial assistance from, the Fund. My authorities, together with the French authorities, have already chaired two informal meetings on Cambodia, and we understand that a consensus has been reached among major donor countries to support the clearance of Cambodia's arrears. As the Fund's preparation for normalizing relations has been proceeding steadily, my authorities have come to the view--which, I believe, is shared by Mr. Landau's authorities--that it would be appropriate to host a meeting of the Support Group in order to obtain the necessary resources for clearing Cambodia's arrears to the Fund. Such a meeting could be held, say, in mid-January 1993.

It is strongly hoped that donor countries will understand the importance attached to this exercise in the overall context of the major reforms being undertaken by many former centrally planned economies, and that they will express their support in a concrete manner for the heroic struggle of the Cambodian authorities, who are faced with the challenge of rehabilitating their country and transforming their economy into a market-oriented one.

With these comments, I support the proposed decisions, including those pertaining to the operational aspects of the Fund's financial relations with Cambodia.

Mr. Landau made the following statement:

We welcome and support today's decisions on Cambodia. It is extremely encouraging that this Board has been given the opportunity to review the matter of Cambodia after the long period of noncommunication brought about by the dramatic situation in the country. The staff and management have worked very hard for this purpose, and I wish to extend to them all my appreciation for the constructive stance that they have adopted, and for the results already achieved.

The task in Cambodia is enormous. Not only are the institutional and political conditions complex and difficult, but the rehabilitative and reconstructive undertakings are also gigantic.

Supported by the UN, the authorities are engaged in a democratic process, which, although it could be impeded by the factions active in the country, needs to be taken forward. In addition, the authorities have embarked on a major reconstruction plan--also with the support of the international community.

I wholeheartedly support the four-stage strategy proposed by the staff. This consists of, first, the resumption of communications between the Fund and the new Cambodian governmental structure; second, the informal monitoring by the staff of the package of stabilization measures adopted by the authorities in order to build an appropriate track record; third, the convening of another meeting of the Support Group in January 1993, chaired by both my authorities and the Japanese authorities, with a view to making further progress in clearing Cambodia's arrears; and, fourth, the negotiation of a program built on the authorities' full cooperation in both reducing their arrears and establishing the necessary track record of policy implementation.

With respect to the economic situation in Cambodia, it is worth recalling that this country is among the poorest in the world, with a per capita income of roughly $200. Nevertheless, the Government has taken very courageous measures aimed at transforming the economy from one based on central planning into one that is market oriented. In the agriculture sector, the system of Krom Samaki, which was based on collective agricultural units, has been abandoned, and the private governance and exploitation of lands have been authorized. Also, a certain number of public enterprises in the agriculture and fishery sectors have been privatized. Moreover, the private sector has been officially recognized, and some private enterprises have emerged in the industrial and services sectors; operational and financial autonomy has been granted to the public enterprises; and most price controls have been lifted, with the exception of the prices of some key commodities. Nevertheless, much remains to be done; as I have already said, the reconstruction of the country will be a gigantic task because of the dramatic devastation of its basic economic structure and infrastructure.

Economic and financial policies for 1992-93 rightly aim at maintaining growth and reducing inflation, with fiscal adjustment bearing the bulk of the burden. I agree with the staff that the emphasis should be put on the revenue side, which represents only 5 percent of GDP. Bold measures have already been implemented, and I welcome the further steps that the authorities intend to take with respect to customs duties and taxes on petroleum products.

Of course, progress will need to be realized on the structural front, with the assistance of the donor community and the multilateral institutions. In this regard, I welcome the decision taken by the Asian Development Bank (AsDB) Board on a special rehabilitation assistance loan and the work already done by the World Bank to prepare an emergency rehabilitation credit.

Concerning arrears, I endorse the proposals made by the staff; however, I would like to underscore the efforts made by the authorities to clear their arrears. Together with the Japanese cochairman, we intend to convene a meeting of the Support Group in the first half of January 1993; this will mark a decisive step in the clearance of Cambodia's arrears. We also welcome the willingness of Cambodia to apply the assets held by the Fund to the settlement of its overdue obligations.

As Mr. Fukui said, clearance of the country's arrears should open the way for a full-fledged, Fund-supported program. As Mr. Fukui also said, it is a matter of urgency to establish such a program. Like Mr. Fukui, I think that, when the staff visits Phnom Penh in the coming month, this program should be formulated and negotiated with the authorities. At a later stage, negotiations on an arrangement under the enhanced structural adjustment facility (ESAF) would appear to us to be appropriate.

With these comments, I support all the proposed decisions, including those pertaining to the operational aspects of the Fund's financial relations with Cambodia.

The Chairman said that he greatly appreciated the efforts of Mr. Fukui, Mr. Landau, and their respective authorities on behalf of Cambodia.

Mr. Esdar made the following statement:

I would like to join other speakers in welcoming the improvement in the relations between Cambodia and the Fund. It is, indeed, a reassuring sign that, after one-and-a-half decades of noncommunication, Cambodia is again committing itself to trying to re-establish links that have been interrupted for some time. I hope very much that we can build upon this progress, and that Cambodia will succeed in normalizing its relations with the Fund and other creditors in the near future.

In this connection, my authorities very much appreciate the leadership displayed by Japan and France in helping to reintegrate Cambodia into the international community. We share the view that the Fund, the World Bank, and the AsDB have a crucial role to play in assisting Cambodia to re-embark on a sustainable growth path on the basis of structural reforms and macroeconomic adjustment. We commend the staff and management of these institutions for the work that has already been done.

