

INTERNATIONAL MONETARY FUND

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M. Camdessus, Chairman  
S. Fischer, First Deputy Managing Director  
A. D. Ouattara, Deputy Managing Director

Executive Directors

A. A. Al-Tuwaijri

I. Clark

H. Evans

W. Kiekens

H. Mesaki

A. Mirakhor

S. Schoenberg

J. de Beaufort Wijnholds

Alternate Executive Directors

A. Fayolle

E. Srejber

J. Guzmán-Calafell, Temporary

J. M. Jones, Temporary

R. Kannan, Temporary

L. M. Cheong

W. C. Keller, Temporary

J. C. Estrella, Temporary

H. A. Barro Chambrier

N. Coumbis

B. S. Newman

A. G. Zoccali

Y. Y. Mohammed

A. V. Vernikov, Temporary

P. Jilek, Temporary

Wei B.

J. W. Lang, Acting Secretary  
M. J. Miller, Assistant

Also Present

IBRD: C. I. Wallich, Europe and Central Asia Regional Office.  
European I Department: M. Russo, Director; J. R. Artus, Deputy Director;  
G. Bélanger, A. Dayal-Gulati, M. G. O'Callaghan, J. Odenius,  
L. T. Sukselainen. European II Department: A. Gagales. External Relations  
Department: P. C. Hole, Deputy Director; R. R. Bräuning. Fiscal Affairs  
Department: A. C. Cuevas. Legal Department: F. P. Gianviti, General  
Counsel; W. E. Holder, Deputy General Counsel; P. De Boeck. Policy  
Development and Review Department: R. M. Brooks, M. E. Edo, M. Fisher,  
K. J. Langdon, C. Puckahtikom. Treasurer's Department: D. Williams,  
Treasurer; D. Gupta, Deputy Treasurer; K. Boese, J. C. Corr, H. Treichel,  
M. A. Wattleworth. Office of the Managing Director: J. Quick, Personal  
Assistant; D. Burton. Advisors to Executive Directors: S. S. Farid,  
M. F. Melhem. Assistants to Executive Directors: S. Al-Huseini, C. Austin,  
P. I. Botoucharov, M. A. Brettschneider, D. S. Hakura, J. Hamilius,  
R. J. Heinbuecher, K. Kpetigo, N. Laframboise, N. Prasad, Zheng H.

1. REPUBLIC OF BOSNIA AND HERZEGOVINA - SUCCESSION TO MEMBERSHIP  
IN THE FUND, AND EMERGENCY POST-CONFLICT ASSISTANCE

The Executive Directors met in informal session to hear a report by the staff on recent developments in the succession of Bosnia and Herzegovina to the membership in the Fund of the former Socialist Federal Republic of Yugoslavia. They also had before them a staff paper on the use of Fund resources by Bosnia and Herzegovina under the policy on emergency post-conflict assistance (EBS/95/215, 12/8/95).

The General Counsel made the following statement:

On the question of membership, three years ago to this day, the Executive Board of the Fund adopted a decision on the *dissolution of the Socialist Federal Republic of Yugoslavia*, and by this decision, the Fund found that the Socialist Federal Republic of Yugoslavia had ceased to exist and was replaced by five successor states.

The same decision set forth the conditions under which each of the five successor states could succeed to membership in the Fund, and these conditions are the same for all of them. At this stage, three successors of the Socialist Federal Republic of Yugoslavia have now become members of the Fund: the Republic of Slovenia, the Republic of Croatia, and the former Yugoslav Republic of Macedonia.

The Republic of Bosnia and Herzegovina is now taking the necessary steps to complete the membership process in the Fund. In order for this process to be completed, three conditions remain to be met. First, Bosnia and Herzegovina must notify the Fund that it agrees, in accordance with its law, to succeed to the former Socialist Federal Republic of Yugoslavia's membership in the Fund, and that it has taken all the necessary steps to do so. Second, Bosnia and Herzegovina must clear all its overdue obligations to the Fund. Third, the Executive Board must find that Bosnia and Herzegovina is able to meet its obligations under the Articles of Agreement.

The situation with regard to each of these three conditions is currently as follows. With respect to the first condition, the Managing Director was informed today by the Minister of Justice of Bosnia and Herzegovina that, on December 12, 1995, the Parliament of Bosnia and Herzegovina passed the Law on the Succession to Membership by Bosnia and Herzegovina in the International Monetary Fund and other International Organizations--that is to say, the World Bank group, in particular--and that the Law will enter into force on Saturday, December 16, 1995.

The Minister of Justice also stated that as soon as the Law enters into force on December 16, the Notification of Succession to the International Monetary Fund would be signed, and that Bosnia and Herzegovina will then be in a position to sign a Memorandum of Law confirming that all the steps required under the laws of Bosnia and Herzegovina to become a member of the Fund have been taken. In particular, the Memorandum of Law will confirm that the Law on Succession to Membership in the Fund is consistent with the provisions of the new constitution that entered into force today upon the signing of the General Framework Agreement for Peace in Bosnia and Herzegovina.

