NOT FOR PUBLIC USE

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 91/114

3:15 p.m., September 4, 1991

M. Camdessus, Chairman
R. D. Erb, Deputy Managing Director

Executive Directors	Alternate Executive Directors
M. Al-Jasser	A. A. Al-Tuwaijri
	L. E. N. Fernando
	J. Jamnik, Temporary
	Zhang Z.
	Q. M. Krosby
J. de Groote	J. Jonas, Temporary
E. A. Evans	G. H. Spencer
R. Filosa	B. Bossone, Temporary
M. Finaish	A. F. Mohammed
M. Fogelholm	I. Fridriksson
	B. Esdar
	S. von Stenglin, Temporary
J. E. Ismael	
	G. Bindley-Taylor, Temporary
	J.-F. Cirelli
	H. Dognin, Temporary
	H. Golriz, Temporary
L. B. Monyake	L. J. Mwananshiku
	P. Wright
	D. Sparkes, Temporary
G. A. Posthumus	
C. V. Santos	N. Toé, Temporary
	E. Martínez-Alas, Temporary
	L. E. Breuer, Temporary
H. Fukui	N. Tabata
	S. Shimizu, Temporary

J. W. Lang, Jr., Acting Secretary
S. L. Yeager, Assistant

Also Present

IBRD: F. D. Levy, Economic Advisory Staff. African Department: M. Touré, Director; E. L. Bornemann, Deputy Director; M. E. Bonangelino, C. V. Callender, J. Kakoza, M. M. Mateus, M. R. S. Sebastiao, R. C. Williams. Southeast Asia and Pacific Department: M. J. Fetherston. European Department: A. R. Boote. Exchange and Trade Relations Department: J. T. Boorman, Director; J. Ferran, Deputy Director; T. Leddy, Deputy Director; A. Basu, R. M. Brooks, B. Christensen, M. E. Edo, K. M. Meesook, Y. Okubo, C. Puckahtikom, K. P. Regling, F. J. Rozwadowski, G. L. Terrier. External Relations Department: E. Ray. Fiscal Affairs Department: I. Coelho, A. G. A. Faria, S. Gupta, C. Liuksila, H. R. Lorie, W. R. Mahler, K. Nashashibi. Legal Department: R. Munzberg, Deputy General Counsel; H. Elizalde. Secretary's Department: A. Tahari. Treasurer's Department: D. Williams, Treasurer; G. Wittich, Deputy Treasurer; E. Decarli, D. Gupta, B. B. Zavoico. Personal Assistant to the Managing Director: B. P. A. Andrews. Advisors to Executive Directors: M. B. Chatah, B. R. Fuleihan, A. Gronn, M. Nakagawa, Y. Patel, D. Powell, A. Raza. Assistants to Executive Directors: J. R. N. Almeida, P. Bonzom, N. A. Espenilla, Jr., S. K. Fayyad, S. Gurumurthi, M. E. Hansen, P. Kapetanovic, W. Laux, J. K. Orleans-Lindsay, L. Rodríguez, S. Rouai, Tin Win, J. W. van der Kaaij.

1. STRUCTURAL ADJUSTMENT FACILITY, ENHANCED STRUCTURAL ADJUSTMENT FACILITY, AND ESAF TRUST - REVIEW OF OPERATIONS

The Executive Directors continued from the previous meeting (EBM/91/113, 9/4/91) their consideration of a staff paper reviewing the operations of the structural adjustment facility (SAF), the enhanced structural adjustment facility (ESAF), and the ESAF Trust (EBS/91/109, 7/2/91; and Sup. 1, 7/15/91), together with a paper on the fiscal dimensions of adjustment in SAF/ESAF countries (EBS/91/142, 8/26/91). They also had before them a background paper on the structural adjustment and enhanced structural adjustment facilities (EBS/91/110, 7/8/91).

Mr. Filosa made the following statement:

On the occasion of the previous review of the operations of the SAF and the ESAF (EBM/90/105 and EBM/90/106, 7/2/90), several chairs, including my own, were concerned about two worrisome developments. The first was the observation that few ESAF arrangements were approved in 1989, and the second was that eligible countries showed a marked preference to negotiate low-conditionality programs under the SAF instead of making recourse to the more comprehensive, and supposedly more effective, provisions of the ESAF.

In this respect, the current review suggests that overall developments in 1990 with respect to the two facilities is even less encouraging. In fact, the number of new arrangements approved is now on a steadily declining path for both facilities, notwithstanding the fact that the overall economic conditions of eligible countries still call for quick and far-reaching adjustment.

At first sight, a declining trend of new arrangements toward the expiration of these two temporary facilities might not appear to be exceptional. However, the intensity of the decline and, more important, the fact that only a limited number of ESAF-eligible countries have availed themselves of the facility, leads me to believe that the falling number of new arrangements reflects mainly a lack of willingness and ability to successfully implement Fund programs.

In my view, the staff's explanation for the slow pace of commitment of ESAF resources confirms this assessment. In fact, the staff indicates that the main reason behind the low number of new ESAF arrangements is "the time needed from progression from SAF to ESAF." This is tantamount to saying that eligible countries are reluctant to move away from low conditionality to standard conditionality. Furthermore, the weak track records under SAF-supported programs and the disappointingly slow progress of arrears countries in settling their overdue obligations to the

Fund confirm a general unwillingness and inability to correct counterproductive economic policies.

For this reason, I strongly support the staff's view that the Fund should support programs only after being reassured of members' political commitment to strong economic reforms. In addition, it would be highly desirable that members have successfully implemented important prior actions. The improvement in the design, coverage, and monitoring of programs is important, and I support the staff's suggestions, but these improvements can yield positive results only if there is the political will to undertake and sustain adjustment.

Against this background, however, the staff states that around 20 new arrangements--15 of which would be under the ESAF--could be requested before November 1992. I would be pleased to witness such a dramatic reversal in the past negative trend, and I would like to know more from the staff about the reasons behind such a dramatic change in attitude of the eligible countries. In the case of the ESAF, in particular, even assuming that all countries will complete their third-year SAF arrangement, some 10 additional members would have to be willing to undertake strong programs if the estimated 15 new ESAF arrangements are to be realized. Would eligible members need less time to progress from the SAF to the ESAF, thus removing the main determinant of the slow pace of new ESAF arrangements observed in the past?

As to the results achieved by countries which have undertaken programs supported by the SAF and the ESAF, I will limit myself to three points: the setting of program objectives, the role of structural reforms vis-à-vis Fund expertise, and the exchange rate regime.

Concerning program objectives, while I am glad to observe that growth performance has improved in more recent programs, I am concerned that external viability and progress in reducing inflation remained elusive, and that when progress has been achieved, it has remained fragile and easily reversible. This raises a number of issues that need to be addressed.

First, I remain skeptical about the fact that the staff finds only a limited correlation between growth on the one hand and the external position and inflation on the other. Indeed, unless programs are capable of significantly increasing productive capacity, particularly export capacity, I believe that program objectives should continue to focus mainly on external viability and less on growth that inevitably would become unsustainable. Since achieving an early supply response is unlikely, like Mr. Esdar, I am afraid that growth has been obtained at the expense of ambitiousness in the setting of macroeconomic targets.

From the staff paper, however, it appears that medium-term viability has been a feasible objective only in one half of the ESAF arrangements. In the remaining cases, the achievement of medium-term balance of payments viability has remained a lengthy process or, in some extreme cases, an impossible objective to achieve at all without the determinant role of donor countries. In these cases, I believe that the role of the Fund, including the provision of financial resources, has been essential. However, one cannot escape the conclusion that an excessively prolonged use of resources is not compatible with the role of the Fund.

A second point of concern is that the overall improvement made in program countries is due largely to progress in implementing structural reforms. Key structural reforms also are crucial to make program countries more resilient to shocks. While the Fund could play a central role in some important structural areas, as the paper on the fiscal dimension of adjustment clearly shows, in the end, the success of ESAF-supported programs depends heavily on the expertise and advice of other institutions, like the World Bank, which are better placed to deal with structural reform. In the past, the World Bank has actively participated in the design of structural reforms, and Fund-Bank cooperation has yielded results. In the future, I am concerned about the possible negative effects that the Bank's stated policy of reducing its adjustment lending could have on the success of ESAF-supported programs. Could the staff comment on this point?

As to the exchange rate regime, I am surprised at Directors' negative reaction to the staff's statement that there is no clear linkage between the choice of exchange rate mechanism and the success in implementing fiscal and monetary policy. I would tend to agree with the staff in the sense that all effective exchange rate regimes require financial discipline. As the Board concluded on several occasions when it discussed the international monetary system, no exchange rate regime is capable of imposing financial discipline.

Which exchange rate regime is most desirable in the case of SAF/ESAF countries is another issue. But, here, too I do not see reason, a priori, to decide which exchange rate system is preferable in SAF/ESAF eligible countries. I have doubts that in these countries a fixed nominal exchange rate is superior to a flexible exchange rate system. On the contrary, the CFA franc experience suggests that a flexible exchange rate could permit a better balance of policy instrument by relieving the unbearable burden on fiscal policy and wage policy and avoiding income and import compression. In addition, a flexible exchange rate in these countries would allow an improvement in the export competitiveness and thus a better growth response to adjustment in a context of financial discipline.

In this context, it is surprising that the staff paper only cursorily refers to the importance of structural reforms in the financial sector. We have a well-written paper on the fiscal dimension of adjustment but surprisingly, a companion paper on the financial sector is not included in the documents for today's discussion. I believe that in the future we should devote more attention to the issue of financial reform in SAF/ESAF countries: the construction of a vital financial sector should rank high in the structural policy priorities of SAF/ESAF eligible countries. No exchange rate regime can be expected to be viable or be effective if it is not supported by a healthy, efficient financial sector.

On operational aspects, I will concentrate my remarks on those proposals on which my views differ from those of the staff, namely, the proposals to augment access and to extend ESAF assistance for a fourth year. I have difficulty in accepting these two proposals because they lead to modifications of our guidelines that are not justified by major changes in the world economy or in the internal economic conditions of eligible countries vis-à-vis the situation prevailing at the time of the establishment of the ESAF.

With respect to the proposal to allow the augmentation of access to ESAF resources in order to help members cope with unforseen financial needs, my reservations arise from the fact that such augmentation would amount to introducing surreptitiously an unconditional contingency mechanism, which would fundamentally alter the nature of ESAF operations. In fact, ESAF resources were originally intended to be used to finance medium-term structural adjustment rather than compensate short-term balance of payments fluctuations. When at the outset of the Middle East crisis, it was decided to allow the augmentation of ESAF resources, the decision was essentially aimed at coping with a potentially disruptive event attributable to a well-identified adverse change in one crucial relative price affecting the majority of ESAF-eligible countries. The suggestion to allow augmentation in general, for reasons beyond the effects of the Middle East crisis, is tantamount to proposing that changes in any one of the innumerable relative prices or variables affecting balance of payments could trigger modifications in the level of access that was judged appropriate at the time of the approval of the ESAF arrangement. Usually access is determined in such a way as to be sufficient to sustain changes in the major determinants of the balance of payments. If ESAF programs need to be protected against shocks, this objective can be achieved through the use of the relevant provisions of the compensatory and contingency financing facility (CCFF).

