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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 91/154

3:00 p.m., November 13, 1991

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

Executive Directors	Alternate Executive Directors
M. Al-Jasser	A. A. Al-Tuwaijri
	B. R. Fuleihan, Temporary
	L. E. N. Fernando
Che P.	
	G. C. Noonan
	C. M. Towe, Temporary
T. C. Dawson	Q. M. Krosby
	S. B. Creane, Temporary
	M. E. Hansen, Temporary
	J. Prader
	F. Moss, Temporary
E. A. Evans	G. H. Spencer
	N. Kyriazidis
	B. Bossone, Temporary
M. Finaish	
I. Fridriksson	J. A. Solheim
	A. Gronn, Temporary
H. Fukui	M. Nakagawa, Temporary
B. Goos	B. Esdar
J. E. Ismael	
A. Kafka	J. C. Jaramillo
J.-P. Landau	H. Dognin, Temporary
A. Mirakhor	
	L. J. Mwananshiku
D. Peretz	P. Wright
	D. Sparkes, Temporary
G. A. Posthumus	
C. V. Santos	N. Toé, Temporary
A. Torres	R. Marino
	L. Rodriguez, Temporary
A. Végh	

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

Also Present

IBRD: G. Brizzi and F. Ettori, Europe, Middle East and North Africa Department; N. Gorjestani, Africa Regional Office. Administration Department: G. F. Rea, Director; H. Wiesner, Deputy Director. African Department: M. Touré, Counsellor and Director; R. Abdoun, E. A. Calamitsis, Deputy Director; N. Abu-zobaa, G. C. Dahl, P. Dhonte, R. A. Franks, A. Jbili, M. Katz, M. M. Lazare, S. Thiam, R. C. Williams. Central Asia Department: Y. Horiguchi. Southeast Asia and Pacific Department: K. Saito, Director. European Department: J. Artus, C. Atkinson, T. A. Wolfe. Exchange and Trade Relations Department: J. T. Boorman, Director; J. Ferrán, Deputy Director; T. Leddy, Deputy Director; A. Basu, M. E. Edo, M. G. Gilman, G. R. Kincaid. External Relations Department: S. J. Anjaria, Director, I. S. McDonald. Fiscal Affairs Department: V. Tanzi, Director; T. M. Ter-Minassian, Deputy Director. IMF Institute: P. Marciniak. Legal Department: W. E. Holder, Deputy General Counsel; R. H. Munzberg, Deputy Director; P. L. Francotte, J. K. Oh. Middle Eastern Department: S. H. Hitti. Research Department: G. Hacche, P. R. Masson, P. Wickham. Secretary's Department: J. W. Lang, Jr., Deputy Secretary; G. Djeddaoui, A. Tahari. Treasurer's Department: D. Gupta, C. A. Hatch. Western Hemisphere Department: S. T. Beza, Counsellor and Director; M. Caiola, Deputy Director. Office of the Managing Director: P. R. Narvekar, Special Advisor; J. Hicklin. Personal Assistant to the Managing Director: B. P. A. Andrews. Advisors to Executive Directors: J. M. Abbott, P. Bonzom, M. B. Chatah, L. Dicks-Mireaux, E. Martinez-Alas, B. A. Sarr, B. Szombati, A. M. Tanase. Assistants to Executive Directors: T. S. Allouba, J. R. N. Almeida, Chen M., S. K. Fayyad, H. Golriz, M. A. Hammoudi, J. Jamnik, P. K. Kafle, V. Kural, W. Laux, J. Mafararikwa, M. Mrakovcic, L. F. Ochoa, E. H. Pedersen, S. Rouai, J. W. van der Kaaij.

1. WORK PROGRAM AND PROPOSED TEMPORARY CHANGES IN ARTICLE IV CONSULTATION CYCLES

The Executive Directors resumed from the previous meeting their consideration of statements by the Managing Director on the work program and on temporary changes in Article IV consultation cycles.