My authorities are prepared to help Cambodia in its efforts to regain financial stability and to overcome internal and external imbalances. We have contributed significantly to the UNTAC mission--about 9 percent of the total cost of $1.9 billion--and we are supporting the reconstruction of the agriculture and health sectors through bilateral project financing and about DM 22 million in technical assistance, disbursed in part as grants. Prompt and effective technical assistance is certainly crucial to the task of overcoming the existing structural rigidities. Moreover, the financial support will help to stabilize the balance of payments, as urgently needed imports will be financed; therefore, it will also assist indirectly in overcoming the arrears problem. However, owing to legal considerations, we are not in a position to provide balance of payments support to the refinancing of other creditors' arrears, as this is not permitted by the legal principles guiding our aid policy.

In this effort to overcome Cambodia's economic problems, it is critical to address effectively the public sector deficit and eliminate its monetary financing. At the same time, inflationary pressures would be alleviated, and the improved budgetary position could compensate at least in part for possible foreign aid shortfalls.

I would like to encourage the Cambodian authorities to strengthen their efforts to meet the objectives as agreed in the shadow program, which, in my view, goes in the right direction. In this respect, it is important to expedite the implementation of structural reform, especially in the financial sector, in order to create an adequate framework for setting free private initiative, and to promote the inflow of foreign direct investment and capital. Successful implementation of the agreed monitoring program would certainly provide a good starting position for a fuller first credit tranche purchase.

With respect to the staff paper on the operational aspects of the Fund's financial relations with Cambodia, I do not have any objections to the decisions relating to the representative rate of exchange and the distribution of profits from the sale of gold. However, the proposed decisions on periodic and special charges and burden sharing raise considerable doubts as to whether the principles of uniformity of treatment are being reflected adequately. The staff states that the rate of charge on the Fund's holdings of Cambodian riels subject to periodic charges had to remain at 6 percent per annum because any change in the rate would have required a consultation with the member, which was prevented by the nonexistent communication links between Cambodia and the Fund. This lack of communication, according to the staff, also prevented the application of the principles of burden sharing and the levy of special charges.

It is difficult for me to understand the rationale behind these guidelines, which seem to have created a situation in which countries that have discontinued their communications with the Fund receive more favorable treatment than those countries in arrears that have maintained communication. In other words, Cambodia's financial position has improved by virtue of its decision not to communicate with the Fund. As this result obviously creates moral hazard problems--at least in the short term--it seems to me to be unreasonable and dangerous. Therefore, I would ask the staff to inform us whether the Fund's legal framework provides the means of overcoming this rather unsatisfactory outcome; having studied the staff's interpretation of the relevant rules, I assume this to be the case. In any event, I hereby request formally that the existing rules be reconsidered and adjusted to prevent such occurrences in the future.

At the same time, I wish to make clear that my remarks do not relate to the special situation in Cambodia; they have been prompted by the need to ensure that such signals will be avoided in the future. I look forward to the staff's comments on this point.

The Deputy General Counsel said that, as was explained in the two staff papers, the charges on the Fund's holdings of Cambodian riels and the adjustments required under the burden-sharing mechanism had remained subject to the schedule of charges established in 1963, when those holdings had been acquired by the Fund. Cambodia was the only member of the Fund with balances subject to charge under the 1963 schedule, which, unlike its successor schedule, specified that the Fund must consult with a member country before it could change the rate of charge on those balances. As Directors were aware, it had not been possible to hold consultations with the authorities from 1975 to 1978 because of the breakdown in communications between the Fund and Cambodia. However, in 1979, the situation had changed; faced with the option of re-establishing communications with the existing de facto Government, the Board had, upon the advice of the staff, decided instead to adopt a wait-and-see approach. The period of waiting and watching had finally come to an end two months previously when the Board had decided to re-establish relations with Cambodia; on the basis of ensuing consultations with the authorities, the staff was proposing that the Fund set the rate of charge on its holdings of Cambodian riels subject to charges under the 1963 schedule at current rates.

In the case of Cambodia, the Deputy General Counsel considered, the Fund had been somewhat cautious in its approach to the consultation requirement. Conceivably, legal arguments could have been formulated that would have allowed the Fund to raise the rates of charge without consulting with the authorities; however, the staff had not recommended that course of action to the Board, and the Board had not taken that decision.

It seemed unlikely that, under the rules currently governing repurchases, the element of moral hazard that had crept into the Fund's relations with Cambodia could reoccur in other cases, the Deputy General Counsel observed. As alluded to earlier, the Fund was no longer required to hold consultations with members before changing the rate of charge on its holding of their currencies. However, in some cases involving special charges, consultation with the authorities, although not mandatory, might be useful.

Mr. Esdar said that it was very important that the Fund not send misleading signals to its members on that point; if necessary, the relevant rules should be reconsidered and adjusted to prevent such occurrences in the future.