But even if I am prepared to accept that in very exceptional instances, a good case could be made for augmenting access, I would note that augmentation as proposed by the staff would not be subject to any guideline, and the modalities for its implementation would be entirely discretionary. Furthermore, in the staff proposal, prior actions by the country concerned to reduce the negative effects of shocks are not taken into consideration in justifying the augmentation. As a consequence, ESAF resources would be used automatically to fill, as a residual financing item, financial gaps caused by an exogenous shock.

Concerning the extension of ESAF assistance to a fourth year, I continue to see a significant difference between the temporary decision to cope with the Middle East crisis and the decision to allow countries to prolong the three-year period of the ESAF in general. This is a belated change of a basic operational feature of the ESAF for which I fail to find convincing justifications. The staff considers that a fourth-year ESAF arrangement would be desirable in a wide variety of country circumstances. I believe that such a provision would implicitly confirm that a sequence of multiyear SAF and ESAF arrangements have not been used appropriately to set sufficiently ambitious medium-term external targets in Fund-supported programs. Perhaps more important, the possibility of extending ESAF assistance to four years, given the deadline of November 1992 for the commitment of ESAF resources, would favor a limited minority of countries, thus discriminating against those members that are still in an early stage of their ESAF-supported adjustment. In sum, like Mr. Al Jasser, I see these proposals as potentially giving special advantages to certain countries, which would violate the principle of uniformity of treatment. With this observation, I support the proposed decision.

Mr. Zhang made the following statement:

We welcome this review of the operations of the SAF, the ESAF, and the ESAF Trust and wish to commend the staff for the comprehensive and useful information prepared for today's discussion. We broadly agree with the staff's analysis on the major issues concerning the operations of the facilities and can go along with the proposed decisions. I would like to make only a few brief observations.

The operations of the SAF and the ESAF since the last review have been successful to a certain degree. As shown in the background paper, improvements in the major target areas of GDP growth, inflation, and the current account balance relative to the three-year preprogram period have been experienced in varying degrees by program countries. Growth performance in particular has been remarkable, with the annual GDP growth increasing to a median of 4.2 percent from an average of 2.6 percent in the three-year preprogram period.

Progress in the reform of domestic pricing, the foreign trade system, and agriculture, as well as the growth of investment in the manufacturing sector, have all contributed importantly to the strong growth performance. Inflation was reduced significantly in the relatively high-inflation countries, although from a medium-term perspective, efforts are required to bring down the median level of inflation. With export receipts recording large increases, the current account deficit was reduced during the program year in more than one half of the cases, despite an overall widening equivalent to 2 percent of GDP in the medium term.

Generally speaking, even in cases where performance fell short of the latest targets owing to policy slippages and exogenous factors, improvement has never been completely absent during the course of an arrangement. This might have been the picture, or worse, if there had been no arrangement in the first place. What also needs to be taken into account when assessing the success of programs is the background of deteriorating terms of trade. Some program countries had already struggled through reforms and were beyond the starting point in terms of the intensity and coverage of program measures.

Despite the accomplishments of program countries so far, we share the staff's view that fiscal and monetary restraint, as well as trade reform, should be carried further in order to expedite an improvement in inflation and the current account deficit, and to provide a better environment for structural reform. With the wide range of problems to be addressed in structural reform, available resources need to be directed to those areas that would best contribute to macroeconomic stability. In this connection, the staff's emphasis on prioritization is well placed, with macroeconomic stability being singled out as guidance for the process.

As to public enterprise reform, we agree with the staff that it is crucial to develop a strong data base for countries which currently lack such information resources. While efficiency and productivity remain the key to structural reform, a wide selection of approaches should be encouraged so that countries can explore ways which best suit their particular situation and thereby build up both efficiency and productivity.

We note the emphasis placed by the staff on the importance of timely and intensive technical assistance by the Fund in facilitating the design and implementation of SAF/ESAF-supported programs. Structural reform in these countries is stretching into a range of areas that require special expertise and strong administrative capacity. We believe that the countries should be adequately assisted in a timely fashion in order to bring about the best program results. The Fund's help is therefore indispensable. In this respect, technical assistance related to SAF/ESAF programs should be continued and reinforced, and Fund attention to other areas of increasing concern should not affect this important aspect of the programs.

We are very concerned about the problem of exogenous shocks--both domestic and external--which has continued to be an important factor impairing the program results. We therefore share the staff's view that a contingency mechanism should be built into programs, in addition to midterm reviews and additional ESAF financing, to enable corrective measures to be taken at an early stage when adverse shocks occur so that program implementation stands a better chance of success.

Regarding post-ESAF relations with countries, we share the staff's view that the improvement and progress made during the three-year program period might be fragile in some cases, and vulnerability to shocks would be detrimental to consolidating what has been achieved, as well as to the overall adjustment process. Where macroeconomic vulnerability persists after the expiration of an arrangement, follow-up support by the Fund is justified and needs to be made available, if requested by members, in ways that are applicable to individual cases so as to enable the countries to stand on firmer ground and be in a better position to carry on the adjustment process in the immediate post-ESAF period.

As to the issue of a fourth-year ESAF arrangement, we support what the staff's view and deem it appropriate to consider a member's request for a fourth-year ESAF arrangement in a broader context when needed to complete the adjustment process. This is especially relevant when satisfactory records in the implementation of policies and measures have been achieved and when other supporting financial arrangements are foreseen.

We also agree with the staff that the present cutoff date of end-November 1992 should remain unchanged at this time and that first priority should be given to intensified efforts by both the Fund and member countries to speed up the conclusion of program negotiations. Meanwhile, we will be understanding of the difficulties that may confront some members in concluding negotiations with the Fund within the prescribed time period. We hope that the Fund will recognize such difficulties and will exercise a certain degree of flexibility in exceptional cases, so that use of the facility by eligible members will not be adversely affected simply because of the cutoff date.

As for the timing of the next review of operations of the SAF, the ESAF, and the ESAF Trust, and of potential access to the SAF and of access limits of the ESAF Trust, we agree with the proposed decisions.

Mr. Bindley-Taylor made the following statement:

We welcome the staff's efforts in producing two relatively lengthy documents reviewing the operations of the SAF, the ESAF, and the ESAF Trust. The objectives of all SAF- and ESAF-supported programs have been the fostering of economic growth and the promotion of medium-term balance of payments viability. It is against this mandate that the facilities must be reviewed. How have they fared?

The staff report indicates that the medium-term outlook continues to be difficult for many countries with SAF- and ESAF-supported arrangements. Some 54 percent will need exceptional financing beyond the three-year arrangement period. This, however, is not an indictment of the facilities, but merely emphasizes the true nature of the long-term difficulties facing SAF- and ESAF-eligible countries and the pressing need for the maintenance of correct policy measures and concessional assistance over the medium term.

The main area of success in SAF/ESAF-supported programs, however, seems to be growth performance. With respect to inflation performance, the results have been mixed, reflecting the influence of the preprogram level of inflation, the ambitious targets for inflation, the level of fiscal and monetary restraint, and the type of monetary union. It is now also clear that structural adjustment plays a critical role in the overall process of macroeconomic adjustment. Moreover, in some areas, such as increasing exports and reducing the size of the debt-service burden, some countries have benefitted from SAF/ESAF-supported programs.

With respect to program design, implementation, and monitoring, the critical area of data collection remains a concern. Deficiencies in the data base not only result in problems of design and monitoring but also hamper the process of implementation in many countries. Technical assistance is therefore critical for strengthening the data base and administrative capacity in these cases.

In the area of structural reform, the appropriate sequencing of reforms is crucial. Here, we agree with the staff that the approach with respect to public enterprises should focus on those few enterprises that have the most immediate and major impact on the macroeconomic situation. The same approach should apply in all other areas of structural reform, namely, the fiscal, monetary, and external sectors. The second important step is the preparation of a timetable of action firmly based on the implementation capacity of the authorities.

We welcome the greater attention being given to the social costs of adjustment in recent SAF/ESAF-supported programs. However, we cannot but emphasize that social measures in adjustment programs must be properly focused and targeted.

The varied response to exchange rate adjustment indicates that the Fund should continue to take a pragmatic approach toward the choice of exchange rate regime by giving more weight to the initial economic conditions in each country, the nature of the exchange rate distortion, and the preferences of the authorities. The staff concludes that large up-front adjustments tend to correct differentials much better and much faster than a gradual approach. This may be true, but we are not certain that one can conclude that no lasting gains are to be realized from a more gradual approach to exchange rate adjustment.

With respect to the monitoring of programs, we note the growing number of structural benchmarks in SAF/ESAF-supported programs. While we can understand the motives behind such benchmarks and recognize the growing emphasis on structural reforms, a profusion of benchmarks simply complicates the already difficult tasks of program monitoring and implementation. We would advise that structural benchmarks and program criteria be kept to a minimum and limited to those essential to achieve program objectives.

The policy framework paper (PFP) process has proven to be successful. The process has obviously helped to provide the authorities a relatively improved data base for decision making and has been critical to garner support from donor countries in the form of debt relief and/or concessional financing. We believe that the PFP process should be enhanced and that greater technical assistance should be provided to SAF/ESAF-eligible countries.

As to operational aspects, we have noted that a number of countries may need additional financing even after the completion of a three-year ESAF arrangement. In some cases, some form of enhanced collaboration with the Fund can be envisaged, while in others, the need for continued Fund financial support may be pressing; in these circumstances, we can support the provision of a fourth-year ESAF arrangement. We do not see any merit in the staff's suggestion that financial assistance should be provided on a limited scale through the Fund's General Resources Account. This runs counter to the logic of the SAF and the ESAF, and it is somewhat perverse to offer lower access and higher-cost funds to countries which need additional resources after concessional resources have proven to be inadequate to provide external viability.

We also oppose the suggestion that medium-term scenarios should include, as a standard practice, downside risk scenarios for financial shortfalls as well as the corrective policies that would be triggered. The former suggestion may lead to a fairly negative bias in the medium-term outlook for some countries, thereby prejudicing external financial support. The latter suggestion can be seen as trying to lock governments into prearranged policy choices--a situation that would most likely be vigorously resisted.

In 1990 the Executive Board approved an extension of the commitment period for ESAF Trust resources to end-November 1992. In view of the fact that some eligible members are in protracted arrears to the Fund as well as the uncertainty surrounding the establishment of support groups and the adoption of programs, an extension would, in our view, be appropriate. The interest rate should be maintained at 0.5 percent, and we hope that lenders will agree to the additional loan and subsidy contributions that would be required.

In conclusion, the performance under SAF/ESAF arrangements has been mixed. Nevertheless, in the absence of these facilities, it is likely that the economic conditions of countries which have implemented programs under the SAF and the ESAF would have been worse. The facilities, therefore, have proven to be useful, and it remains the Board's task to attempt to improve continuously their usefulness through periodic reviews.