With respect to the second condition, it is expected that Bosnia and Herzegovina will clear its overdue financial obligations to the Fund on December 20, 1995, with, we understand, the assistance of a bridge loan made by the Netherlands. With respect to the third condition--that is, the finding of an ability to perform membership obligations--the signing of the Peace Agreement should enable Bosnia and Herzegovina to fulfill its obligations in accordance with the Fund's Articles, but it is for the Executive Board to make this finding.

In conclusion, if Executive Directors agree that Bosnia and Herzegovina is now able to meet its membership obligations, the membership process in the Fund could be completed by December 20, 1995.

The Director of the European I Department made the following statement:

With regard to the use of Fund resources by Bosnia and Herzegovina and, in particular, the intended request for a repurchase in the amount of SDR 30.3 million under the Fund's policy on emergency post-conflict assistance, the staff has received today the memorandum of economic policy signed by the authorities, a draft of which has already been circulated to the Board as Appendix I in the report before you. Following today's informal Board meeting, and if there is support in this Board for Bosnia and Herzegovina's membership and use of Fund resources, the Managing Director intends to send a comfort letter to the central bank of the Netherlands, which will enable the latter to start the procedure for extending a bridge loan to Bosnia and Herzegovina in the amount equal to the arrears due to the Fund. We expect, therefore, that the arrears will be cleared on December 20, thus permitting the Board to find that Bosnia and Herzegovina has met this condition to succeed to membership.

We also understand that the U.S. authorities would be helping in a similar way by providing Bosnia and Herzegovina with the SDRs needed to complete the quota increase. If on December 20 the Board approves the requested purchase, Bosnia and Herzegovina will

be in a position to repay the bridge loan and, as indicated, the authorities also intend to keep in an SDR account in the Fund the remaining amount, which would be used to meet future obligations to the Fund. This is the decision of the Bosnian authorities, to which we have acceded.

Staff members have been in Sarajevo continuously since September 21, 1995, helping the authorities in preparing legislation and other requirements for membership, as well as the economic policy memorandum. Diagnostic missions have visited Sarajevo in the areas of statistics, public finance, and central banking.

The authorities intend to request as soon as feasible an arrangement in the upper credit tranches, possibly even an arrangement under the enhanced structural adjustment facility (ESAF), if they become eligible for that facility. To the extent possible, we intend to continue with almost permanent missions in Sarajevo. We are also coordinating our work closely with the World Bank and other institutions, and we plan to open a post of Resident Representative in Sarajevo as soon as possible. The presence of the staff mission and the discussion on the economic policy memorandum have, as a useful and desirable by-product, improved communication within the Government of the Federation itself, and provided the first opportunity for a meeting with the authorities dealing with economic policy matters in the Republika Srpska. All these discussions are reflected in the staff paper.

Mr. Wijnholds made the following statement:

In light of the big strides made in recent weeks toward peace in Bosnia and Herzegovina it is now finally possible to welcome the war-torn country to the ranks of the international financial community. Of course, this is only the start of a process in which important steps need to continue to be taken for some time to secure a better future for the people of Bosnia and Herzegovina.

Economic recovery and reconstruction should make an extremely important contribution to the maintenance and strengthening of the peace process in the country. In the effort toward economic recovery, the Fund will have a very important role to play by providing financial resources and technical assistance. A rapid succession by Bosnia and Herzegovina to The Fund membership will bolster the momentum of the financing and reconstruction effort, in addition to opening the door to World Bank membership. Moreover, timely Fund membership will make way for a sustained movement toward an upper credit tranche arrangement or an ESAF, which in turn will be an important further step in the

reconstruction effort, allowing for a more lasting solution of the country's external arrears.

Succession to Fund membership hinges on two aspects: the clearance of the arrears to the Fund that Bosnia and Herzegovina has inherited from the former Yugoslav Republic, and a finding by the Board that Bosnia and Herzegovina is able to fulfil the requirements of Fund membership. The arrears are to be cleared by a bridging operation, finalized by a purchase by Bosnia and Herzegovina under the emergency assistance policy. This operation is to take place on December 21. To allow for the necessary assurance that this operation can be concluded on that date, Fund Management is seeking the support--in principle--of the Board in the meeting scheduled for December 14 for this purchase under the emergency assistance policy. In addition, an indication of support is sought from Executive Directors on December 14 for the succession to Fund membership of Bosnia and Herzegovina under the assumption that the arrears are cleared and that all other requirements for Fund membership will be in place. The Staff expects to be able to report shortly, and in any case before the December 21 meeting, that all requirements of Fund membership, excepting the clearance of arrears, have indeed been met.