Mr. Mwananshiku made the following statement:

> I welcome the Managing Director's statement on the work program for the next semester. There is no doubt that a very busy period lies ahead. Given time and staff resource constraints, the tasks confronting management in achieving the objectives stated in the statement become particularly onerous.
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> The drive for economic transformation in the U.S.S.R., as in the rest of Eastern and Central Europe, is encouraging. Notwithstanding the difficulties imposed by the uncertainty of future political and economic arrangements in the U.S.S.R., the commitment of the Fund to economic reform there is commendable. The need for technical assistance for the various republics has in fact been described as enormous and is likely to increase as more republics assert their autonomy.
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> In putting emphasis on the U.S.S.R. and the republics, care should however be taken to ensure that the interests of other members, particularly the developing countries currently undertaking major economic reform programs, and the traditional responsibility of the Fund to the entire membership, are not jeopardized. Given the difficulty of augmenting staff resources in the short run, it is hard to see how the massive technical assistance envisaged for the U.S.S.R. and the Baltic states would be met without diverting resources from other areas of equal importance. Already, it has been indicated that a number of Article IV consultations will be postponed, while a few others will be put temporarily on the bicyclic or two-year cycles. Besides, some research studies that are vital to the adjustment effort and to the pursuit of development objectives of many developing countries will inevitably be suspended in order to respond to emergency needs for staff resources. Also, technical assistance assignments to certain member states will need to be delayed.
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> I see the need for management to keep the work program constantly under review during the coming months to ensure the reinstatement of those activities related to developing countries that may be suspended as a result of this current exercise.
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> On policy and operational issues, I look forward early in 1992 to the proposed papers on management of the debt situation and on the role of the SDR. It is my hope that the paper on the role of the SDR will come out with concrete proposals on the

resumption of SDR allocations and thus pave the way for the establishment of the SDR as the principal international reserve asset. The important role of SDRs in the management of international liquidity has always been recognized.

Equally important is the paper on the expansion of eligibility for the enhanced structural adjustment facility (ESAF). There is a need to sustain the support which the Governors have given to the proposal by management to extend the list of ESAF-eligible countries by securing as quickly as possible an Executive Board decision on the modality of its implementation. In setting out the rationale for expanding the list, the staff should be guided by its experience with countries undertaking economic reforms. The urgency of the matter stems from the fact that certain low-income and lower middle-income countries that are now excluded face excruciating debt burdens and persistent balance of payments pressures. Such countries would benefit from concessional financing under the ESAF in their effort to restructure their economies and achieve economic viability. In essence, the Fund should be willing to provide concessional assistance to members in cases in which it would make a difference in propelling those countries toward self-sustaining growth with a viable balance of payments position.

Mr. Végh stated that he supported the Managing Director's statements, especially that on the work program for the U.S.S.R. They were well thought out and careful, and he supported their main thrust. However, like other Directors, he had been worried about the consequences of the new work schedule on the quality and direction of the Fund's other work, especially with respect to its chief responsibility, surveillance. In that connection, he supported the opinions and concerns of Mr. Posthumus and other Directors.

According to the revised schedule of Article IV consultations proposed by the Managing Director, one of the countries in his constituency, Chile, would be placed under the bicyclic procedure, Mr. Végh observed. He was certain that that ran against the Chilean authorities' desires. Although Chile did not have a Fund-supported program at present, the authorities had stated that they wished to have a type of enhanced surveillance mechanism, with reviews every six months. He was not sure that they would appreciate being moved in the opposite direction.