Mr. Martínez-Alas made the following statement:

At this stage, I will not elaborate on many of the important points contained in the well-prepared staff papers, since most of my concerns have been covered by other Directors, particularly by Mr. Finaish. I welcome this annual review of the operations of the SAF, the ESAF, and the ESAF Trust, and I found it reassuring that, overall, some SAF/ESAF countries have returned to satisfactory growth rates in terms of income and export volumes even during a period when the external environment has been unfavorable. It is also reassuring to find that where adjustment policies have been fully implemented, the country has achieved some progress toward regaining monetary stability and, in some cases, external viability. However, it is indeed worrisome that some countries which have made important structural changes continue to face a fragile economic situation in which even minor policy slippages may lead to a sharp reversal of achievements under the program.

The vulnerability of these countries to internal and external shocks highlights the need for contingency planning. The staff acknowledges the role played by the traditional shock absorber--international reserves--and programs have appropriately placed considerable emphasis on this aspect. However, other actions to reduce program vulnerability are needed, such as the building up of a contingency fund in times of favorable developments. Predetermined expenditure cuts to be enacted in the event that fiscal revenues fall short of initial expectations, or making certain expenditures contingent on the actual availability of resources would be equally useful.

It is encouraging to find in the staff paper a recognition of some factors that have rendered adjustment programs unsustainable, such as overoptimism in program design regarding the responsiveness of fiscal revenue measures or the practicability of expenditure control, or the realism of the timing of important underlying structural measures. It is hoped that in future programs, these factors will be fully taken into account and that the true size of the financing gap is recognized at the outset.

We are well aware of the serious difficulties in forecasting the timing and impact of structural policy measures on the fiscal accounts and the external sector. The uncertainty surrounding programs leads to the need for up-front, sustained support by donors and creditors. Insofar as an SAF/ESAF country can rely on timely financial support, and thereby minimize the prospects of a financing shortfall, the disruptive effect of abrupt changes in expected financing flows on financial policies would be ameliorated and the chances of regaining external viability would increase. It is important for the Fund to avoid situations where a solid program, with a strong political commitment by the authorities, is not implemented because the financial support from donors and creditors turns out to be too little and too late.

As to operational issues, I am in broad agreement with the staff's analysis regarding access, post-ESAF relations, fourth-year ESAF arrangements, and the cut-off date. However, like many previous speakers, I am concerned about the relatively slow pace of ESAF use. I agree that the standards of programs should not be compromised in an effort to promote more rapid use of ESAF. However, an appropriate balance should be sought between prior actions and program feasibility, and ways and means to achieve an agreement with the authorities of SAF/ESAF-eligible countries have to be continuously explored. The requirement of a long, satisfactory policy track record or lengthy prior actions and commitments should not be overemphasized, since the phasing of disbursements already assures that only performing countries will have continued access to Fund resources, and the fact that the mobilization of other sources of financing depends on Fund approval of programs and performance criteria give the right incentives to countries to continue in their adjustment path. In some cases, the reform process needs initial support from the international community to gain momentum and grow into a bold reform effort. For countries with such deep-rooted structural problems and low per capita incomes, the Fund has to be willing to incur some calculated risk taking, since the upside potential in terms of the numbers that stand to better their condition is immense. I completely agree with Mr. de Groote's analysis in this regard. One sentence in particular summarizes my chair's position, namely, "We do not defend soft conditionality, but are merely pointing out that if conditionality can be too soft to accomplish, it can also be too hard to implement successfully." Moreover, I can support the proposed decisions as well as the extension of the list of SAF/ESAF-eligible members to include those countries with a per capita income and overall economic situation comparable to that of countries currently eligible to use the facilities.

Mr. Evans made the following statement:

The staff has once again presented a comprehensive set of review papers. Those papers largely confirm the usefulness of the ESAF in particular and, more generally, present some generalizations regarding the requirements of successful Fund-supported programs that conform with the experience from other reviews. Although this type of objective confirmation is essential from time to time, I would agree with Mr. Al-Jasser that next year's review might usefully be more focused on some specific topics. There will be, in any case, a need then to consider arrangements post-November 1992, but one other topic may be worthy of specific attention. For the moment, as I agree with many of the staff's conclusions, I will comment on only a few general issues.

The first is the general set of questions surrounding conditionality, including what is seen as a disappointing take-up of ESAF arrangements, and the difficulty of judging the adequacy of the political commitment necessary to ensure the success of a program. This year's review, like its predecessors, should leave no doubt that the conditionality attached to the ESAF, ensuring, as it does, the adoption of comprehensive programs, has been the key to those programs' success. Some, nevertheless, see this conditionality as a prime cause of the slow take-up of ESAF arrangements. There is, however, no firm evidence to support that view. These reviews, by their nature, analyze agreed programs, not situations that might have become programs. If we are to reach an objective judgment on the reasons for the slow pace of resource use under the ESAF, we will need to review more carefully those cases where negotiations have not led to the adoption of a program. We should therefore look at whether the fault lies, as is assumed by many, with the authorities or, as is assumed by others, with the conditionality. Perhaps next year's review could give special attention to such cases as part of the input into the consideration of arrangements post-1992.

It is, of course, regrettable that so few countries have availed themselves of ESAF arrangements, yet all of our experience should tell us that we would be going in the wrong direction if were we to see a lessening of conditionality as a solution to that perceived problem. The more appropriate solution is to devote greater effort to convincing governments that only comprehensive programs, and the conditionality necessarily attached to them, ensure success.

A closely related issue is the responsibility of Fund management for reaching a judgment on whether and when to seek Board approval for an arrangement. This is one of the most crucial elements of program formulation, and I wonder whether there would not be benefit in making more use of informal consultations between management and the Board prior to such decisions being reached. This process might provide scope, for example, for the Board to send a message to the relevant authorities or, where appropriate, to management.

Although Directors appear generally to be in agreement with the staff's conclusions, several have taken exception to the staff's statement that "there appears to be no causal linkage of the choice of exchange rate mechanism with the success in implementation of fiscal and monetary policies and inflation performance." Like Mr. Filosa, I found that statement innocuous and not at all surprising. Mr. Cirelli might recall that I reached the same conclusion in supporting CFA franc arrangements when those were last reviewed, and for the same reason, the staff has drawn the only conclusion that the facts will support. The staff's statement is not a thesis or an hypothesis, but a statement of fact--based, I should add, on the observation of only five country cases. Mr. de Groote has reached a different conclusion, based on the observation of two different country cases. The Board, however, should be more wary of being so readily provoked into recitations of dogma.

I agree with the staff's emphasis on technical assistance and would stress that much remains to be done in ESAF-supported programs and elsewhere to ensure better coordination between technical assistance provided by different organizations and, equally important, appropriate follow-up of technical assistance reports. Indeed, we should insist that the team putting together the review of a Fund-supported program also follow up on technical assistance reports.

On operational issues, I will comment only on the question of a fourth-year ESAF arrangement. I agree entirely with Mrs. Krosby that fourth-year arrangements should be the exception. In particular, in view of the importance of ensuring the adequate pursuit of policies under the third-year arrangement, there should be no presumption that a fourth-year arrangement will be made available. The decision should be taken entirely on a case-by-case basis, giving full consideration to whether an additional year under the ESAF would be more appropriate than access to another Fund facility.

In supporting the proposed decisions I note that they call for a further review by July 31, 1992. That is now less than 11 months away, but I believe there would be merit in conducting the review as scheduled.

Mr. Posthumus remarked that the wider use of prior actions, which had been requested by a number of Directors, appeared to be contradictory in view of the fact that the SAF was in itself viewed as a prior action for access to a regular stand-by arrangement for SAF-eligible countries. He therefore questioned whether that approach would be in the right direction.

As to the choice of exchange rate regime, the choice for a stable exchange rate could reflect a commitment to low inflation, Mr. Posthumus continued, but the the essential point was that the exchange rate was not the main or the only instrument to attain low rates of inflation.

He was still somewhat concerned that the PFP linked Fund and Bank financing arrangements, Mr. Posthumus commented. The Board must beware of going one step further by making agreement on certain policies in the PFP a condition for the approval of Fund- and Bank-supported programs. As long as the two institutions kept to their particular responsibilities, such linkage would not be necessary.

As to concerns about the slow pace of commitments under the ESAF, overestimates of commitments and disbursements in a specific year were not surprising when a new financial program was getting off the ground, Mr. Posthumus observed. That, and the overreaction which followed--including efforts to accelerate the implementation of the entire program--were the norm. The concern instead should be that the Fund avoid overcommitting its resources.

The staff representative from the Exchange and Trade Relations Department stated that the experience with inflation performance and the achievement of external objectives under SAF/ESAF-supported programs had been mixed and had not been as satisfactory as growth performance. It was extremely important to note that cross-country data showed that export volume growth rates had generally improved in real terms and were much higher than in the preprogram years, while import volume growth rates had not been as high. Together with the data on terms of trade losses, those outturns gave the impression that the underlying real trend of exports and of adjustment of the trade deficit was positive. In those cases where there had been strong rehabilitation needs, import volumes had increased owing to generous donor support for the rehabilitation process and the higher investment needs. That trend was, for example, particularly noticeable for Mozambique.

As to the linkage between exchange rate regimes, the implementation of fiscal and monetary policies, and the inflation rate, the issue remained an important one and would have to be revisited in the context of the next review of the SAF and the ESAF, preferably with a broader country coverage, the staff representative continued. In that regard, Directors would recall that the review of conditionality had suggested that when fiscal and monetary policy implementation was weak or had slipped, a fixed exchange rate regime had, in some circumstances, led to a weakening of the external position while a flexible exchange rate regime had yielded higher rates of inflation. In the current papers, the staff had taken the view that the distortion caused by a highly overvalued exchange rate could be corrected in various ways--through an up-front action, through a determined timetable of step-wise corrections, or through a transitional dual exchange rate regime for a limited period of time. In most instances, the staff had sought to accommodate authorities' preferences regarding the approach to exchange rate adjustment. It was, however, important that once the baseline policies in support of that adjustment had been set--especially fiscal and monetary policies--there should be no deviations from them. That was the basic message that the staff had sought to convey.

Several Directors had referred to the so-called time element, which subsumed the issue of a fourth-year ESAF, the staff representative observed. In some Directors' view, the ESAF was intended for a limited time period and should be used to change policies and introduce reforms on a shock-approach basis. At the same time, it was well recognized that the Fund was deeply involved in supporting the structural reform process in many countries, particularly in the areas of central banking, fiscal policy, and public enterprise reform, and that different countries had made varying degrees of progress in each of those areas. Other Directors therefore considered that there was room for continuing that progress and that a fourth-year ESAF arrangement could help bring those reforms nearer to completion.

The time element issue also subsumed the results that those policies could achieve, the staff representative continued. Even with the best of policies and their complete implementation during an ESAF arrangement, it was not certain that a viable external payments situation would be achieved within a three-year period. There were in fact lags between the implementation of a policy package and its results. To the extent that member countries could benefit by strengthening their adjustment effort and policy packages as well as from a further year of financial support, a fourth-year ESAF arrangement might be useful.