It cannot be denied that uncertainties remain about the future economic and political cooperation within the different regions of Bosnia and Herzegovina. It is my conviction, however, which I trust colleagues will share, that we should base ourselves on the agreements to which the different parties have committed themselves. I would, moreover, point out that the Fund is also active in other parts of the world where similar risks exist. Adopting this positive approach toward considering the request for the use of Fund resources for emergency post-conflict assistance, two aspects may be highlighted:

Given the desperate circumstances, it can be argued that the recent track record of economic policy has been rather positive in the regions that the Staff has been able to analyze more closely. It is especially noteworthy that the monetary authorities of the Bosniac-majority area managed to tackle hyperinflation and implement a de facto currency board in the presence of all but depleted budgetary resources. Furthermore, the authorities with which the Staff and my office have had close contacts, have shown themselves to be dedicated to take appropriate adjustment measures.

The room for discretionary monetary and fiscal policy will be quite limited, in accordance with the content of the peace agreement to be signed in Paris. The Central Bank will operate as a de facto currency board, the Central Government and the Federation will refrain from borrowing from the domestic banking

system. These limitations imposed on macroeconomic policy would in themselves seem to meet the requirements of the more limited conditionality with respect to a purchase under the emergency post-conflict assistance.

As a final note, I wish to pay tribute to Management and the Staff for their rapid and dedicated response to the developments in Bosnia and Herzegovina of recent months. The Fund Staff in Sarajevo, supported by their colleagues in Washington, has made a tremendous effort in the actual implementation of the economic policy and institutional aspects of the Federation agreement and is currently playing a pivotal role in implementing similar aspects for the Republic, in line with the peace agreement for the Republic of Bosnia and Herzegovina as a whole.

Mr. Evans made the following statement:

I am grateful to the staff for its report, and to Mr. Wijnholds for his statement. I look forward to the membership of Bosnia and Herzegovina in the Fund, and I want to congratulate the staff and the Bosnian authorities on the dedication and hard work they have shown in getting to this point. The Fund has promised all along that there will be no delay in helping Bosnia to normalize relations with the outside world. The fact that we are meeting here just a few hours after the signing of the Dayton agreement in Paris says that the Fund has, indeed, well lived up to that promise.

The Fund's work here is important and largely unsung. I note that World Bank staff have worked closely with Fund staff, and I hope that that will continue. I know how much the Bank staff has relied on the expertise of the Fund in its areas of competence.

I am also grateful for the contribution that the Fund staff made in preparing for the London Peace Implementation Conference, which helped that to be successful.

I give my full support to the proposal to admit Bosnia and Herzegovina to membership in the Fund, and to make available to it immediately an amount equivalent to 25 percent of quota under the emergency post-conflict facility.

It is right to make clear what an immense task the Bosnian authorities, with the assistance of the Fund and others, face in setting up an institutional structure that will be capable of formulating and implementing coordinated policy throughout the country. We cannot overemphasize the importance of involving all parties to the maximum possible extent in operations carried out by the Fund. The current Federation government is recognized as an interim government until the elections, but if any arrangement

were to last beyond this period, it must have the full support of all sides. I was encouraged to see that contact with representatives of the Republika Srpska has been established recently, and I trust that this can be built upon.

This need for involvement of all sides could have been brought out a little more strongly in the report. We must remember that we are dealing not just with a case of reconstruction, but also of transition. We must not resurrect, or encourage others to resurrect, the old, inefficient interventionist system. That case has been brought out very well by the World Bank in its first big report on Bosnia, when it said that Bosnia was actually well placed to pursue a private-sector-led recovery, because the large state-owned enterprises are inoperative and could well be left that way.

I was a little concerned by the various references to incomes policies. So far as the public sector is concerned, I understand fully the need for such a policy, but it should be limited to that.

While I appreciate that all the calculations in the paper are extremely preliminary and of a speculative nature, even by the standards that the Board is accustomed to, we must nevertheless be on our guard against basing the financial scenarios on too high an estimate of external financing, both in terms of what Bosnia can absorb, and what the international community can realistically provide. Therefore, we may need to look at some alternative external financing assumptions.

I do very much agree with the paper that some kind of currency board arrangement for monetary policy is the most sensible and pragmatic option.

Mr. Kiekens made the following statement:

I very much welcome today's discussion, and can express my firm intention of supporting, on December 20, the proposed decisions on membership and access to Fund resources for Bosnia-Herzegovina in an amount of 25 percent of its quota under the emergency facility.

I also would like to join Mr. Wijnholds in paying tribute to Management and the staff for their rapid and dedicated response to the developments in Bosnia-Herzegovina in recent months.

On the succession to membership, I agree that with the peace agreements and the new institutional framework, Bosnia-Herzegovina is able to meet its obligations under the Articles of Agreement. I further rely on the staff's finding that all necessary steps

have been taken to enable Bosnia-Herzegovina, in accordance with its laws, to succeed to the Fund membership with the quota determined by the Board's decision of December 14, 1992.