He, like Mr. Prader, was skeptical as to the productivity of the work effort that the Fund was undertaking in the U.S.S.R., Mr. Végh went on, although he understood the political reasons behind the decision of the Fund management to undertake it. In that sense, he shared the concerns of Mr. Evans. It was clear that the U.S.S.R. would not exist for very much longer, and the Fund was thus working mainly with the republics under Article VI of the association agreement that had been signed in Moscow on October 5, 1991. He wondered about what had happened to the report of the Fund and other international organizations--a considerable effort--that had been presented to the Heads of State of the G-7 countries on December 20, 1990. Many talented people had completed the work on the report in a very short space of time and very efficiently; he wondered what the reaction of the various republican authorities had been to it. For example, had the republics made any contributions, or were they leaving the work entirely to the Fund, the Bank, and the OECD. Perhaps it would be better for the Fund to concentrate its efforts on training and the improvement of statistics.

He had been happy to find a reference in the Managing Director's statement to the small staff teams that were employed to keep abreast of developments and to provide policy advice, Mr. Végh commented. He had taken note of the Managing Director's comment that the U.S.S.R. officials were being overwhelmed and, indeed, even crowded out, by foreign advisors. He had recalled the same problem in the context of certain Latin American countries as well. The World Bank in particular needed to exercise caution in that regard.

The question of the costs involved in the Fund's program of assistance to the U.S.S.R. that Mr. Finaish had drawn attention to was a very important one, Mr. Végh stated. Some time previously, the Board had been told that the costs would be minor in 1991, and that a more careful assessment of the costs and their implications for burden sharing would be made for 1992. It appeared that the costs would be quite substantial already in 1991, not only in terms of money, but also in terms of the use of scarce and high-quality human resources.

Like other Directors, he supported the proposed scheduling of matters such as an SDR allocation and burden sharing, Mr. Végh continued. Although it was unlikely that any new system of burden sharing or the determination of the rate of charge could be agreed upon, he agreed with Mr. Torres that those subjects should be of concern to all Fund members. He supported an earlier consideration of the rules for the 1992 Regular Election of Executive Directors.

He agreed with Mr. Goos and Mr. Dawson on the possibility of establishing resident representatives in the republics of the U.S.S.R., Mr. Végh concluded. In order to cover the increased expenditure for the Fund that those posts would require, the Fund should consider eliminating resident representative positions in those countries that had already made significant progress in their adjustment efforts. Also, a cost-sharing arrangement for the resident representative posts in the U.S.S.R. should be put in place early in 1992.

Mr. Noonan made the following statement:

> This chair broadly supports the proposed work program and the priority it gives at this stage to work on the U.S.S.R. The worldwide and relatively sudden shift away from attempts to plan economies to a far greater reliance on market mechanisms has been accompanied by many requests for large-scale assistance from the Fund, both technical and financial. The provision of such assis-

tance has already placed a heavy extra burden on the Fund's resources. Responding to the needs of the U.S.S.R. will greatly add to that burden.

This chair also supports the Managing Director's view that the Fund should be able to respond rapidly to the needs of the Russian republic, and those of the other constituent republics of the U.S.S.R., which have embarked on their own structural and other reforms. I recognize that the provision of assistance at the republic level will place even greater demands on the Fund's resources than the heavy demands which would arise if we could limit our dealings to a single centralized authority for the whole U.S.S.R.. In light of the impending increase in work load, the focus of my comments will be on how the Fund should respond to these new demands in terms of managing the limited resources at its disposal.

We should give priority to helping the central authorities in the U.S.S.R. to build up their own capacity to coordinate and manage the reform process themselves to the greatest extent practicable. There are many obvious reasons for encouraging and fostering mutual interdependence among the Soviet republics. The buildup of a central core of knowledge and expertise in market economics in the U.S.S.R. would contribute to that process while also helping to contain potential demands on Fund staff resources. In this context, I would like to warmly commend the generous offer by the Austrian authorities of facilities for this purpose for Eastern European and other countries.

That point being made, we cannot ignore the rapidly evolving situation in the U.S.S.R.. The Fund's management must be realistic in planning for the size of the demands that are going to be made on Fund resources. That realism, in our view, requires it to expect to have to deal not only with the Soviet central authority and systemic issues, but also with individual republics. A two-pronged strategy is required to cope with the size of these extra demands. One element would be to increase the total of resources available for deployment by the Fund. Further ways and means of doing so need to be explored. The second element requires that priorities be identified with more precision than they have been in the past, so that existing resources can be released from less important activities. Both elements of this strategy seem to underlie management's approach to present demands, but, in our view, there is scope to implement it more broadly across more of the Fund's activities.