Ms. Creane made the following statement:

> It is a true pleasure to be able to discuss Cambodia in the Board after a long hiatus. We fully join the other speakers in welcoming the rapid progress made since this past summer in normalizing relations with the Fund--progress that was indispensably aided by the cooperative efforts of the Cambodian authorities. I have only a few comments on the decisions and issues under discussion today.
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> Regarding the operational aspects of normalizing financial relations with the Fund, we accept the proposals outlined in the staff papers. The issue of whether or not to impose charges retroactively did give us pause, notwithstanding the legal reason, which was just re-explained by the staff. This chair was not keen on the Board decision taken this past spring (Executive Board Decision No. 10000-(92/58) G/TR, adopted 4/17/92) to change the rules on special charges; however, given that, under the new rules, special charges are meant as a disincentive mechanism to deter members from falling behind in payments in the first place, applying them at this stage to Cambodia--which appears very willing to cooperate with the Fund on the arrears that it has already accumulated--would not seem to be consistent with that decision. In this context, we welcome the Cambodian authorities' agreement to utilize the assets held by the Fund for partial clearance of the arrears.
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> An adjustment program, such as that described in the Memorandum of Understanding on Economic and Financial Policies for 1992-93, will be essential to stabilize the macroeconomic situation; we are very much encouraged that the Cambodian authorities and the Fund have worked out a comprehensive program through end-1993. We support the goals and objectives of the program, and we would particularly caution the authorities to stick close to the key goal of strictly limiting the domestic bank financing of the budget deficit. That the authorities have already taken important reform and stabilization measures encourages us to expect fully

the significant tightening of the program that would be necessary for an upper credit tranche arrangement.

However, thinking responsibly about the Fund--as well as about Cambodia's future--we are uneasy with what seems to be some degree of haste in the movement toward a formalized Fund-supported program. In line with our enthusiasm for the improved situation in Cambodia, we suggest the injection of a note of caution as we move ahead. While very supportive of the ultimate objective of a stand-by program, we would very much prefer a longer informal monitoring period before negotiations on a stand-by arrangement are completed and brought to the Board for approval. In this way, as has been required of other countries in arrears, Cambodia would be given sufficient time to establish a track record by meeting some of the quantitative benchmarks under the proposed stabilization policies before Fund resources would be committed anew. We would propose a monitoring period of about six months, starting from October 1992. This should give the Cambodian authorities adequate time to set a convincing record--as we fully expect that they will--in meeting their commitments on policies and payments coming due.

We are very pleased with the comments from our French and Japanese colleagues regarding a Support Group meeting in January 1993 for Cambodia. I would like to observe that our proposal for a somewhat longer monitoring period would be fully consistent with this new timing of the Support Group meeting, as EBS/92/188 notes that the conditions for any discussions on the possible use of Fund resources include having the necessary financing assurances in place.

Finally, we are much encouraged by the coordinated international effort to assist Cambodia by the authorities of our colleagues on the Board and the Fund staff, working with the other international financial institutions. We look forward with great interest to the opportunity to consider Cambodia's stabilization program in greater detail during the Board's consideration of the Article IV discussions.

Mrs. Szombati made the following statement:

We join other speakers in welcoming the recent steps taken by the authorities to normalize Cambodia's relations with the Fund. We particularly welcome the authorities' decision to utilize Cambodia's assets held by the Fund for partial settlement of the country's overdue obligations to the Fund. This is an important first step toward full clearance of these long-standing arrears.

The political and economic events of the past few years have left Cambodia in a situation that is difficult, but not hopeless.

During those years, Cambodia passed through a severe civil war and a period in which the economy was rebuilt as a centrally planned system. Now, the authorities are engaged in a market-oriented restructuring of the economy. Despite progress with fundamental reforms, however, serious financial imbalances have emerged, owing largely to major shortfalls in external assistance. Stabilization measures are urgently needed to reduce the large fiscal deficit, the high inflation rate, and the large volume of currency substitution, and to keep the reform process on track. A key to the external financial support that successful recovery will require from the international community will be the speedy regularization of the country's relations with its external creditors.

In the area of stabilization, we endorse the Government's policy package, which consists of fiscal adjustment, the establishment of positive interest rates, and the maintenance of a realistic official exchange rate. Given the importance of the fiscal element of this package, we welcome the Fund's provision of technical assistance in the formulation of the 1993 budget. Corrective measures are necessary in both the revenue and expenditure areas. Military spending is certainly the first candidate for substantial cuts, and we hope that the stabilization effort will not be derailed by an escalation of the internal conflict. The planned increase in capital expenditures, which is crucial to the recovery, will have to be supported by both reining in current spending and obtaining donor assistance.

On the monetary side, the short-term task is to slow the growth of domestic liquidity. The long-term task is more ambitious: to liberalize and reform the financial sector. Given Cambodia's present stage of financial development, the authorities are correct to rely on bank-specific credit ceilings in order to establish the needed control over credit expansion. The planned move toward positive real interest rates for riel-denominated assets and liabilities is an important step toward containing the massive currency substitution. Full control over monetary developments will also require stabilizing the exchange rate, and the recent steps toward unifying the exchange rate are most welcome.

To accomplish the needed easing of input constraints, and to rehabilitate the infrastructure and public services, Cambodia will need various forms of external assistance--most of it on concessional terms. Here, the news that major support is on the way from bilateral and multilateral donors in the form of project and commodity assistance is very welcome. However, before Cambodia's relations with its creditors can be fully normalized, further steps will be needed, including the full clearance of its arrears to the Fund.

The authorities' adjustment efforts and the steps that they have taken toward settling Cambodia's financial obligations to the Fund have opened the way for the country to receive needed help in the form of a Fund-financed program, which we would support. I would appreciate some comment from the staff about the progress that the authorities have made in furnishing the Fund with economic data under Article VIII, Section 5(a)--which is also an important element of the normalization of its relations with the Fund.