Various Directors had expressed concern about how to detect potential problems in policy implementation in a program, how to improve the predictability and assurances that governments would persevere in their adjustment effort, and how to ensure that authorities respond to external shocks through a strengthening of policies in a timely manner, the staff representative recalled. The answer comprised four elements. The first was technical assistance--in the design of the appropriate measures and in the early implementation of those measures. More, and early, technical assistance to help countries to evaluate their policy choices and their benefits would increase the chances of convincing the authorities and securing their commitment to the adjustment effort.

The second element was monitoring, the staff representative continued. In that regard, several Directors had mentioned that prior actions were critical in key areas to lay a solid basis for a new program. In that connection, when agreed measures were not implemented, the staff had shown some flexibility in cases where an understanding was reached on a feasible timetable for implementing such measures. Moreover, the staff had sought prior actions in cases where they could be carried out immediately or phased in a timely fashion.

The third element was a complete specification of the baseline policy path, including benchmarks, performance criteria, and the quantification of all key aggregates of the program, the staff representative considered. A shock treatment or strengthening of policies must be defined through reference to, for example, benchmarks and prior actions. Benchmarks and performance criteria could apply to specific, clearly defined policy actions that needed to be taken or, in some cases, to inflation, reserve, or balance of payments objectives. In some cases, fiscal deficits had been included as benchmarks, not to increase conditionality but to establish a transparent baseline policy path so that if slippages occurred, the authorities would be prepared to make an appropriate correction. There could be considerable flexibility with respect to benchmarks and performance criteria, but an important commitment should be made by the authorities to respond to the need for policy adjustment.

The fourth element was contingency planning, the staff representative remarked. In that connection, several Directors had mentioned the need for defining better fallback measures in the event that shocks occurred. The staff's approach had been to convince the authorities that all four elements were needed to protect their own policy framework. It should be noted that a program review could be completed even if a performance criterion was breached, as long as appropriate policy responses had been put in place. Thus, there was no real danger of an arbitrary disruption of disbursements. In that regard, Mr. Santos's point on midterm consultations was well taken: they were a useful method of alerting authorities of new developments in the global environment that might require early action or corrective measures to avoid slippages.

As to the usefulness of enhanced monitoring for those countries that did not need further Fund financing, two principal points should be kept in mind, the staff representative considered. The first was the need to coordinate technical assistance so as to ensure that donor involvement in a member country was well coordinated to support the adjustment reforms being undertaken. Enhanced monitoring would provide a means for donors to assess the underlying macroeconomic framework and to see how other donor initiatives in different policy areas were being coordinated. The second point was that many country authorities considered it important to have continued advice from the Fund on macroeconomic programming and financial policies. Thus, if countries so requested, enhanced monitoring was being recommended.

On the fourth-year ESAF arrangement, two Executive Directors had raised the issue of uniformity of treatment, the staff representative recalled. In fact, all eligible countries had known from the time of the establishment of the ESAF that the early negotiation of a program would in fact be beneficial, as it would enable them to advance the structural adjustment process and mobilize donor assistance for the adjustment effort. The countries that had delayed entering into an arrangement would probably run the risk of not being able to avail themselves of a fourth-year ESAF arrangement. However, for any country that was eligible, had a financing need, and was willing to put an adjustment program in place, its current need could be met within the ESAF framework, those countries were not being crowded out in any sense.

The possibility of augmentation under the ESAF had been present from the facility's inception, the staff representative from the Exchange and Trade Relations Department observed. From the outset, annual access and three-year access under the ESAF could be reviewed at the time when the Board considered the authorities' request for an annual arrangement. The more recent change was that augmentation could take place at the time of midterm reviews. Thus, in that regard, the staff was not proposing something new.

The staff representative from the Treasurer's Department, commenting on the pace of SAF-supported programs and staff projections of resource use, observed that one additional SAF arrangement had been approved by the Board since the staff paper was issued, for Comoros, bringing the number of SAF arrangements in 1991 to 3, and the total number of arrangements to date to 35, out of a possible 59. The staff had estimated, together with the area departments, that there might be 3 to 6 more arrangements, which would bring the total to about 40. Of the remaining 19 eligible countries, 15 were not expected to require balance of payments financing under the SAF, and some countries were expected to enter directly into ESAF-supported programs. In sum, the utilization of SAF arrangements had been high, and the slackening in the pace of commitments reflected the fact that a large number of countries had already either entered into arrangements or did not have a financing need. It was projected that SAF resources would be fully used under either SAF arrangements or cofinancing under ESAF arrangements.

The projection of a total of 15 ESAF arrangements in the 15-month period to November 1992 had been made in consultation with area departments and had included an ESAF arrangement for Tanzania, which had already been approved by the Executive Board, as well as an ESAF arrangement for Sri Lanka, which would be discussed by the Board in the near future, the staff representative from the Treasurer's Department explained. In addition, 8 countries that had completed, or would soon complete, SAF-supported programs were expected to complete negotiations on an ESAF-supported program over the coming 15 months. In those particular cases, the experience under SAF-supported programs should be helpful in moving to an ESAF-supported program. Of the remaining 5-6 other cases, preliminary discussions had begun on the use of ESAF resources. However, there were the usual uncertainties surrounding projections, particularly because ESAF-supported programs had to be strong, and this was reflected in the wide range given for the projection of total ESAF Trust commitments, namely, SDR 3.5 billion to SDR 5 billion.

The staff representative from the Fiscal Affairs Department observed that a number of speakers had expressed concern about overambitiousness in setting some revenue targets. In fact, the staff had at times underestimated the institutional rigidities which faced some of the recommended structural reforms as well as the weakness of administrative capacity. Typically, the Ministry of Finance--which was not often the most powerful ministry--agreed to a specific set of measures but then encountered resistance from various other quarters that inevitably resulted in delay. The staff's response had been to shift the emphasis of some technical assistance toward the early diagnosis of weaknesses in administrative capacity and fiscal performance and to closely coordinate that diagnosis with program design so as to structure and sequence the reforms to avoid those rigidities.

Delays in implementing certain structural measures that resulted in revenue shortfalls would not be accommodated in program design even when the staff had overestimated the implementation capacity; instead, it would suggest compensatory measures, the staff representative explained. In that case, it was true that the staff typically relied on quick-yielding revenue measures, because they were much easier to put in place and to balance the budget deficit than expenditure measures. In that respect, the staff had run into the problem of formulating measures that would be consistent with the general direction of the fiscal or tax reform so as not to sacrifice the criteria of efficiency, the simplification of the tax system, and the improvement of the whole incentive structure. Typically, the staff relied on broad-based, low-rate consumption tax measures.

While in the short term it was easier to fall back on revenue measures, in the medium term the staff had increasingly paid attention to the composition of expenditures as well as to expenditure control and wage policy and it had encountered two problems, the staff representative continued. One was that in the composition of expenditures, a number of structural reforms--including poverty alleviation, banking reform, interest rate liberalization, and public enterprise reform--entailed budgetary costs. The other problem was that the authorities had often shown resistance to too much Fund involvement on the expenditure side. Identifying and reducing nonproductive expenditures had proven difficult to carryout in the context of staff missions relating to the use of Fund resources, yet the Fund received many requests for technical assistance on tax reform but few requests with respect to expenditure policy.

He agreed with Mr. Breuer that some civil service reform measures might result in the departure of the most capable people, the staff representative from the Fiscal Affairs Department remarked. The staff was skeptical about voluntary departure and early retirement schemes; in fact, in some cases it had preferred to talk about negotiated departure schemes rather than voluntary departure schemes. The staff had, however, been paying increasing attention to the structure of the civil service, particularly to overstaffing in the lower echelons. It had also stressed greater wage differentiation, which was typically needed where there were some very capable people at the top but they were paid much less than their counterparts in the private sector.

The staff representative from the World Bank observed that from the outset, the World Bank's program of quick-disbursing loans in support of balance of payments adjustment had been considered an exceptional activity in response to particular needs. It had not been anticipated that such lending would become a permanent activity of the Bank, at least at the high levels experienced in the past decade. Thus, the Bank's intention to reduce gradually such lending was not a new policy direction but was rather an integral part of the original concept of World Bank adjustment lending. That was not to say that there would be a sudden decrease in lending. As countries undertaking Bank-supported adjustment completed their programs, it was expected that Bank lending would shift toward sector investment and project loans. At the same time, countries beginning adjustment programs and those countries currently implementing programs would continue to have access to Bank lending to support their adjustment effort.

The Chairman recalled that the question of extending the list of ESAF-eligible countries had been raised earlier in the context of the Middle East crisis. The Board had quickly become convinced that for a small group of member countries, there was a more general case for considering ways to provide Fund resources on concessional terms, especially in light of the changed, and worsened, situation of some of those countries since the SAF and the ESAF were originally established. That case was reflected as well in the World Bank's ongoing expansion of the list of IDA-eligible countries, which currently included most of the additional countries that Fund management was considering to propose for ESAF eligibility.

Management had been discussing the expansion of eligibility with contributors to the ESAF Trust but had not yet been able to find a broad consensus on the modalities for such expansion, the Chairman stated. The matter was complex, partly because of the very limited SAF resources that remained uncommitted, partly because of the perennial problem of trying to project the use of ESAF resources by those members that were already eligible--including countries currently in arrears--and partly because of the difficulty in defining objective criteria by which to identify a clearly separable group of countries to which to extend eligibility. He was, nevertheless, encouraged enough by early contacts to continue, and intensify, discussions with contributors, and he hoped to have something positive to report to Directors in the coming few weeks so that the Board could take a decision on the matter in the near future.

The Chairman then made the following summing up:

This review of experience under programs supported by SAF/ESAF arrangements has provided a basis for drawing tentative conclusions and lessons on the design of programs and the prioritization of structural policies, and on how to help strengthen and maintain policy momentum. Directors were encouraged that considerable strides have been made, especially under the ESAF, and a few countries now seem to be approaching a position where further recourse to exceptional financial assistance--including from the Fund--would not be needed. Despite the progress made so far and because of its fragility, Directors attached importance to continuing efforts by the authorities to sustain and bolster policy adjustments in order to ensure the achievement of external viability with sustainable growth.

Directors welcomed the stronger growth performance of countries which had sustained their adjustment effort over several years. Reforms in the domestic pricing and exchange and trade systems, supported by strong fiscal and monetary policies, were key contributing factors to this performance, which was also reflected in export growth and diversification.

Directors noted the mixed record in external adjustment and the slower than expected progress in reducing inflation. These were in part linked to unforeseen external developments, including major losses in the terms of trade, but also to weaknesses in program design in some cases and policy slippages, particularly in the fiscal area. The experience underscored the need to move quickly in policy areas that promoted the external sector, and to target an ambitious inflation objective. In particular, Directors urged that needed exchange rate adjustments be made early on in the adjustment program and that more gradual approaches be eschewed. In this connection, a range of views was expressed on the linkages between the choice of the exchange rate regime and the successful implementation of fiscal and monetary policies. These questions certainly deserve continuing review. Directors emphasized that whatever the regime, effective exchange rate policy must be underpinned by tight monetary and fiscal policies and supporting structural measures. Directors suggested that greater emphasis be placed on fiscal restraint, and in this connection, they welcomed the in-depth analysis of the fiscal dimensions of adjustment. Noting that fiscal adjustment as measured by the major indicators of budget deficits had often fallen short of program objectives, Directors called for more cautious programming of revenue responses to tax reform, closer attention to the effectiveness of expenditure control and monitoring mechanisms, while paying attention to reducing unproductive current expenditure. They also encouraged more realistic programming of public investment and assessment of its level and composition, and for closer collaboration with the World Bank in this area.