For example, this chair believes that the redeployment of existing resources is an urgent task for management. Accordingly, we look forward to the further identification of management's views on future work priorities in the documentation which is to be issued soon on the Fund's budgetary outlook in the medium term.

Like Mr. Peretz, I hope that this documentation will be succinct and issue related. That is what is needed to catalyze an incisive Board discussion on priorities. I would also wish to support Mr. Peretz and Mr. Dawson in their calls for more focused and shorter research papers. At the same time, we have reservations, like Mr. Posthumus and others, about the extent to which the Managing Director's proposals for temporary changes in Article IV consultation cycles will actually increase the availability of the specific resources sought. Many of the proposed bicyclic cycles will still require interim consultations. We would therefore appreciate any clarification the Managing Director can give as to the actual quantum of specific resources which he expects to be released by means of these proposals.

Notwithstanding the scope we believe there is for releasing further staff resources through redeployment, we also recognize that this scope is limited in relation to prospective demands. An important consideration in this context is that the extra demands for Fund assistance call for the provision of specific skills and expertise. Another relevant consideration is that these extra demands should not be of indefinite duration, a point already emphasized by Mr. Goos and others. Mr. Evans, of course, has made the legitimate point that what should be the case may not necessarily turn out to be the case, but I hope that he is being unduly pessimistic in this regard.

A complementary approach to the provision of further staff resources--and I emphasize complementary, rather than alternative--is the approach whereby many members have already contributed in various ways to the Fund's efforts to deploy additional resources--in the provision of central banking expertise, for example. We believe that there is both considerable scope to do more along these lines on a broader front, and that the goodwill and cooperation of Fund members is there to facilitate such an approach. The Canadian authorities wish me to be explicit as to their willingness to facilitate such an approach. They are at present examining the potential they have to release specific skilled resources to the Fund should they be so requested. Greater use of members' resources, under the general direction of the Fund, would also reduce any undesirable repercussions on country-related activities. In that context, we would underline the emphasis the Managing Director has put on the importance of flexibility in meeting the needs of members under the proposed changes in Article IV consultation cycles. Some Caribbean members of my constituency listed in the Managing Director's proposals have particular difficulties at present and will need to be treated with flexibility. Greater use of nonFund resources would enhance the degree of flexibility available in meeting members' needs. In concluding, I would urge that management of all Fund Departments be alert to appropriate opportunities for such short-term enhancement of the Fund's staff resources.

Mr. Al-Jasser made the following statement:

The challenging work program before us highlights the dramatic increase in the demands on the Fund and, consequently, in the workload of the staff. As accurately noted, this increase requires a corresponding redefinition of priorities and a redeployment of staff resources on a temporary and exceptional basis. As a result, it is necessary to experiment with different procedures, in order to ensure that the Fund is capable of fulfilling its additional responsibilities. This is advisable, since the exceptional task of assisting the U.S.S.R. to transform its economy is now at its peak.

Bearing this in mind, I welcome the Managing Director's proposal to tackle the various aspects of the special association agreement between the U.S.S.R. and the Fund. Given the continued uncertainty in the U.S.S.R., the nature and degree of the Fund's involvement in providing assistance, both to the center and the republics, are unpredictable. Nevertheless, I share the Managing Director's view that the Fund must press ahead with the provision of technical assistance to decision makers at various levels of the governmental structure. However, it is essential to devise a mechanism that ensures that the Board is kept fully abreast of the Fund's activity in this area. Hence, I welcome the Managing Director's suggestion to provide periodic briefings, every two weeks, to the Executive Board. These will prove even more helpful if short briefing notes on the latest developments, including, possibly, updates of tables on key economic variables, are distributed to the Board prior to the biweekly discussions. Moreover, it would be helpful if the Board were informed on a timely basis about staff and administrative changes, including recruitment.