I support the proposed decisions, including those concerning the operational issues between the Fund and Cambodia.

Mr. Quattrociocche said that he wished to express his chair's satisfaction with the ongoing normalization of Cambodia's relations with the international financial community and--after so many years--with the Fund. The peace process that was under way in the country seemed to be keeping pace with expectations, and the holding of regular elections in May 1993 would greatly benefit not only Cambodia, but also the whole region.

Nevertheless, Mr. Quattrociocche noted, unsolved political and military problems were casting a shadow on that scenario, and the way to establishing a truly lasting peace might prove to be harder than was expected. Undoubtedly, the quick restoration of sound economic conditions was needed to ensure that Cambodia's return to normality would not be endangered. The reality of the current economic situation was such, however, that its amelioration would require exceptional efforts and an undiminished commitment on the part of both the authorities and the Cambodian people. He strongly hoped that the Government's attempts to effect a recovery would soon prove to be successful.

The case of Cambodia was quite peculiar, Mr. Quattrociocche remarked. In light of the duration of its overdue financial obligations to the Fund, a declaration of ineligibility should already have been issued; under the Fund's strengthened arrears strategy, additional actions might also have been contemplated. However, it should be emphasized that he agreed with the approach taken by the Fund, namely, to reset the clock in order to permit the new Cambodian authorities to build their reputation on their own achievements. Although the period leading to the May 1993 elections was fraught with uncertainty, the prospects for a prompt settlement of Cambodia's arrears seemed to be good: the amount of the country's overdue obligations to the Fund was rather modest, and broad-based support was emerging from the international donor community. As he agreed with the thrust of the staff's analysis, he could support all the proposed decisions.

More caution, however, was warranted on policy implementation grounds, Mr. Quattrociocche observed. For obvious reasons, a policy track record did not exist as yet, and, until May 1993, the process of economic reform was likely to be slowed by a still unsettled political climate. In those circumstances, great care should be taken in considering the possible use of

Fund resources; perhaps, also, the desirability of starting negotiations for a stand-by arrangement in the first credit tranche as early as January 1993 could be questioned. Only three months would have elapsed since the re-establishment of formal communications between the Fund and Cambodia--too short a period for adequately assessing a policy track record. In that respect, he fully shared the concerns expressed by Ms. Creane; a longer assessment period would better serve both Cambodia's and the Fund's interests.

The staff representative from the Central Asia Department said that, as Cambodia was something of a special case in many respects, the strategy devised by the staff differed somewhat from the approach usually taken to resolve problems of prolonged arrears. It was hoped that the Fund could move forward quickly to support the broad, UN-led efforts of the international community to facilitate the peace process, and, in particular, to help pave the way for the general elections scheduled for May 1993. At meetings in Tokyo in June 1992, and--on the occasion of the Annual Meeting--in Washington in September 1992, donor countries had voiced their support for that strategy. That strategy had also been endorsed by speakers at the present Board meeting.

The prospects for an early clearance of Cambodia's arrears to the Fund were bright, the staff representative considered. Donors, however, had expressed legitimate concerns about the country's macroeconomic stability and the authorities' capacity to implement the difficult policies that were needed. In that context, the authorities had agreed in October 1992 to implement under informal staff monitoring a package of stabilization measures--which had also included some prior actions--by January 1993. Presumably, implementation of that policy package would precede any further review of the authorities' program; in any event, the staff would have an opportunity to assess the results at the next Article IV consultation discussions, which had tentatively been scheduled for January 1993.

Staff discussions with the authorities on a stand-by arrangement, the staff representative continued, would depend greatly on two factors: the clearance of Cambodia's arrears to the Fund, and the satisfactory implementation of the agreed policy package. As had been mentioned previously, policy implementation--on the part of both the Government and the UNTAC--had thus far been very good. If the authorities could meet those two conditions, the Fund could play its traditional, important role as a catalyst of additional resources during the transition period before the May 1993 elections.

With respect to the budget, the staff representative commented, the target for defense expenditure that the staff and the authorities had agreed on would probably not be met if the planned demobilization of the government forces could not take place. The technical assistance team currently in Phnom Penh was exploring with the authorities contingency measures that could be taken, but the number of options at the authorities' disposal was quite limited. Although it would be difficult--given the Government's rudimentary tax system--additional revenue sources would have to be found to cover any overruns in military expenditure.

In that vein, additional policy measures could be envisaged if there were to be a shortfall in aid, the staff representative remarked. However, it should be emphasized that, without foreign assistance, the authorities would not be able to implement a stabilization program.

Surprisingly, it seemed unlikely that the availability of economic data in Cambodia--or, more precisely, the lack thereof--would pose a major problem, the staff representative from the Central Asia Department noted. Because of the great efforts made by the authorities over the past six months, reasonably adequate data were available for most areas of the economy for the 1988-92 period. The Article IV consultation discussions planned for January 1993 would, it was hoped, enable the staff to both refine that data base and extend it backward, thereby satisfying Cambodia's obligations to the Fund as specified under Article VIII, Section 5(a).