In dealing with possible exogenous shocks, Directors agreed that an appropriate response should continue to be policy adaptation in the context of the midterm review, and greater use of prespecification of contingency policies--especially in the tax area.

Directors stressed the continued need for a clearer prioritization of structural measures, to focus on those areas that contributed directly to sustaining macroeconomic stability, and the critical need to help strengthen administrative capacity in countries. They emphasized the strengthened role of timely and well-coordinated technical assistance in this regard. More specifically, in the area of public enterprise reform, where the financial difficulties of a few enterprises threatened macroeconomic stability, they suggested a more selective approach by concentrating on these enterprises, with a closer monitoring of their financial and structural performance through benchmarks and performance criteria. In addition, greater attention should be given to specifying concrete policy measures, and designing privatization programs with a more realistic timetable, in collaboration with the Bank, and supported by appropriate technical assistance.

Directors noted recent difficulties in sustaining the adjustment process, relating in part to weaknesses in administrative capacity and to domestic political developments. In these circumstances, they took the view that Fund support should be extended on the basis of a satisfactory track record, and active use of prior actions, including in structural areas, and technical assistance to help strengthen administrative capacity, to assure that the program would be successfully carried out.

Directors emphasized the need to pay close attention to a strengthening of the medium-term balance of payments outlook under

ESAF-supported programs. Noting that in a number of cases prospects for external viability were now less promising than initially envisaged, a number of Directors attached particular importance to adhering to the three-year time frame for achieving external viability. In view of the critical importance of continued support by the Bank and donors in the adjustment effort, Directors urged the staff to continue to improve information on aid flows and on the coordination of such flows. Given the inherent uncertainties in the medium-term prospects for financing, most Directors called for a more transparent analysis of medium-term scenarios, to identify downside risks and indicate the nature of associated corrective policy measures.

Directors agreed that the PFP process continued to be useful in promoting Bank, Fund, and country collaboration and in coordinating financial assistance. They urged that this process be strengthened and that the PFP also be used more effectively to coordinate technical assistance in areas that were essential to the programs. They attached particular importance to the early identification of technical assistance needs and the timely provision of technical assistance to strengthen the implementation capacity of countries. Particular emphasis was placed on assistance in the areas of public expenditure control, central banking, and in collaboration with the Bank and donors, for civil service reform. To the fullest extent possible, policy measures with potentially adverse social impact should be accompanied by well-conceived, efficient social policies, designed in collaboration with the Bank to help protect the poorest during the transitional phase.

On operational aspects, Directors agreed to maintain the cutoff date for commitments under three-year ESAF arrangements at end-November 1992 and to take up this matter again at the 1992 review of the SAF and ESAF. While concern was expressed about the slow pace of use of ESAF resources so far, there was broad agreement that the standards of ESAF programs should be maintained. They stressed that a first priority now was to encourage countries speedily to adopt strong programs that could be supported by the ESAF. In view of the disparity in performance under programs supported by SAF arrangements and those supported by ESAF arrangements, Directors urged that greater attention be given to improving the monitoring under the SAF, including greater use of prior actions and benchmarks in the key structural reform areas.

Directors also agreed to maintain the ESAF Trust target of SDR 6 billion and the interest rate on ESAF Trust loans at 0.5 percent. I should note, however, that to reach the target for ESAF Trust lending of SDR 6 billion at that interest rate, additional loan and subsidy contributions would need to be sought.

Directors agreed that current policies on access, access limits, and phasing of disbursements would continue. In this connection, they noted that the current provisions for rephasing and augmenting access under the ESAF had provided appropriate means to help members cope with the adjustment and financing needs stemming from adverse exogenous shocks.

On post-ESAF relations with members, Directors noted that where countries had no need for exceptional financing and macroeconomic stability had broadly been attained, Article IV consultation discussions would be sufficient for maintaining policy dialogue. In other cases, most Directors considered that it might be useful to rely on enhanced consultation and monitoring arrangements for a limited transitional period, if requested by the member country. Such arrangements might also be supplemented, for a limited transitional period, by the preparation of a PFP, if this were seen as beneficial by the authorities as well as by the Bank and the donor community. Directors stressed that in its post-ESAF relations with members, the Fund should be prepared to be pragmatic and to adapt its approach to the needs and the specific circumstances of the countries concerned, drawing as appropriate on its variety of experiences.

Directors noted that some countries could continue to face a need for exceptional financing and policy adjustment upon completion of their three-year ESAF arrangements. Most Directors agreed that support under a fourth-year ESAF arrangement--on an exceptional basis rather than as a rule and probably at a declining level of access--might be appropriate for countries where use of the resources of the General Resources Account would not be fully compatible with the country's debt-servicing capacity, policy performance had been strong, and continued reform efforts were expected to be supported by concessional assistance from donors and creditors. This would be recommended only when the arrangements could be approved by the November 1992 cutoff date. Concern was expressed by a number of Directors that such a continuation of assistance could lead to a lengthening of the adjustment process. In recognition of this concern, management would proceed with caution in bringing requests for fourth-year ESAF arrangements for approval by the Board.

The operations of the SAF, ESAF, and ESAF Trust would be reviewed again by July 31, 1992, at the latest.

Finally, on eligibility, a number of Directors, including one for an ESAF creditor, noted that several low-income countries were facing balance of payments problems and debt profiles similar to those of many currently SAF/ESAF eligible countries, and in light of ESAF resource availability, consideration might be given to extending ESAF assistance to them as well. Complex issues are, however, involved and the subject would be kept under continuing consideration in the coming period. As I told you earlier, I hope personally for sufficient advances to be made so that I can report positively to you for necessary decisions on this matter around the time of the Annual Meetings.

The Executive Board took the following decisions:

Structural Adjustment Facility, Enhanced Structural Adjustment Facility, and ESAF Trust - Review of Operations

Pursuant to Decision No. 9487-(90/106) SAF/ESAF, adopted July 2, 1990, the Fund has reviewed the operation of the Structural Adjustment Facility, of the Enhanced Structural Adjustment Facility, and of the Enhanced Structural Adjustment Facility Trust. The operation of these facilities and of the Enhanced Structural Adjustment Facility Trust shall be further reviewed not later than July 31, 1992.

Decision No. 9808-(91/114) SAF/ESAF, adopted
September 4, 1991

Structural Adjustment Facility - Potential Access

Pursuant to paragraph 4(1) of the Regulations for the Administration of the Structural Adjustment Facility Within the Special Disbursement Account (Annex to Decision No. 8238-(86/56) SAF, as amended), the Fund determines that the potential access of each eligible member to the resources of the facility established by Decision No. 8240-(86/56) SAF, adopted March 26, 1986, as amended, continues to be adequate. The potential access under the facility shall be reviewed again before the increase in quotas under the Ninth General Review becomes effective in accordance with paragraph 3 of Board of Governors Resolution No. 45-2, adopted effective June 28, 1990, but in any event not later than July 31, 1992.

Decision No. 9809-(91/114) SAF, adopted
September 4, 1991

ESAF Trust - Review of Access Limits

Pursuant to Decision No. 9489-(90/106) ESAF, adopted July 2, 1990, the Fund as Trustee has reviewed the maximum limit and the exceptional maximum limit on access to the resources of the Enhanced Structural Adjustment Facility Trust established by Decision No. 8845-(88/61) ESAF, adopted April 20, 1988. These limits shall be further reviewed before the increase in quotas under the Ninth General Review becomes effective in accordance with paragraph 3 of Board of Governors Resolution No. 45-2, adopted effective June 28, 1990, but in any event not later than July 31, 1992.

Decision No. 9810-(91/114) ESAF, adopted September 4, 1991

2. PEOPLE'S REPUBLIC OF ANGOLA - 1991 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1991 Article IV consultation with Angola (SM/91/163, 8/14/91). They also had before them a background paper on recent economic developments in Angola (SM/91/173, 8/23/91).

Mr. Monyake made the following statement:

My Angolan authorities are grateful to the Fund staff for the second comprehensive review of the economy since Angola joined the Fund on September 19, 1989, thus helping to identify areas in which action must be taken to rehabilitate the economy.

When the Board considered the staff report for the first Article IV consultation with Angola on June 25, 1990 (EBM/90/101 and EBM/90/102), it observed that despite Angola's high potential for growth, given its rich and diverse natural resources, the prolonged internal conflict and the lack of administrative capacity to formulate and implement meaningful economic policies since 1975 had increasingly impacted negatively on economic performance and the living standards of the people. The need for Angola to urgently implement a comprehensive economic reform program to tackle its serious economic and financial problems has thus been established.

Angola's first attempt to reverse the decline of its economy started in 1987 when the Program of Economic and Financial Reforms was launched. The immediate targets were the restoration of domestic and external equilibria and the reduction of state involvement in the economy. Adjustment efforts were reinforced in 1989 when the Program of Economic Recovery was introduced. Regrettably, not much could be accomplished mainly because of the effects of the continued civil war, the drought of 1987-90, and the acute shortage of skilled manpower. Angola's economic problems thus persisted as demand pressures on the economy intensified and influenced the widening of domestic and external imbalances. Notably, real GDP growth plummeted, unemployment increased, and the standard of living fell to poverty level in both the rural and urban areas.

To address those problems, the Government initiated the Program of Action in mid-1990 under which a number of macroeconomic and structural policy measures were introduced aimed at stabilizing domestic prices and strengthening external sector performance.

In the fiscal area, the authorities introduced revenue enhancement and expenditure control measures in order to reduce the budget deficit. These included the taxation of sales of goods in foreign currency, a 10 percent across-the-board customs duty, and a 200 percent increase on the tax on international airfares. In particular, the authorities took exceptional steps to contain the wage bill by pursuing a prudent wage policy. Specifically, the creation of new posts was frozen and redundant civil servants were identified for retrenchment. The authorities have commissioned a survey of public and private sector wages, which is to form the basis for formulating a national incomes policy.

Public enterprise reform was also put in place to relieve the financial burden on the government budget. Effective from 1990, public enterprises were required to pay taxes and retain a major part of their profits. Steps were also taken to strengthen the management and financial accountability of these enterprises. The completion of sectoral and subsectoral studies commissioned by the Ministry of Industry would allow the authorities to implement more significant reforms and embark on a privatization program.

The need to reduce subsidies was also recognized by the authorities. In this regard, administered prices were increased, and the list of goods subject to price controls was reduced. Gasoline, gas oil, and fuel oil prices were more than doubled in September 1990, and further increases were allowed in April 1991 to achieve total elimination of subsidies to the fuel distribution company.

In the monetary sector, the authorities enacted basic legislation that defined the new role of the Central Bank and created other financial institutions to cater to the various sectors of the economy. A currency changeover was introduced in September 1990 as a strategy for mopping up excess liquidity in the system. The national currency was also devalued to boost exports and curb parallel market activities.