The case of Bosnia-Herzegovina clearly fulfills all the requirements for the Fund's emergency assistance. There is obviously an urgent balance of payments need, and the Fund must play its critical role in catalyzing support from other official sources. The country's institutional and administrative capacity has been so disrupted by the conflict that it is not yet able to develop and implement a comprehensive economic program. There is, however, sufficient capacity for planning and policy implementation, and a demonstrated commitment on the part of the authorities. Mr. Wijnholds refers rightly to the de facto currency board in the Bosnia area, and to the determination of the authorities to take appropriate adjustment measures.

The constitutional requirement for a single central bank to operate as a currency board for at least the first six years is a wise decision. The most difficult aspect of the future policy design and implementation will be the high degree of decentralization of the fiscal authority. Only 5 percent of total public sector expenditures will be within the competence of the central government, while 25 percent is assigned to the Federation and the Republika Srpska, while the remaining 70 percent will be under the control of local governments. It will be critical to ensure, as the staff notes, that the authorities do not engage in borrowing that exceeds the potential to generate fiscal resources to service the loans.

Our decisions of next week will be a critical step for Bosnia-Herzegovina toward its integration into the world financial community. The new republic still has a very long way to go, during which it should receive the full assistance of the Fund, including the much needed technical assistance, as well as the generous support of bilateral donors. With its Fund membership, Bosnia-Herzegovina accomplishes only one step, albeit a very important one, in its succession to the former Socialist Federal Republic of Yugoslavia. Many succession issues remain under discussion in the succession conference in Geneva. The international community can be most helpful for Bosnia-Herzegovina by using its influence on all parties to these discussions to come to an early and equitable conclusion, and to assure Bosnia-Herzegovina's fair share in the assets of the former Socialist Federal Republic of Yugoslavia, in particular the foreign reserves held in other countries in the name of the former Central Bank of Yugoslavia. These assets were long frozen under the sanctions resolution of the U.N. Security Council. Since the suspension of these sanctions, the authorities of each country where these assets are held are expected to take appropriate

measures to facilitate the expeditious collection of the funds and assets still held in the name of the former Central Bank of Yugoslavia and possibly other entities, and their transfer to the appropriate parties and the resolution of claims related thereto.

Mr. Al-Tuwaijri made the following statement:

I welcome the signing of the General Framework Agreement for Peace in Bosnia and Herzegovina. This agreement has put an end to the devastating civil war and sparked a glimmer of hope for the people of Bosnia and Herzegovina.

It is time now to move expeditiously with the difficult process of economic reconstruction of the country. In this regard, I join Mr. Wijnholds in paying tribute to Management and the staff for their rapid and dedicated response.

I am confident that the Board will be no less expeditious in approving Bosnia and Herzegovina's succession to Fund membership once the arrears are cleared and other requirements for Fund membership are in place. I am also confident that the Board will approve the use of Fund resources for emergency post-conflict assistance.

It goes without saying that such a use of Fund resources poses large risks. However, the post-conflict facility was created for precisely this kind of situation including the associated risks. Moreover, as noted in Mr. Wijnholds' statement, the strong commitment of the authorities to take appropriate adjustment measures, as well as the limited room for discretionary monetary and fiscal policies provide some assurances.

In conclusion, I wish Bosnia and Herzegovina all the success in the coming period and support its succession to Fund membership as well as its request for use of Fund resources under the post-conflict facility.

Mr. Newman made the following statement:

This morning's signing of the peace agreement in Paris marks a historic opportunity for reconciliation in Bosnia and Herzegovina. The Fund also is faced with a historic opportunity to support this process through its efforts in encouraging the country onward in its economic stabilization, adjustment, and reform policies. We share Mr. Wijnholds's view that a rapid succession by Bosnia and Herzegovina to Fund membership will bolster the momentum of the financing and reconstruction effort, and we welcome the comments by the General Counsel today that indicate that we are almost there, and will be able to complete the process next week.

We with also would like to join others in commending the staff and the Fund as an institution for the role they have played over the last several months in helping the authorities develop an economic program, in contributing to the process that led to the agreement in Dayton, and for the subsequent efforts they have made both in the London conference and in Paris. I am confident that the Fund will continue to play a critical role in the days, weeks, months, and indeed, years ahead.

The program builds on progress already made by the authorities in a number of areas over the past year in what was clearly most trying conditions. The real work, however, is just beginning, and the task is clearly a daunting one. Success will depend on each region learning to cooperate to fulfill the commitments that have been made at both the political and economic levels. It is clear that it will take time for the two entities to begin functioning as integral parts of a new republic. This uncertainty will pose significant risk for all concerned. The risks to implementation are discussed candidly in the staff paper, and where possible, the program has been designed to minimize these risks. The unique aspect of this program is that it not only minimizes the risks, but it enhances the incentives for the various sides to cooperate with one another as part of an integral whole. We hope that as the program moves forward in these areas, it will act as a unifying force to help strengthen the country as a single entity.