Ms. Creane said that she agreed that policy implementation in Cambodia had been very good thus far. She also agreed that each arrears case was unique and should be treated accordingly, and that the Fund's role as a catalyst for additional financing was important. However, it would not be inconsistent with any of those principles--or, for that matter, with the strategy pursued by the Fund in other arrears cases--to impose a somewhat longer monitoring period than had been suggested by the staff.

Mr. Fukui said that it was important to keep in mind the urgency of the situation in Cambodia. Naturally, it was essential for the staff to monitor closely developments in that country, but the monitoring period should not be unnecessarily prolonged. As he had noted earlier, the authorities had already made significant efforts to normalize their relations with the Fund; a clear sign of approval from the international community should be sent to them as soon as was feasible.

Mr. Kaeser remarked that he had shared the concern expressed by Mr. Esdar about the positive effects of Cambodia's noncommunication with the Fund. However, the comments of the staff on that point had dispelled his concern. Clearly, only a country that, like Cambodia, had gone through the ordeal of being without a proper government for many years would be able to invoke the proposed decisions as a precedent.

The people and the Government of Cambodia were making courageous efforts to rebuild their economy, Mr. Kaeser noted. They could rely on the firm support of bilateral donors and multilateral institutions. The time had come for the Fund to normalize its relations with Cambodia. His chair endorsed all the draft decisions that had been proposed in the two staff documents, as well as the idea of approving an arrangement with Cambodia under the ESAF as soon as the preconditions for such an arrangement could be met. He would also convey to his authorities Mr. Fukui's plea for donor support for the authorities' valiant efforts.

Mrs. Martel commented that she agreed completely with Mr. Fukui that, in light of the massive job of rehabilitation and restructuring facing the Government--as well as the vulnerability of the democratic process that it was engaged in--an unnecessary prolongation of the informal monitoring period should be avoided. It was a matter of urgency for Cambodia to enter into a stand-by program with the Fund as quickly as was feasible. Of course, as the staff had pointed out, that outcome would depend on the clearance of the arrears and the implementation of sound economic policy measures.

Mr. Thomas said that his chair welcomed the progress made toward normalizing the Fund's relations with Cambodia. Particularly welcome--even if the external assets at the disposal of the authorities were minimal--was their request that the Fund apply the assets held by the Fund on Cambodia's behalf toward the partial settlement of the overdue financial obligations.

The authorities should be commended for the market-oriented steps that they had taken from 1985 onward, Mr. Thomas remarked. He was pleased to note that property rights had been restored, agricultural land returned to the tillers, and considerable autonomy granted to state-owned enterprises. Those actions had helped to increase output by about 9-10 percent in 1988. However, the economy had slowed down in 1989-90, owing to unfavorable external factors. Encouragingly, the economy had been on the upswing since then, reflecting a supply response to the acceleration of market reform and increased confidence over the prospects of national reconciliation. Nevertheless, despite the 7-8 percent growth in output recorded in 1991, the Cambodian economy was still very fragile and vulnerable to adverse external shocks.

He shared the staff's concern about the prevailing high rate of inflation and the decline of revenue in relation to GDP, Mr. Thomas stated. Given the imperative to rehabilitate and reconstruct productive potential, the decline in capital spending, coupled with the increase in the overall deficit, considerably impaired the prospects for sustained recovery. Equally, the monetary financing of the deficit was a cause for concern, as it had significantly increased domestic liquidity and accelerated inflation. Clearly, stabilization was the number one priority.

The Cambodian authorities would require considerable technical help, Mr. Thomas observed. It was satisfying to note that, following the signing of the Paris Peace Accords in October 1991, a series of Fund missions had visited Phnom Penh. The Fund should continue to give positive consideration to requests for such technical aid from Cambodia.

On the financial side, it was essential to help Cambodia to develop and strengthen its banking system, Mr. Thomas considered. In order to create domestic confidence in the currency and expand the perimeter of official monetary policy, the authorities should raise the interest rates on riel-denominated assets and liabilities to positive levels in real terms. At the earliest, moreover, they should initiate actions to close the gap between the official exchange rate and the parallel market rate.

Taking into consideration the efforts made by the authorities, the staff had rightly suggested that the application of the strengthened arrears strategy should be related to the date of re-establishment of relations with Cambodia, Mr. Thomas commented. It was unrealistic to use any date prior to that. He supported the proposed decisions as presented in both staff papers.

Mr. Dorrington said that, first, he associated himself with most of the comments that had been made on the Cambodian economy, as well as with the expressions of goodwill that had been extended toward the authorities.

Second, Mr. Dorrington continued, he shared the concerns expressed by Mr. Esdar about the proposed decisions on periodic and special charges and burden sharing. The staff's reassurances on that point were welcome; however, it should take action to ensure that any remaining loopholes in the rules governing those decisions were closed at once.

Third, on the question of the overall strategy that the Fund should follow with respect to Cambodia, the arguments presented by both sides were very powerful, Mr. Dorrington considered. He would continue to listen to the views of remaining speakers on that subject, but, on balance, he tended to agree with Ms. Creane.

Mr. Solheim said that his chair had previously welcomed the initiation of the process of normalizing the Fund's relations with Cambodia. With the eventual re-establishment of normal relations, the Fund would be able to take its part in an international cooperative effort to stabilize and rehabilitate Cambodia's economy. The Fund's role would be crucial in assisting the authorities in their difficult task of addressing the country's macroeconomic problems. In a country with an impoverished population and a great need for institution rebuilding, there was an urgent need to prepare for a stabilization program. In that connection, the adverse consequences of past policies were briefly, but clearly, illustrated in EBS/92/188.