Notwithstanding the authorities' commitment to these reforms, performance was seriously constrained by the difficult circumstances imposed by the continuation of the war. However, the signing of the peace agreement on May 31, 1991 is expected to lead to a considerable reduction of these constraints and enable my authorities to implement sound macroeconomic policies. Indeed, they have expressed their renewed commitment to bring the economy back on the path of sustainable growth. As part of this commitment, they are giving necessary consideration to a further, more substantial devaluation as advised by the staff mission. Necessary institutional structures are also being put in place, including the creation of the post of a Prime Minister, who is to be charged with the task of monitoring and coordinating the implementation of government policies in a much more coherent and dynamic manner.

The Angolan authorities face enormous challenges during the postwar period. Apart from building the administrative machinery, professional skills, and the statistical base for a market economy, they need to lay a solid foundation for economic viability in the medium term in a stable macroeconomic environment. Above all, they face the social task of resettling millions of people who were displaced by war as well as repairing the physical damages. In the medium term, the external sector will require concessional foreign financial inflows to relieve the high debt burden and finance the liberalization process.

In this regard, the Fund's assistance in putting together a comprehensive adjustment program as well as the mobilization of concessional external financing, including debt relief, is crucial to the achievement of the objective of reviving the economy. In addition, the authorities have attached great importance to the continuation of the current Fund-UNDP program of technical assistance in the critical areas of government finance, monetary control, and bank supervision.

Extending his remarks, Mr. Monyake stated that even as the staff mission was conducting the consultation, his authorities were fighting on three fronts, all of which were unfamiliar and uncharted territory. First, they were embarked upon a program of economic transformation from a command to a market economy. As the Board had already noted, there was no blueprint for that exercise, and more developed countries had found the task formidable. Second, the authorities had decided to change the political system and usher in a multiparty system of democracy. Since independence, only one party had legally existed, so that the party and the Government had hitherto been virtually indistinguishable. Most existing political and administrative structures had either to give way to new ones or undergo major transformation. Third, a country that had been at war since independence was currently entering an era of peace. Old enemies had to work together to build a new country; armies had to be disbanded and war damage repaired; and displaced persons and demobilized military personnel had to be resettled and reintegrated into society. Those tasks required skill, courage, and resources. While his authorities had the courage, they did not have sufficient skills and resources to see the process through. The Fund and the international community should offer as much assistance as was required. His authorities were truly grateful for all the assistance that had been given so far.

Mr. Golriz remarked that he agreed with the staff that the recent peace agreement offered an excellent opportunity for the Angolan authorities to speed up economic reforms and to implement comprehensive adjustment measures if the economy was to improve substantially. Indeed, he had noted that despite measures taken in the areas of wages and prices as well as in the exchange and trade system, distortions and imbalances still characterized the Angolan economy. However, the civil war had had a deep impact on the economy and on institutions, and it would therefore take a long time for the country to return to normalcy. In that regard, Angola should be given more time to get back on its feet and to revitalize its economy.

He broadly agreed with the main thrust of the staff report, Mr. Golriz continued. In the area of fiscal policy, it was important that all revenues and expenditures should be included in a single budget for all governmental institutions. He also agreed that the fiscal deficit should be reduced to a reasonable level. In that regard, the relations between the Treasury and the Central Bank should be rationalized in order to limit, in a legal fashion, the Government's recourse to central bank resources. As to expenditures, there was room to streamline expenditures, even though the authorities faced constraints that would not permit a substantial reduction, namely, the need to cope with the postwar settlement of veterans and displaced populations as well as the reconstruction of war-ravaged infrastructure.

As to monetary policy, adequate measures were needed to make resource allocation more efficient, Mr. Golriz considered. In that regard, he agreed with the staff that banking institutions should be independent in their lending policy so as to encourage the financing of productive, profitable investments. Modernizing the financial system was the most important reform that needed to be initiated as soon as possible. Efficient financial intermediation should be promoted so as to pave the way for other economic reforms.

In the external sector, while a substantial depreciation of the domestic currency would help nontraditional exports, he was not convinced that Angola was currently in a position to export products other than oil and diamonds, which were competitive at current rates of exchange, Mr. Golriz commented. However, he agreed that in the near future Angola should set an appropriate exchange rate to boost its nontraditional exports and attract investment in the non-oil sector.

He also agreed with the staff that the authorities should become current with Paris Club members, Mr. Golriz remarked. Furthermore, to obtain an agreement on rescheduling from the Paris Club, it was necessary for Angola to design an economic program within the framework of an arrangement with the Fund. A legal framework covering the budget, taxes, monetary policy, prices and wages, the trade and exchange system as well as the judicial system to enforce legal and contractual provisions, was of utmost importance for Angola to attract foreign investors. He agreed with the proposed decision.

Mrs. Krosby recalled that at the discussion on the 1990 Article IV consultation with Angola, her chair had urged the authorities to translate their stated commitment to economic reform into concrete action. Although she welcomed the advances that had been made since then toward peace and political reconciliation, little progress seemed to have been made in introducing the economic policies and reforms required to correct Angola's severe internal and external imbalances. She could only conclude that, despite some tentative steps in the right direction, Angola remained a highly administered economy, and that it was making much less progress in its transition away from central planning toward free markets than many other economies currently so engaged.

The staff report again offered a considerable amount of constructive policy advice on reducing the fiscal deficit, exercising monetary control, adopting a market-determined exchange system, and undertaking the structural reforms required to unleash Angola's productive capacity, Mrs. Krosby observed. She continued to urge Angola to act upon that advice in a comprehensive manner.

At the previous consultation, her chair had also suggested that, in view of Angola's policy inadequacies, severe data deficiencies, and, hence, current inabilities to fulfill the obligations of membership, it would be inappropriate for the Fund to consider providing its own financial support to Angola for some time to come, perhaps even for several years, Mrs. Krosby remarked. That remained her view.

With the assistance of the Fund, the UNDP, the World Bank, and others, a welcome beginning had been made to strengthen data availability, Mrs. Krosby continued. However, fundamental information on inflation, output growth, and the financial condition of public enterprises remained unavailable. She continued to believe that such information was essential if Angola was to fulfill the obligations of membership and if the Fund was to exercise firm surveillance. Thus, she supported the continuation of technical assistance to Angola, but continued to view the use of Fund resources without the initiation of fundamental market-oriented changes in macroeconomic, exchange rate, and structural policies as premature and misguided.

In conclusion, she hoped that the prospect of peace and the adoption of appropriate domestic economic policies would enable Angola to take advantage of its rich resource base and develop a dynamic, diversified economy, Mrs. Krosby stated. In any event, she hoped that by the time of the forthcoming Article IV consultation with Angola, the staff would be able to make a more positive report on the authorities' progress in moving toward a market economy and in providing the basic data that was a sine qua non for fulfilling the obligations of Fund membership.

Mr. Toé remarked that he welcomed the opportunity to review recent economic and financial developments in Angola and to make policy recommendations that would help the Angolan authorities, at the current critical juncture in the country's post-independence history, to meet the challenging task of rebuilding the economy. As the staff had pointed out, the end of the protracted civil war with the signing of the peace agreement in May 1991 had presented the authorities with a new opportunity for economic reform. That opportunity should not be missed. In that regard, he was encouraged by the authorities' indication of a renewed commitment to bring the economy back on a sustainable growth path commensurate with the country's vast potential. He noted in particular the institutional changes being introduced, as highlighted in Mr. Monyake's statement, and the authorities' intention to take action on the exchange rate along the lines suggested by the staff.

In view of the magnitude and urgency of the task ahead, it was difficult to pinpoint priority areas where the difficult process of adjusting the economy should begin, Mr. Toé considered. He noted, however, that the staff, in its appraisal, had correctly identified the exchange rate, pricing, the fiscal and monetary sectors as areas where coordinated measures were urgently needed. At the same time, it was essential that structural reforms in the financial system as well as institutional reforms to create an appropriate legal framework were put in place to underpin the macroeconomic stabilization. An adequate mix of policies encompassing comprehensive financial and structural measures was called for to address the difficult economic and financial situation. However, as recognized by the staff, in the transition period and until the general elections in late 1992, it was difficult for the Government to introduce significant adjustment measures.

The economic situation in Angola required a pragmatic approach suited to the special circumstances of that country, Mr. Toé continued. Specifically, the bold, global policy approach recommended in the staff report should go hand in hand with substantial, front-loaded financial assistance. For example, the exchange rate adjustment suggested by the staff could be facilitated by the establishment of a special fund to lend credibility to the exchange rate action. The provision of adequate financial assistance at the inception of the adjustment program was all the more important, since for such a program to succeed, the problems of demobilization and the resettlement of war-displaced populations would have to be satisfactorily solved. The solution of those problems and the repair of the war-damaged infrastructure required a substantial amount of resources.

He therefore supported the Angolan authorities' call for Fund technical and financial assistance in putting together a comprehensive adjustment program and, more important, in helping to mobilize concessional external financial assistance to buttress their efforts, Mr. Toé stated. He supported the proposed decision.

Mr. Shimizu observed that the Angolan economy was characterized by large distortions and imbalances as a result of centrally planned economic management. A wide range of prices--including exchange rates and interest rates--were rigidly controlled, and there was a wide divergence between official prices and those in the parallel market. Imbalances were found, for example, in the fiscal and external areas in the form of large deficits. As the staff correctly noted, only a comprehensive adjustment policy would help the economy gain medium-term viability, and the recent peace agreement ending the civil war provided the best opportunity for carrying out such a policy. As he endorsed the thrust of the staff's assessment of the economy, he would comment only on those points which he believed deserved emphasis.

Reduction of the budget deficits--which amounted to more than one quarter of GDP in 1990--was imperative, Mr. Shimizu remarked. He welcomed the introduction of a centralized system to improve cash management. At the same time, the speedy adoption of the monitoring of expenditure on a commitment basis was warranted in order to contain slippages in the fiscal area. Moreover, extrabudgetary expenditure should be banned by all means. Specifically, the wage bill, which comprised one half of total expenditures, should be contained. The authorities should first count the number of public employees and then pay all salaries in cash rather than in-kind. That approach would make the wage bill more transparent. They would then have to decide the appropriate number of employees and an appropriate wage level. In that connection, it would be helpful to know how the salary level of government officials in Angola compared with that of other African countries. While expenditure cuts should play a central role in reducing the deficit in the near future, the tax base should be widened to provide fiscal viability over the medium term. In that connection, the authorities were encouraged to introduce the tax reform--including a general sales tax--that had been recommended by the Fund-UNDP technical assistance experts.

He urged the authorities to establish an accountable monetary system under which they could conduct more active monetary policy, Mr. Shimizu continued. In that connection, he welcomed the reform of the National Bank of Angola, in particular, the separation of the central bank and commercial bank functions. The reforms, however, should not stop at that stage, and efforts to make the central bank more independent and responsible should be continued. There should be a legal limit on central bank financing of budget deficits, and appropriate interest should be paid to the central bank on government borrowing. Also, the current rigid interest rate system should be restructured so that interest rates reflect market conditions. He also fully agreed with the staff that positive real interest rates should be maintained.