This is particularly true in the framework of monetary and fiscal policy. Both areas necessarily require rules that limit policy independence in an environment in which economic data and policy administration and coordination are weak or lacking, and must be created. We recognize that there is significant room for slippage given that effective economic policy coordination mechanisms among the regions remain in the earliest stages of development. Nevertheless, we believe that the risks are well worth taking.

Regarding the program itself, the new constitution calls for the establishment of a single central bank that will act as a currency board for the first six years of its life. This a vital step, and we fully support it. We recognize that the challenges ahead to establishing a successfully functioning central monetary authority are large, but the engagement of the Fund in helping to design the new authority--indeed, in even selecting its new president, as well as providing technical assistance along the way--bodes well for a successful outcome. We commend the efforts of the Fund in this regard. The discipline imposed by a currency board arrangement is the most direct route to stemming renewed hyperinflation. In the medium term, it will act as a unifying

force among the diverse economic and currency arrangements currently existing in the different entities.

On an interim basis, the existing central bank will be in Sarajevo, and will be the sole monetary authority until the new central bank can be established, hopefully over the next year. Each region will also be expected to implement a currency board arrangement until the single central bank is established. It is essential that the single central bank be established and begin functioning as soon as possible, both to enforce a single monetary policy, and to start building the economic ties that will lead to an effective common currency.

There are, perhaps, even greater challenges ahead for fiscal policy. Although part of the country has been operating on a cash basis since last year, policies to curtail government borrowing from the domestic banking sector will need to be formalized. Additionally, it is crucial that all levels of government continuously monitor and reduce spending priorities when revenues fall short, as they almost certainly will. We fully agree with the staff that there is also an immediate need to develop and implement adequate mechanisms to safeguard against excessive foreign borrowing that exceeds the long-term capacity to repay, and here, I would caution donors to also be mindful of the administrative and other constraints that exist in Bosnia and Herzegovina, as much as we ask the authorities to be mindful of their ability to borrow.

Each level of government will need to build up revenue sources, which will take time. The moves toward a unified customs administration are clear steps in the right direction. All avenues of revenue need to be mobilized, since shortages in government receipts are such a large magnitude. At the same time, we need to recognize that all steps to maximize revenue may not pan out. In this vein, although the Federation may be considering a 5 percent import duty on reconstruction-related imports paid by donor assistance, it would be prudent to make sure that such steps do not prejudice the amount of assistance that might be forthcoming from donors, and here, prudence in expectations might be advisable on the part of recipient and donors alike. In light of limited revenue flows, the Government will need to set clear spending priorities, including on social spending. Pensions, for example, will need to be brought more in line with the ability to pay. Major budgetary savings will also be available for privatization and rationalization of major government-owned firms, and here, I take Mr. Evans's point that we should not try to recreate the old, but rather should start afresh, and see if we can avoid some of the problems that occurred in the former Yugoslavia in the past. In this area, of course, of particular concern to this institution is the development of a bank

enterprise system that is fully and soundly based on prudent policies.

It goes without saying that the technical assistance needs of Bosnia and Herzegovina are huge. Economic institutions need to be built, in many cases from the ground up, and other immediate assistance needs challenge all of us. The United States looks forward to being a part of the international effort in this respect, and to coordinating with the Fund and the Bank on this essential work. In this regard, I would note that we are already working closely with the Bosnian Federation to provide technical assistance, and we are willing to do more when appropriate opportunities arise. I would close by underscoring once again that the main burden in restoring peace and prosperity on the new nation will need to be carried by the citizens themselves. There is, however, a major role for the international community. We believe that the reform program before us today provides a solid first step. We in the United States will do everything we can to help that process, and to move forward as rapidly as possible. I am confident that all the other countries represented around this table will do likewise.

Mr. Vernikov made the following statement:

We welcome the signing of the historic peace agreement.

Allow me to congratulate the staff for the great amount of work on Bosnia and Herzegovina that they performed within a limited period of time. It was difficult work, mainly field work, and it comprised establishing and maintaining contacts with the various parties involved and finding a compromise between different views.

I also welcome the clarifications made by Mr. Gianviti concerning the legal formalities of succession to membership by Bosnia-Herzegovina. I noted that there are good chances for these formalities to be completed by December 20, 1995. Normalization of Bosnia-Herzegovina's membership in the Fund will constitute a great step ahead forward toward completion of succession to membership of all states that have emerged in the place of the Socialist Federal Republic of Yugoslavia.

As for economic and financial policies in Bosnia-Herzegovina, I believe we will have a good opportunity to discuss them in detail rather soon, that is, on December 20. I am looking forward to that discussion.

Mr. Schoenberg made the following statement:

We highly appreciate the work done by the staff for the preparation of the report in very difficult circumstances.

I can support the use of Fund resources to the extent of SDR 27.2 million as emergency assistance in the post-conflict situation in Bosnia and Herzegovina based on the understanding that all steps will be taken in advance which are necessary for obtaining Fund-membership and for clearing all arrears to the Fund.