A first step toward normalizing relations had recently been taken with the resumption of formal communications between the Fund and Cambodia, Mr. Solheim observed. The formulation of a Memorandum of Understanding on Economic and Financial Policies for 1992-93 and the prospect of Fund consultations were other encouraging steps toward the fulfillment of Cambodia's nonfinancial obligations to the Fund.

As long as the peace process was on track, and as long as it remained realistic to expect that UN-certified general free elections would take place, Fund support was fully appropriate, Mr. Solheim considered. However, as the situation was still highly complex and uncertain, the further clarifications offered by the staff were appreciated.

Given the magnitude of the problems, Cambodia would have a great need for external assistance in a number of areas in the years ahead, Mr. Solheim suggested. It was, therefore, encouraging that there appeared to be positive prospects for the mobilization of donor support--provided that Cambodia implemented a comprehensive adjustment program.

The staff papers dealt with a number of the operational aspects of the Fund's financial relations with Cambodia, Mr. Solheim noted. As Mr. Esdar had suggested, the proposed decisions on charges might include some elements of moral hazard; however, as the situation in Cambodia had been influenced by so many adverse, special factors, he was not overly concerned about the moral hazard element. Moreover, he was not convinced of the desirability of lengthening the monitoring period, as Ms. Creane had proposed. Therefore, he supported the course of action, as well as the draft decisions, that had been proposed in the two papers. He also agreed with the staff that, in the circumstances, no remedial measures were called for.

Finally, it was reassuring to learn that Cambodia had begun to formulate and implement economic adjustment policies in collaboration with--and informally monitored by--the staff, Mr. Solheim remarked.

Mr. Chen said that he wished to join other Directors in welcoming the progress that the Cambodian Government had made with respect to normalizing its relations with the Fund. The recent efforts by the donors to help Cambodia settle its longtime arrears to the Fund were very welcome and commendable; those efforts were also important in initiating the normalization process.

Chronic war in Cambodia had brought catastrophe to both the Cambodian people and the economy, Mr. Chen observed. It had also given rise to Cambodia's long-standing arrears to the Fund and the resultant deterioration in its relations with the Fund. In that regard, it should be emphasized that continuous efforts should be made by all parties concerned to achieve a final national reconciliation. In his view, that was a crucial element, as it would determine whether a credible and solid political basis could be established, which could, in turn, sustain the permanent rehabilitation and reconstruction of the devastated economy. It should be recognized that, at present, potential elements of instability and uncertainty remained in Cambodia that could prevent the authorities from implementing a thorough and sustainable overhaul of the economy.

Nevertheless, the recent positive developments, as well as the actions that the authorities had committed themselves to taking, would contribute to the success of the process, Mr. Chen considered. It was imperative that the international community should not hesitate to encourage and assist the authorities in the various aspects of their endeavors. The Fund, in particular, should not refrain from proceeding along those lines; accordingly, he supported all the proposed decisions set out in the staff papers.

Mr. Meron said that the present Board meeting marked an important step toward the reintegration of Cambodia into the Fund membership, as well as toward the restoration of the country's economy. The three short paragraphs on page 7 of the main staff paper summarized the terrible fate endured by Cambodia and its economy during the past two decades. Having been all but devastated in the 1970s, the economy had then been subjected to central planning and direct control. More recently, after the reintroduction of some elements of the market mechanism, the economy had plunged into instability, with fiscal imbalances, accelerating inflation, and the repeated devaluation of the currency feeding upon one another.

Obviously, there was an urgent need to bring public finances under control, Mr. Meron continued. In that respect, the authorities should benefit from the Fund's guidance, as well as from its technical assistance. The forthcoming discussions on an Article IV consultation should also give both the staff and the authorities a clearer picture of the macroeconomic situation and the underlying problems. However, like Ms. Creane and other speakers, he wondered whether it might not be somewhat premature to embark on stand-by arrangement negotiations at the same time as the Article IV consultation discussions, as Cambodia had not yet had a chance to establish even a minimal track record.

Cambodia's request to apply its assets held by the Fund to the partial settlement of its overdue obligations to the Fund was a good indication of its intention to clear all of its arrears to the Fund as soon as possible, Mr. Meron considered; he supported the proposed decision concerning Cambodia's overdue obligations to the Fund. He also supported all five of the proposed decisions concerning the operational aspects of the Fund's financial relations with Cambodia.

Mr. Fuleihan said that, like other speakers, he welcomed the progress that had been made toward normalizing relations between Cambodia and the Fund. He shared the views of other speakers regarding economic developments in Cambodia. As he also agreed with the concerns expressed by Mr. Esdar about the proposed decisions on periodic and special charges and burden sharing, he was reassured by the staff's response on that point.

On the issue of the monitoring period, he, like Mr. Dorrington, saw the strength of both arguments, Mr. Fuleihan remarked. However, he agreed more with the views of Ms. Creane.

Mr. Evans said that he supported the proposed decisions. He also supported the strategy proposed by the staff for dealing with Cambodia. Although the concerns that Ms. Creane and other speakers had expressed were understandable, he believed that it would be wrong to follow the approach that they had suggested. Cambodia was a very special arrears case, and, as such, it should be given special treatment.