On the external front, while he welcomed the recent 100 percent devaluation of the kwanza, the disparity between the official rates and the market-clearing rates was still large, Mr. Shimizu commented. Such a disparity in exchange rates sent the economy a wrong price signal, discouraged exports and encouraged imports, and thus continuously worsened the external prospects. Therefore, a much larger, systematic devaluation of the kwanza was necessary and should be accompanied by tight fiscal and monetary policies, because devaluation would surely increase inflationary pressure on the economy.

He fully agreed with the staff that corrective policies should be firmly adopted before the authorities appeal for further debt rescheduling, Mr. Shimizu remarked. He supported the proposed decision.

The staff representative from the African Department stated that it was difficult to compare salaries in the Angolan public sector with those of other African countries because it was extremely difficult to translate public sector compensation into a monetary wage. The monetary wage was only a small part of the total compensation that an employee received in Angola. Employees also received bonuses, which they could exchange for goods at official prices; those goods could then be sold in the parallel market for extra income. Based on some studies by the authorities, the comparative level of Angolan public sector salaries was on the low side. It should be noted, however, that some higher-ranking employees received many fringe benefits, such as transportation, housing, and even some allowances for food.

Mr. Fogelholm remarked that the staff report was very clear and concise and should be commended. He could fully endorse the recommendations of the staff appraisal.

There was absolutely no excuse for delaying reforms and adjustment in Angola, and that was the most important point that Mr. Monyake could convey to his authorities, Mr. Fogelholm considered. Moreover, all recommendations by the staff were important, including those on stabilization policies. He would, however, emphasize two of the most important. First, it would be extremely important for the authorities to get relative prices right. That would include the foreign exchange rate and interest rates. He agreed with previous speakers--and the staff report was very clear on the point--that the foreign exchange correction so far had been inadequate, and there should be fuller exchange rate action, because if prices were not roughly at the correct level, the economy will not get going in the right direction. Second, it was equally important to create and enforce a legal framework that would be conducive to private ownership. Those two measures, if introduced and instituted, were absolutely important for any kind of foreign investment that could be expected and were the only way to attract foreign investment.

As Mrs. Krosby had already noted, a Fund-supported program could not be considered before a comprehensive economic program was in place, Mr. Fogelholm commented. Moreover, that program should include a number of prior actions. He wondered what were the prospects for such a program, and what were the sentiments in the country. The staff report indicated that the authorities would not be inclined to move before the election at the end of 1992, but clearly, something needed to be done before that time.

Mr. von Stenglin stated that he could fully support the staff's analysis and policy recommendations. The staff report described a difficult economic situation in an open and clear manner. Although the authorities had taken some adjustment measures that were in the right direction, it appeared that no substantial change in policy orientation had taken place since the first Article IV consultation with Angola a year earlier. He agreed with the view of previous speakers that the current piecemeal approach was grossly insufficient to turn around the economic situation and, above all, to mobilize the external financing that was so badly needed. Instead, a comprehensive adjustment program covering all policy areas was required, which would elicit confidence in the authorities' reform efforts. Moreover, the effective formulation of a meaningful adjustment program would depend critically on considerable improvement in the administrative capacity, the institutional framework, and the statistical database.

With the end of the civil war, Angola should not miss the opportunity to implement far-reaching reforms, Mr. von Stenglin remarked. Otherwise, undue gradualism would increase the costs of adjustment, if not undermine the achievement of an overall viable economic position. As to the Fund's involvement, it was hoped that the authorities would make efficient use of the technical assistance already provided by the World Bank, the UNDP, and the Fund in order to improve policy formulation and implementation. However, he shared the view of Mrs. Krosby that in the absence of tangible progress in that area, as well as convincing efforts at financial and structural adjustment, the consideration of a Fund-supported program seemed to be premature. He could support the proposed decision.

Mr. Dognin made the following statement:

> The staff report makes it very clear that a sustained recovery of Angola's economy will not be achieved unless the authorities embark on a comprehensive adjustment program. The prevailing huge macroeconomic imbalances and distortions continue to hinder the immense task of reconstruction and to delay further the support of the international financial community.
>
> Despite last year's oil revenue windfall and the initiation of a significant set of revenue measures, the budget deficit is still extremely large--at about 27 percent of GDP in 1991--and fully financed monetarily. Moreover, the deterioration of the external position has led to the accumulation of payment arrears to Paris Club creditors. Therefore, we fully endorse the staff's assessment and recommendations, and we urge the authorities not to delay the adoption of decisive reforms, particularly in the areas of the exchange rate, pricing, and fiscal and monetary policies. This being said, we do not underestimate the enormous challenges facing the authorities, and we are encouraged by their efforts to lay the groundwork for a comprehensive program with the technical assistance of the Fund.

On the fiscal side, the scope for reducing the fiscal deficit appears to be limited in the short term as the increase in peace-related expenditures, particularly for demobilization and the relocation of veterans as well as infrastructure reconstruction, is likely to offset the reduction of war-related outlays. Nevertheless, we encourage the authorities to take, without further delay, every measure necessary to widen the tax base and strengthen expenditure control. In this regard, the introduction of a new general sales tax and the enactment of a new tax legislation would be steps in the right direction.

Likewise, on the expenditure side, it is urgent to implement and tighten the monitoring of outlays on a cash basis while rendering more transparent the revised budget for 1991. In addition, without waiting for the conclusion of the review of public expenditures envisaged with the collaboration of the World Bank, the Government should adopt a set of concrete measures to cut expenditures, especially in the wage bill and in subsidies to public enterprises.

On the monetary front, the authorities are to be commended for the decisive reforms they have introduced in the financial sector with the creation of a two-tier banking system as a first step toward the establishment of an independent central bank. Nevertheless, much remains to be done in the area of monetary and credit control. We agree with the staff that a direct control on the banking system, with credit ceilings complemented by an adequate interest rate policy, could be more effective in the short term. In any case, the authorities should strive to follow a firmly restrictive policy of credit to the Central Government as well as to the public enterprises, consistent with fiscal restraint and the need for public savings.

Two other major issues that deserve to be emphasized are the level of interest rates, which have to remain positive to stimulate savings, and the settling of all pending matters related to the currency changeover. The latter is indeed a precondition to restore the authorities' monetary credibility and public confidence in the financial system.

As to structural reforms, we cannot but encourage the authorities to pursue price liberalization. This, together with an adequate exchange rate level, is a prerequisite to remove all current distortions that dampen domestic production and exports while stimulating a parallel market. Such reforms are crucial to diversify the economy, especially to revive agriculture output and provide adequate incentives for the relocation of war-displaced populations in the countryside.

Concerning wage remonetarization, we fully agree with the staff that if it is not implemented cautiously, it will have damaging consequences on the stabilization process. In any event, the staff rightly points out that it should take place after domestic price and exchange rate realignments.

As to the external sector, we share the staff's view that the authorities should set the exchange rate at a realistic level and should establish a unified exchange rate as soon as possible. The success of such an adjustment would, of course, depend critically on the ability of the Government to adhere firmly to a tightened fiscal and monetary policy. The authorities should endeavor to reverse the deteriorating trend of the external position, which is becoming increasingly unsustainable as reflected by the share of interest payments on external debt in terms of GDP--14.5 percent in 1990.

To conclude, we urge the Angolan authorities to take advantage of the momentum of the peace process and the support that it brought about both inside and outside Angola to design and implement a comprehensive set of macroeconomic policies and structural reforms. Such a new stance in the adjustment effort, together with the re-establishment of normal relations with Paris Club creditors, would trigger the international financial support that the authorities deserve for their efforts to consolidate the peace process while laying the groundwork for economic recovery.

Mr. Jamnik remarked that, despite constraints posed by a weak statistical base, the staff had presented a sound and sobering analysis of Angola's current economic situation and its future prospects. He had no major disagreement with the staff's appraisal and recommendations and wished only to reinforce their general stance.

As other speakers had indicated, Angola faced many pressing problems, Mr. Jamnik continued. The authorities appeared convinced that there was a need for comprehensive economic adjustment. However, the staff report conveyed the impression that the translation of the authorities' conviction into action would benefit from a greater sense of urgency, based on a more decisive thrust of policy and more specifically articulated intentions.

He concurred with the staff appraisal that the large imbalances and distortions pervading the Angolan economy could not be corrected through isolated and partial measures but rather must be addressed through a global policy approach, Mr. Jamnik commented. The question was how best to initiate a comprehensive and cohesive approach. Although the use of Fund resources might not be contemplated in the near term, it would be opportune at the current stage to embark on an exercise analogous to the policy framework paper process. Such an exercise would permit the authorities, with Fund and Bank assistance, to focus on the main policy areas and reflect on their priorities. Moreover, they would be provided with the opportunity to outline, with a timetable, coordinated measures in the areas of pricing, fiscal, monetary, and exchange rate policies. Data inadequacies would, of course, complicate describing the prospective evolution of macroeconomic and balance of payments aggregates. However, he remained to be convinced that data problems alone would present an insurmountable hurdle.

He wondered whether the staff could comment on the feasibility of using the policy framework paper process to help elaborate a coherent economic strategy incorporating macroeconomic, structural adjustment, and development objectives, Mr. Jamnik continued. The Fund would, of course, want to avoid placing an excessive bureaucratic burden on the authorities, and he could readily accept that the precise policy framework paper format might need to be modified and adapted to Angola's unique circumstances.

He had some reservations about assertions that it might be difficult for the authorities to introduce significant measures during the political transition until general elections in late 1992, Mr. Jamnik stated. As the staff and other speakers had rightly pointed out, the recent peace agreement had created a new opportunity and had provided momentum for reform, both political and economic. He believed that it was incumbent upon the authorities to attempt to forge a consensus on the content of an economic reform and adjustment program. The authorities deserved the support of the international community as they faced the enormous task of moving from a war-ravaged, centralized economy to a post-war, market-oriented economy.

Mr. Zhang remarked that the Angolan authorities should be commended for their strong efforts in implementing economic reforms over the past five years through three successive Plans, and for the good results achieved. However, economic growth was still far below potential, and a comprehensive economic strategy was urgently needed. With the recent peace agreement ending the civil war, the favorable political and economic situation--combined with the social environment--had provided a valuable opportunity for indepth economic reform of significant historical importance, which should not be missed. He could go along with the staff's analysis and recommendations. He also found Mr. Monyake's statement informative and helpful. He therefore wished to make only a few brief comments.

It was of paramount importance to implement tight fiscal policies in order to maintain macroeconomic stability and lay a solid foundation for overall economic reform, Mr. Zhang considered. The fiscal deficit had been equivalent to about 27 percent of GDP in 1990 and was expected to remain close to that figure in 1991. He therefore endorsed the staff's recommendation that it was essential to reduce the budget deficit. The authorities were encouraged to adopt the measures necessary to implement the reform of the tax system. It was also crucial to build up and improve the monitoring system in order to keep budgetary expenditures under control.

Since the public sector occupied an important position in the economy, determined efforts must be made to undertake public enterprise reform, Mr. Zhang continued. He noted that the authorities had decided to reduce subsidies to the public enterprises. Measures should also be taken to ensure that public enterprises met their tax obligations and that they transferred a share of the after-tax profits to the budget.