I also can share in principle the policy advice to the authorities as presented in the staff document. For the time being and under existing uncertainties and constraints the subordination of financial policies to the tight set of policy rules which the staff has outlined, seems indispensable in order to prevent a weakening of the still weak fundament for further reforms in the context of a comprehensive medium term framework.

At this stage it seems of special importance to make every effort to build quickly functioning institutions and implementation capacities.

Besides these general remarks let me make the following three remarks for emphasis:

First, to contain the risks inherent with potentially diverging of fiscal policies in the different parts of the country, it might be helpful not only to agree on a "no bail-out" clause as for instance included in the Maastricht Treaty, but also to strive for stability-oriented arrangements between the area governments to limit budget deficits to agreed levels.

Second, the plan of the Federation authorities to finance the budget with a 5 percent import duty on reconstruction-related imports paid by donor assistance seems worth considering. I wonder, however, whether it would be more efficient at least at this early stage in light of the limited implementation capacities and institutions to simply ask donors to set aside 5 percent of their assistance for administrative purposes.

Third, the staff's scenario for the next 12 months or so entails the setting up of a currency board system to be run by a common Central Bank. Such a basically automatic pilot-monetary arrangement seems appropriate as a transitory solution due to prevailing circumstances. However, such a currency board needs an appropriate amount of foreign exchange which is probably much higher than the level of reserves of the existing currency board in the Bosnic area. Maybe the staff can comment what the plans

are to equip the proposed currency board with sufficient reserves and if there are already plans to channel circulating foreign currency to the Central Bank in exchange of domestic currency.

Mrs. Latifah Cheong made the following statement:

I join others in welcoming the Dayton Peace Agreement. I also wish to express the appreciation of my authorities for the Fund's quick response to assist the re-establishment of sound economic management in Bosnia and Herzegovina. I note Mr. Evans' comment on the preliminary nature of the data in the staff report, but nevertheless am in broad agreement with the staff appraisal as well as the points raised in Mr. Wijnholds' helpful statement.

This chair supports the proposed bridging operation via a purchase under the emergency assistance policy for Bosnia and Herzegovina to clear its arrears to the Fund. Such assistance would be in line with the criteria set out under the policy on emergency assistance for post-conflict countries. In this regard, I am encouraged by the authorities' intention to move toward an upper credit tranche or ESAF program as soon as a comprehensive economic program can be finalized. More importantly, as Mr. Wijnholds and the staff rightly pointed out, the authorities have already demonstrated their commitment to pursue appropriate financial policies, with the institution of a de facto currency board and safeguards to avoid domestic bank financing of the budget.

We can also support, in principle, the succession to Fund membership of Bosnia and Herzegovina, once all arrears and other membership obligations have been settled. We appreciate the staff's efforts to facilitate a speedy succession to Fund membership which is essential for Bosnia and Herzegovina's return to the ranks of the international community. In this regard, we will continue to support the Fund playing its appropriate role in providing the necessary financial and technical assistance, and in the process, act as a catalyst for stronger financial assistance from the international community.

On a country basis, I wish to inform the Board that some members in my constituency remain committed to provide assistance in restoring civil order in Bosnia and Herzegovina. We have also received reports that the Organization of Islamic Countries are meeting within the next few days to decide on the nature of their assistance in the reconstruction efforts of Bosnia and Herzegovina.

Mr. Zoccali made the following statement:

I wish to join other speakers in commending Management and the staff for their dedication and fruitful results. Similarly, I would like to echo the sentiments expressed by Mr. Wijnholds in his helpful statement regarding the importance of securing economic recovery and reconstruction for the strengthening of the peace process in Bosnia and Herzegovina.

Despite a climate of understandable uncertainty regarding future economic and political cooperation within the different regions, the apparent commitment of the parties and the first steps taken by the authorities to restore economic order to reduce the margin for discretionary monetary and fiscal policy in the context of a currency board arrangement are reassuring. They set the stage for a credible transition toward a quantified policy framework consistent with the urgent technical support from the international community.

On these, this Chair supports the succession to Fund membership of Bosnia and Herzegovina on December 21 and is ready to consider warranted the full-scale involvement of the Fund under its Policy of Emergency Assistance in Post-Conflict Countries.

Mr. Keller made the following statement:

We welcome the historical agreement signed today. We appreciate the staff's and management's quick response to the peace process. We would like to thank them for the hard work they have already undertaken--and will have to continue to undertake--to lay the bases for the analysis of the economic situation in Bosnia and Herzegovina, as well as--more importantly--for a successful initiation of economic policy. This work, including intense technical assistance, is the key to a rapid strengthening of the economic pillar of the peace process and the integration of the new Republic. It has opened the way for the Republic of Bosnia and Herzegovina to a head-start as a new Fund member.