It was essential that the entire international community should become involved in solving Cambodia's problems, Mr. Evans remarked. In that context, the Fund would be seen as stumbling if it were to endorse a longer monitoring period. The Fund must involve itself in Cambodia wholeheartedly; at the same time, it should be recognized that, regardless of whether the authorities were implementing a monitored or a Fund-supported program, the probability that the program would go off course--given the state of the economy and the Government--was extremely high. Concerns about the ability of the authorities to implement a Fund-supported program must be met by building appropriate conditionality into the program, and by providing relevant technical assistance.

Mr. Kabbaj commented that, like previous speakers, he welcomed the resumption of normal relations with Cambodia. He commended the authorities for their efforts in that regard, and for reviving the economy. Moreover, the initial support received from the international community, as evidenced by Mr. Fukui's and Mr. Landau's statements, was encouraging. He supported all the proposed decisions.

As soon as the Government cleared its arrears to the Fund and satisfied the conditions laid down in the staff paper regarding its nonfinancial obligations under the Articles of Agreement, Mr. Kabbaj considered, the Fund should proceed with normalizing its relations with Cambodia, including through the negotiation of an appropriate arrangement.

Mr. Glazkov said that, although he understood the concern expressed by some Directors about the strategy proposed by the staff, he wished to emphasize that Cambodia's case required a special--rather than a standardized--approach. In light of the disastrous events of Cambodia's recent past, it would require tremendous efforts from both the people and the Government to revive its economy. The Fund was to be thanked for not abandoning the country during such a difficult situation. He fully supported all the proposed decisions.

Mr. Zoccali noted that the positive recent developments and actions aimed at political and economic reconciliation in Cambodia were encouraging. Although the concerns expressed by Ms. Creane and others regarding the duration of the monitoring period were understandable, special importance and urgency should be attached to the catalytic function of the Fund. Naturally, Fund support for a program would be predicated on satisfactory policy implementation and the prior clearance of the arrears. He supported the four-stage normalization strategy, as well as the decisions that had been proposed, including those relating to the operational aspects of the Fund's financial relations with Cambodia.

The staff representative from the Central Asia Department said that, at a Tokyo ministerial meeting held in June 1992, the donor community had reaffirmed its support for Cambodia's efforts by pledging to disburse \$880 million in aid over the next two to three years. Since then, however, very little aid had actually been disbursed to Cambodia, as countries had adopted a wait-and-see attitude on a bilateral basis. At the same time, almost \$2 billion was being spent in support of the UN's attempts to ensure a neutral political environment in the country. In that context, the catalytic role that the Fund could play in Cambodia was far larger than the very modest amount of the stand-by arrangement that would be considered.

The Chairman remarked that the Fund was confronted with a very unique--and extremely difficult--situation in Cambodia. It was not at all certain that the UN would succeed in its costly mission. It was certain, however, that as Mr. Evans had suggested, if the Fund were to be seen as stumbling in its job, the nascent program to rebuild the country's economy would collapse.

At the same time, the Chairman commented, in their further discussions with the authorities and the members of the Support Group, management and staff would keep in mind the concerns expressed by Ms. Creane and other speakers. The Board would be kept closely informed of all pertinent developments, particularly through the workings of the Support Group.

Mr. Esdar suggested that, with respect to the decision on the restitution of gold, it would be helpful to include wording that would indicate why the Fund was refunding gold to Cambodia. Accordingly, in the second line of the decision, the words "equivalent to Cambodia's share in the restitution of gold between 1977 and 1980," could be inserted after the word "Cambodia."

The Chairman said that he took it that Mr. Esdar's suggestion was acceptable to Directors.

The Executive Board then took the following decisions:

Overdue Financial Obligations - Review of Decisions
<u>on Complaints Under Rule K-1 and Rule S-1</u>

1. The Fund has reviewed Decision No. 5990-(78/200) and Decision No. 5989-(78/200) S in light of the facts and developments described in EBS/92/188 (11/24/92).

2. The Fund welcomes the progress toward the normalization of relations with Cambodia. The Fund further welcomes the authorities' adoption of macroeconomic adjustment policies aimed at sustained economic growth, financial stability, and balance of payments viability, and the progress Cambodia has made toward fulfilling its nonfinancial obligations to the Fund. The Fund intends to collaborate actively with Cambodia in this effort and stands ready to assist Cambodia in any appropriate way.

3. The Fund welcomes Cambodia's request that the Fund apply the assets held by the Fund on its behalf toward partial settlement of Cambodia's overdue financial obligations. Nevertheless, the Fund regrets the continued existence of Cambodia's arrears to the Fund, which places a financial burden upon other members and reduces Fund resources available to help others. The Fund

stresses that full settlement of arrears to the Fund should be given the highest priority and notes that steps toward their settlement are being taken. The Fund calls on the membership to cooperate fully in the implementation of the intensified collaborative approach so as to facilitate the prompt and full clearance of Cambodia's overdue financial obligations to the Fund.

4. The Fund will review the matter of Cambodia's nonfulfillment of its obligations to the Fund again at the time of the Executive Board's consideration of the report for the 1993 Article IV consultation with Cambodia, and in any event within four months from the date of this decision, in the light of actions taken by Cambodia in the meantime to fulfill its obligations, including the settlement of its arrears to the Fund, and to implement a comprehensive adjustment program.