Regarding monetary policy, he welcomed the progress achieved under monetary reform, including the separation of the central bank and commercial bank functions of the National Bank of Angola and the creation of commercial banks, Mr. Zhang commented. He would emphasize the importance of correcting the practice of automatic accommodation of public entities' financing needs and also that interest rate policy should reflect the costs of providing alternative uses of credit. In that way, financial resources would be utilized efficiently. He believed that technical assistance from the Fund in the areas of monetary control and bank supervision would play an important role in meeting the authorities' request.

As to exchange rate policy, the authorities had taken significant and decisive action when they devalued the kwanza by 100 percent in March 1991, Mr. Zhang observed. However, the overvalued currency could only dampen domestic production and exports, and, therefore, adoption of a flexible exchange rate policy in line with the country's specific situation would help improve the external position and economic development as a whole. He supported the proposed decision.

Mr. Bossone stated that his chair fully shared the views expressed in the staff report. On the occasion of the 1990 Article IV consultation with Angola, his chair had joined others in welcoming what seemed to be at that time a receptive attitude on the part of the authorities toward the advice of the Fund. One year had since elapsed, but, unfortunately, expectations of any significant progress in policy implementation had been defied: serious economic distortions remained; the undertaking of major measures had been bypassed; and those policies that had been implemented represented, to use the staff's words, "an example of the inadequacy of isolated measures and poorly defined objectives." He therefore joined previous speakers in urging the authorities to implement swiftly the reforms indicated by the staff as essential, and he echoed the concern that new measures might again be taken without the benefit of a coordinated policy framework.

During the previous Article IV consultation, many Directors had emphasized the need for a Fund-supported adjustment program, Mr. Bossone recalled. The continuation of economic mismanagement that had been witnessed so far should, however, dissuade the Board from considering any such program for the time being, until a clear signal of a full government commitment to economic reforms was manifest. Moreover, a minimum of prior actions should be required before a program was considered by the Fund, and he would include within such prior actions the imposition of a strict budget discipline and the correction of current major price distortions, including the adjustment of the exchange rate level.

Prior action would also be necessary to secure the needed financial assistance from abroad, Mr. Bossone continued. In that connection, it would be essential that Angola fulfill its external financial obligations and, in particular, eliminate its arrears to Paris Club creditors under the 1989 rescheduling agreement.

In the period prior to the consideration of a Fund-supported program, the Fund should continue to provide the authorities with specific technical assistance and policy advice in view of Angola's extremely limited institutional capacity, Mr. Bossone commented. The authorities' lack of knowledge with respect to the use of basic policy instruments would impede the implementation of any program, however strong their policy commitment. He wished to commend the staff for the work currently being done, and for the results being achieved, under the UNDP-financed, Fund-executed technical assistance program in Angola.

Although the authorities deserved recognition for important reform in the financial sector, two points warranted comment, Mr. Bossone considered. First, he noted with concern that the new central bank law did not set any statutory limit on central bank financing of the government budget, leaving to the Government the decision on how much credit was to be extended to finance the budget. For a country like Angola, where the monetization of the fiscal deficit was the rule, the absence of a binding constraint could seriously hinder the implementation of antinflationary policies. Second, in line with the staff's recommendations, his chair believed that the financial sector reform should contemplate, as a matter of urgency, the issuance of government bonds to replace the receipts given by the National Bank of Angola in exchange for the old currency, and the freeing of bank deposits that had been frozen at the outset of the currency changeover. That would be essential to restore public confidence in the monetary authorities.

While he was gratified that the process of consultation between the Fund and Angola was solidly in place, he hoped to see soon a much more receptive attitude on the part of the authorities to the Fund's policy advice, Mr. Bossone concluded.

Mr. Sparkes stated that he endorsed the staff's appraisal and the remarks of previous speakers. In view of the authorities' limited administrative capacity, he agreed with Mr. Fogelholm that it was useful to focus on a few key objectives for the coming year, namely, the adoption of market-oriented interest and exchange rates and a proper legal framework for the private sector. A third important objective was fiscal consolidation, particularly a reduction in public sector employment. He did not believe that the implementation of any of those objectives were beyond the authorities' capacity, and he hoped to see evidence of tangible progress in all three respects by the time of the next review of Angola's economy.

The staff representative from the African Department commented that the policy framework paper could serve as a vehicle to aid the authorities in framing their objectives for structural and macroeconomic reform, but it could only be fully effective if it was supported by a program of actions, including exchange rate adjustment. What was important for the authorities at the current stage was to begin to prepare the basic statistics that were required to quantify such a program. The staff had suggested at the end of the consultation discussions with the authorities that it was open to collaborate in a process that could eventually lead to the quantification of a comprehensive program. It had to be recognized, however, that there were difficulties in view of the lack of sufficient data.

The staff representative from the Exchange and Trade Relations Department observed that the authorities had already articulated three successive program documents along the lines of the policy framework paper--the 1987 "Program Reform"; the 1989 "Program of Economic Recovery"; and the 1990 "Program of Action." Experience with those documents suggested that more work was needed in terms of capacity building before proceeding to formulate further policy paper. It should be noted that in parallel with the Fund's emphasis on technical assistance, the World Bank had approved in June 1991 a project designed primarily to strengthen the authorities' capacity to implement programs. It was hoped that the progress achieved under the Bank project and under the Fund's technical assistance program, Angola could move to the stage where work could begin on designing a document similar to the policy framework paper.

Mr. Monyake stated that he wished to thank Executive Directors for their contributions to the discussion on Angola. As to the observation that there had been no change in Angola, he would argue that there had been considerable change. The main problem facing his authorities was that the three transformations he had mentioned at the outset were taking place concurrently. In particular, the attitude of the people had to be changed completely from reliance on the Government for economic decisionmaking to reliance on market mechanisms. The authorities were currently engaged in trying to effect each change. Until that was accomplished, the implementation of the best thought-out programs would face the constraint of a lack of consensus among the people. In considering the pace of reform, account had to be taken of the fact that a sizable part of the country had not been under the control of the current administration because of the war, and that a period of consolidation and consensus building was required. In any event, the situation was not straight forward as some Directors had implied.

It was not for the lack of goodwill, or political will, that the transformation seemed to be progressing slower than was perhaps desirable, Mr. Monyake remarked. There had been some progress, but a lot of assistance would also be required. It was unfortunate that some Directors considered that Fund financial assistance or a Fund-supported program should be delayed for some time. He believed that with consultations and discussions, a program could be put together before the elections in 1992. All that was required was to sit down, follow the suggestions that had been made by the Fund staff on the programs that had been designed by the authorities, and to see how much could be done in Angola's current situation. Above all, it was important to tailor the program to the situation that it was supposed to correct. The authorities were not merely paying lip service to change; they meant what they said, as the staff could bear witness. The task before them was, however, a formidable one.

The Acting Chairman made the following summing up:

Directors were in agreement with--and indeed, they reinforced--the thrust of the staff's analysis and policy recommendations. They encouraged the authorities not to miss the opportunities created by peace and stressed the urgent need to face the tasks of shifting from a highly centralized administered economy, which has been severely devastated by war, to a market-based economy, which would rely on appropriate market signals, a more active private sector, and a streamlined and more efficient public sector, including a strong central bank.

Directors observed that Angola needs more comprehensive changes in its economic policies to address the large internal and external imbalances as well as the distortions that pervade the economy and prevent strong noninflationary growth and the realization of the country's potential given its broad resource base. Directors emphasized that the positive economic response to the peace process could be jeopardized by the maintenance of inadequate macroeconomic policies. At the same time, they expressed the view that it was important to avoid isolated and partial measures; rather, a comprehensive approach should be taken so as to reinforce the credibility of the authorities to pursue the necessary reforms and adjustment.

Directors attached particular importance to getting relative prices right, including the exchange rate and interest rates. With respect to the exchange rate, Directors noted the devaluation of 1991, but indicated the need for further substantial adjustment in the context of eliminating relative price distortions. This approach would need to be reinforced by a tightening of fiscal and monetary policies in order to eliminate, on a sustainable basis, the still large overvaluation of the domestic currency. These policies, accompanied by comprehensive structural reforms, are urgently needed to address the serious problems facing the economy.

In the fiscal area, Directors commended the authorities for the introduction of a centralized cash management system in the Treasury and for other improvements made in the budgetary process and in tax administration in accordance with the technical assistance provided by the Fund. However, they believed it was imperative to reduce the budget deficit, to scale down expenditures and improve their composition, to eliminate the excessive central bank lending to the Government and to the rest of the public sector, and to speed up the privatization process, including the strengthening of the accountability of public enterprises. Directors also cautioned that any increases in expenditures associated with the peace process, including expenditures relating to the demobilization of veterans and the relocation of war-displaced populations, should be offset by reductions in other expenditures or financed in a noninflationary way, including assistance from abroad.

While supportive of the initial steps already taken in the area of financial sector reform--namely, the creation of a two-tier banking system--Directors urged the authorities to continue to pursue their agenda of financial sector reform forcefully so as to create the basis for an independent central bank and to establish a monetary program based on restrictive credit ceilings and a positive real interest rate policy. A tight monetary policy was seen as essential to cope with the monetary aspects of the transition to a market economy, particularly to ensure the successful functioning of the new banking system and avoid the inflationary consequences of relative price changes. The authorities also were encouraged to free deposits that had been frozen and to substitute bonds for the currency receipts.

Directors expressed concern about the external debt situation. They encouraged the authorities to pay the existing arrears on debt rescheduled by the Paris Club in 1989 and to implement policies and structural reforms that eventually could provide the basis for improving the external position and obtaining further Paris Club debt rescheduling.

Directors noted the progress made to date under the Fund-executed UNDP-financed technical assistance project and generally endorsed the recommendations of the first review of the project. There were calls for the continuation and expansion of such assistance to Angola. However, Directors indicated that further efforts are needed to strengthen the critical weaknesses of the statistical data base and institution building with a view to facilitating policy design and implementation.

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

The Executive Board took the following decision:

1. The Fund takes this decision in concluding the 1991 Article XIV consultation with Angola, in the light of the 1991 Article IV consultation with Angola conducted under Decision No. 5392-(77/63), adopted April 29, 1977, as amended (Surveillance over Exchange Rate Policies).

2. Angola maintains restrictions on payments and transfers for current international transactions in accordance with Article XIV, Section 2, as described in SM/91/173. The Fund encourages Angola to remove these restrictions as soon as possible.

Decision No. 9811-(91/114), adopted
September 4, 1991

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/91/113 (9/4/91) and EBM/91/114 (9/4/91).

3. RULES AND REGULATIONS - AMENDMENT OF RULE N-16(d)

The first sentence of Rule N-16(d) shall be amended to read as follows:

The advance approval of the Executive Board shall be necessary for technical services by persons on the staff of the Fund in response to requests by nonmembers or international agencies. (EBD/91/244, 8/15/91)

Adopted September 4, 1991

APPROVED: February 13, 1992

LEO VAN HOUTVEN
Secretary