Indeed, the staff report, albeit still mostly relying on tentative information, gives a first assessment of the situation and the daunting reconstruction and development challenge ahead. Closer to the Fund's mandate, it takes stock of the authorities' understanding of the principles for sound economic policy. Their encouraging stance clearly deserves early support by the Fund.

Under the present circumstances, a currency board system--enforced by provisions to avoid spontaneous credit creation--is clearly the only viable option. This set-up, however, has to be underpinned by quick and decisive action on the

structural front. The restructuring of the financial system and the reconstruction of enterprises should be done on a realistic assessment of the value of still existing assets and in reference to an unequivocal market-oriented model. This implies simultaneous systemic transformation of the economy, including the institutional system.

We are looking forward for Bosnia and Herzegovina meeting all the necessary conditions for Fund membership by December 20. Although we were critical on the use of Fund resources in post-conflict situations, we recognize that we are presented here with a case where such emergency assistance is justified. We, however, hope that this assistance can be supplemented early by support in the framework of a regular Fund program.

Ms. Srejber made the following statement:

I have read the staff's paper on the Republic of Bosnia and Herzegovina with great interest. It is indeed a fragile balance that is in the process of being established, and I am very impressed by the staff's early and valuable involvement in this process. I certainly believe that the Fund--in close cooperation with the World Bank and other multilateral institutions--has a role to play in laying the foundation for a rapid and sound development in the area.

I find a further Fund involvement in Bosnia and Herzegovina to be a logical consequence of the active support that is given to the efforts in creating peace in this area - both from countries in the international community and from other multilateral institutions.

I find the--so far limited--proposals for Fund assistance to be fully in consistence with the policy for Fund involvement in post conflict countries, and as soon as Bosnia and Herzegovina has prepared the conditions for membership, I stand ready to support the formal decisions that have to be taken.

Mr. Mesaki stated that, like other speakers, he very much welcomed the peace agreement for Bosnia and Herzegovina. He commended the dedication of the management and the staff for the difficult work they had done. He wished also to express his appreciation to the Netherlands and the United States for their contributions.

He fully supported the proposal to find that Bosnia and Herzegovina would succeed to the membership in the Fund of the former Socialist Federal Republic of Yugoslavia at a Board meeting on December 20, 1995, Mr. Mesaki continued. He also fully supported the proposed purchase under the emergency post-conflict assistance facility. He assumed that the criteria under which such assistance would be extended--for the first time, as he

understood it--was that laid out in the Chairman's summing up of the Board's discussion of that matter on September 19, 1995.

He was unsure about the difference between a drawing under the first credit tranche and a purchase under the facility for emergency assistance, Mr. Mesaki observed. In the case currently before the Board, he wondered whether emergency assistance was being sought instead of a first credit tranche drawing because the expectation was that emergency assistance would be followed by a request for an ESAF arrangement or an arrangement in the upper credit tranches.

Mr. Mirakhor stated that he associated himself fully with Mr. Kiekens's statement. In particular, he adhered to Mr. Kiekens's point about the share of Bosnia and Herzegovina in the former Yugoslavia's assets. He also wished to express his appreciation to both the management and the staff for their efforts, as well as to Mr. Wijnholds and his Government for their work in bringing the matter to the Board at such an early but ripe juncture. He fully supported Bosnia and Herzegovina's succession to membership in the Fund, as well as its access to the use of emergency resources. He looked forward to welcoming Bosnia and Herzegovina as a full member of the institution.

Mr. Clark stated that he would like to commend the work of all those who had contributed to the cooperative and sensible proposals before the Board. Few would have predicted, just six months previously, when the Board was discussing the emergency assistance for post-conflict situations, that it could actually be considering applying it to Bosnia and Herzegovina in 1995. He would gladly support the proposed decisions on December 20.

Mr. Guzmán-Calafell stated that, like previous speakers, he welcomed the progress that had been made toward restoring peace in Bosnia and Herzegovina. His chair would be happy to support the succession to Fund membership of Bosnia and Herzegovina, as well as the purchase requested under the emergency assistance policy. He wished to join other Directors in congratulating the management and the staff for the rapid response to developments in Bosnia and Herzegovina in recent months.

Mr. Coumbis stated that he joined Mr. Wijnholds and previous speakers in congratulating the management and the staff of the Fund and the Bank for their immediate and successful response to the developments in Bosnia and Herzegovina. Peace in Bosnia and Herzegovina was a fact, and he would be happy to welcome the country into the international financial community. He agreed with the policy advice given by the staff for the stabilization and restructuring of the economy, and he supported the use of Fund resources and the succession of Bosnia and Herzegovina to Fund membership.

Mr. Mohammed stated that he wished to join other speakers in paying tribute to the staff and management, and to Mr. Wijnholds, for their hard work in preparing the groundwork for the impending membership of Bosnia and Herzegovina, and for their immediate response to the need for emergency

financing under the policy on post-conflict assistance. He would definitely support both proposals.