Decision No. 10229-(92/149) G/S, adopted
December 11, 1992

Representative Rate for Cambodian Riel

The Fund finds, after consultation with the authorities of Cambodia, that the representative rate for the Cambodian riel under Rule O-2(b)(i) against the U.S. dollar is the rate for official transactions as determined from time to time based on market conditions by the National Bank of Cambodia.

Decision No. 10230-(92/149) G/S, adopted
December 11, 1992

Rate of Charge

Following consultation with Cambodia, the Fund has reviewed, pursuant to Rule I-7(9), the rate of charge payable by Cambodia under Rule I-7(5)(a) with respect to its holding of Cambodian riels that became subject to charge before July 1, 1974. Effective January 1, 1993, the rate of charge under Rule I-7(5)(a) on the Fund's holding of riels subject to charge shall be equal to the rate of charge determined under Rule I-6(4), as adjusted pursuant to burden-sharing mechanisms.

Decision No. 10231-(92/149), adopted
December 11, 1992

Burden Sharing

1. Effective January 1, 1993, Decision No. 9997-(92/57), adopted April 17, 1992, shall be amended as follows:

   (a) In Section II, Paragraph 1, "and Rule I-7(5)(a)" shall be added after "Rule I-6(4)"; and

   (b) In Section IV, paragraph 1: (i) "Rule I-7(5)(a)" shall be added after "Rule I-6(4)(a) and (b)," and (ii) "and Rule I-7(5)(a)" shall be added after "Rule I-6(4)."

2. Effective January 1, 1993, Decision No. 9471-(90/98), adopted June 20, 1990, shall be amended as follows:

   (a) In paragraph 1, "and Rule I-7(5)(a)" shall be added after "Rule I-6(4)";

   (b) In paragraph 2, first sentence, ", Rule I-7(5)(a)" shall be added after "Rule I-6(4)(a) and (b)"; and

   (c) In paragraph 2, first and third sentences, "and Rule I-7(5)(a)" shall be added after the words "referred to in Rule I-6(4)."

Decision No. 10232-(92/149), adopted
December 11, 1992

Restitution of Gold

In light of the request received from Cambodia, the Fund shall:

(a) sell 21,396 ounces of fine gold to Cambodia, equivalent to Cambodia's share in the restitution of gold between 1977 and 1980, in exchange for Cambodian riels at a price of one SDR per 0.888671 gram of fine gold; and

(b) accept the gold sold to Cambodia pursuant to paragraph (a) of this decision in partial payment of Cambodia's overdue financial obligations to the Fund. The gold accepted shall be valued in terms of the SDR on the basis of prices in the market by: (i) using the morning fixing price of gold in terms of the United States dollar in London on the date of the Fund's acceptance of the gold pursuant to this decision and (ii) the value of the United States dollar in terms of the SDR as determined under Rule 0-2(a) on the same date.

Decision No. 10233-(92/149), adopted
December 11, 1992

Distribution of Profits from Sale of Gold

In light of the request received from Cambodia, the Fund as Trustee shall:

(a) distribute to Cambodia through the Trust Fund Cambodia's share, amounting to US$3,990,776, in the profits from the sale of gold for the benefit of developing countries as referred to in paragraph 7 of Executive Board Decision No. 5069-(76/72), adopted May 5, 1976, and Section VI of the Instrument to Establish the Trust Fund; and

(b) apply the amount distributed to Cambodia pursuant to paragraph (a) of this decision in partial payment of Cambodia's overdue financial obligations to the Fund.

Decision No. 10234-(92/149) TR, adopted
December 11, 1992

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/92/148 (12/9/92) and EBM/92/149 (12/11/92).

3. GENERAL ARRANGEMENTS TO BORROW (GAB) - BORROWING AGREEMENT BETWEEN SAUDI ARABIA AND FUND - RENEWAL

Pursuant to Article VII, Section 1 of the Articles of Agreement, the Managing Director is authorized to send to the Minister of Finance of Saudi Arabia a letter as set forth in the attachment to EBS/92/204, proposing a further renewal, for a period of five years from December 26, 1993, of the 1983 borrowing agreement with Saudi Arabia in association with the General Arrangements to Borrow. When a reply is received from the Minister accepting the proposal, the Managing Director's letter and the reply shall constitute an agreement on the further renewal of the 1983 borrowing agreement between Saudi Arabia and the Fund, which shall enter into force on December 26, 1993.

Decision No. 10235-(92/149), adopted
December 10, 1992

4. SAN MARINO - REPRESENTATIVE RATE FOR ITALIAN LIRA AS CURRENCY OF SAN MARINO

The Fund finds, after consultation with the authorities of San Marino, that the representative rate under Rule 0-2(b)(i) for the Italian lira (as currency of San Marino) against the U.S. dollar is the quotation at the closing of the Milan and Rome markets if the quotation in each market is identical, or the middle rate between the two quotations when they differ. If official quotations of foreign currencies against the Italian lira are suspended by the Italian monetary authorities, the representative rate for the Italian lira under Rule 0-2(b)(i) will be the daily indicative rate as established and published by the Banca d'Italia on the basis of rates communicated between central banks at 2:15 p.m. (EBD/92/293, 12/4/92)

Decision No. 10236-(92/149) G/S, adopted
December 9, 1992

5. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 92/44 and 92/45 are approved.

6. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors and by an Advisor to Executive Director as set forth in EBAM/92/133 (12/8/92) is approved.

APPROVED: August 12, 1993

LEO VAN HOUTVEN
Secretary