Mr. Fayolle stated that he wished to join other speakers in welcoming the current meeting, and to commend the staff for the paper. Like Mr. Newman, he agreed that it was necessary not to underestimate the challenges that the authorities were currently facing. He was ready to support the proposed decisions on December 20.

With respect to the Paris Club's conditions for a future arrangement with Bosnia and Herzegovina, he understood that many members of the Paris Club were ready to support extending Naples terms to Bosnia and Herzegovina, along with deferral of post-cutoff date debt, Mr. Fayolle observed.

The Chairman observed that all speakers appeared to wish to join their colleagues in warmly supporting the proposals.

The Director of the European I Department stated that some of the requirements for membership, particularly the enactment and coming into effect of the legislation, was purely technical, in the sense that Parliament had approved the legislation, and it had been published in the official gazette. The passage of a certain amount of time after publication in the gazette was needed before the legislation could become effective.

Any subsequent Fund-supported program for Bosnia and Herzegovina would address the problems of structural reforms, the Director continued. As Mr. Evans had intimated, it was an opportune time to create a new economic system, as the old system was largely in ruins. At the same time, given what was known about the behavior of wages and the incentive structure in labor relations in the former Yugoslavia, controls on wages in the public sector would remain essential.

The currency board arrangement would ensure that there would be no domestic credit creation, which was a safeguard for the program, the Director considered. The staff would need assurances that the currency board system would not break down. In its next report to the Board, the staff would present a more complete program. It was to be hoped that that report could be brought to the Board some time in the spring of 1996. It would contain details on all the policies--some of which the staff was already discussing with the World Bank, in particular--that would need to be implemented.

With regard to the question of the origin of the foreign reserves needed to underpin the currency board, it needed to be borne in mind that the National Bank of Bosnia and Herzegovina was already operating as a de facto currency board, and there were already enough reserves to cover the monetary base, which was all that was needed normally for a currency board, the Director pointed out. In the future, foreign exchange would have to come from sales of foreign exchange arising from a balance of payments surplus. In any case, there were significant amounts of foreign exchange in

the hands of the public and circulating in the country at present, which would have to be converted into local currency in order for it to become part of the money supply. It was clear that there would be strains in the system, and that the currency board would not be easy to administer, especially if the fiscal resources of the country were not developed. That was why an arrears buildup, in particular for wages and other transfer payments, would be allowed at least in the initial phases of the program. That was one way to contain spending and cut incomes. While it could be admitted that that was not a very orderly way of restraining expenditure, under the circumstances it was difficult to find an orderly way. In time, and the staff hoped soon, institutional developments, the reestablishment of the fiscal infrastructure, and agreement at the various levels of government on how to finance spending, would enable the currency board to operate with less strain. The currency board was specified in the constitution, and would have to be operated for six years, so it would not be a temporary system.

In his view, all of the criteria for a purchase under the emergency facility for post-conflict cases had been met in the case of Bosnia and Herzegovina, the Director stated. At the same time, it was clear that the staff did not have a quantified policy framework to work from, and in consequence, the staff was relying on institutional arrangements. A first credit tranche drawing would have needed to have had some quantified framework. The emergency facility had been created to assist a country whose institutional and administrative capacity had been disrupted by conflict, and which was not yet able to develop and implement a comprehensive economic program, but nevertheless had sufficient capacity for planning and policy implementation, as well as a demonstrated commitment to a policy of adjustment; all of those applied to the case of Bosnia and Herzegovina. Moreover, the country needed Fund resources to act as a catalyst to generate additional funding from outside. With respect to conditionality, Bosnia and Herzegovina fulfilled the requirement that a country would have to request an arrangement in the upper credit tranches in the future--that was the stated intention of the authorities. The conditions also required a statement of economic policy and, to the extent possible, a quantified macroeconomic framework; the staff believed that, in the case of Bosnia and Herzegovina, the latter was not possible at the current juncture.

It was the tradition of the staff not to prejudge the decision of the Paris Club with respect to its treatment of countries that came before it, the Director concluded.

The Chairman added that it was not unusual for the Paris Club to treat countries a bit better than the Fund staff usually assumed, with its characteristic conservatism. In the case at hand, he would encourage the Paris Club to match its best standards in that regard.

He wished to thank Directors for their readiness to accept such an unprecedented procedure, the Chairman continued. In particular, he wished

to thank the U.S. authorities and the Netherlands authorities for having arranged the two necessary bridging arrangements, which allowed for the succession to membership and emergency assistance to be set in progress.

At the suggestion of the Bosnia and Herzegovina authorities, he would issue a brief press statement that day, the Chairman concluded, noting that the Fund was starting to clarify the complicated sequence of operations that would lead from membership to financing through the new emergency facility, following the clearance of Bosnia and Herzegovina's arrears to the Fund.

Directors agreed to consider these matters in formal session on December 20, 1995.

LEO VAN HOUTVEN  
Secretary