In light of the need to redirect staff resources, I can support the Managing Director's proposal to alter the schedule of Article IV consultations. However, given that surveillance is the primary role of the Fund, this must be regarded as a purely temporary measure. Indeed, the withdrawal of staff resources from other departments should be a one-time shift that lapses after a specified period of time. While still on this issue, I note from the Managing Director's statement on work related to the U.S.S.R. that certain technical assistance assignments to other regions will need to be delayed. While this is understandable, it is important not to ignore the requirements of those of our members which may be equally dependent on the Fund's technical assistance. Indeed, priorities and needs should be measured in terms of national as well as global priorities.

I look forward to reviewing the guidelines on the allocation of currencies under the operational budget. In this context, it is crucial to preserve the Fund's liquidity position as well as its cooperative nature. Therefore, these guidelines should be based on balancing a member's position in the Fund with its gross reserve position.

With respect to the section of the work program on the world economic outlook (WEO), debt and trade issues, I endorse the proposed focus of the spring 1992 WEO, as well as the continuation of our periodic informal sessions on exchange market developments. However, it may be helpful if, on an experimental basis, we prepare a paper on the management of the debt situation once a year rather than every six months, particularly since the WEO covers the recent developments of this issue biannually. In addition, I join Mr. Mirakhor in emphasizing the importance of the study on trade requested by the Development Committee.

On systemic issues and the role of the SDR, while I welcome the forthcoming study on the role of the SDR, it is imperative that the papers dealing with key issues in international capital markets and exchange rate issues be of operational significance.

Regarding policies on the use of Fund resources and the design of Fund policy advice, it is essential that the annual review of the operations of the SAF, ESAF, and ESAF Trust be limited to pressing operational issues. In addition, I am disappointed to note that the paper on issues in energy pricing policy has not yet been placed on the agenda, despite the fact that the staff has completed its work and that there is a strong desire on the part of a number of Directors for such a discussion. This issue has a special significance because the lack of a clear, well-defined, and theoretically sound approach to energy pricing in this institution has created many difficulties during negotiations with member countries, as well as painful debates in the Board.

On several occasions, the Managing Director has mentioned that the increased demands on this institution necessitate some prioritization of its workload. Consequently, I can support his proposal to postpone the review of the CCFF. In addition, consideration of other issues could be postponed, such as that of the broad principles of burden sharing and the cost of Fund financing, as well as the examination of quota formulas. In light of previous experience with these delicate issues, I could only expect prolonged and heated discussions without any major conclusions. Clearly, this is not the most opportune time to reopen these debates that will exhaust scarce staff resources and precious Board time without any conclusive results. In addition, I support the views of Mr. Goos and Mr. Evans on the scheduling of Board meetings, and I join others in calling for the establishment of an independent evaluation unit.

On the quota increase, I share the Managing Director's views on the need to approve the quota increase and the Third Amendment as soon as possible. Here, I am glad to inform the Board of Saudi Arabia's approval of the Third Amendment.

Mr. Ismael made the following statement:

I am in broad agreement with the proposed work program. The focus of my intervention will be on our involvement in the U.S.S.R.

At the recent Annual Meetings in Bangkok, the Minister of Finance of Indonesia made the following statement:

> The movement toward political freedom and democracy must be welcomed, as must be the recent announcement of the agreement setting out the Soviet Union's special relationship to the Fund. However, we cannot stress too strongly that it is equally important to a growing world economy and trading system that the programs in Eastern Europe and the Soviet Union are not to be at the expense of the developing countries. After all, Eastern Europe and the Soviet Union have large natural resources and production facilities of their own. Largely what is needed is effective mobilization and allocation of those resources. It is necessary to make this point with great urgency, and it is not a hypothetical question. My country has already experienced the reassignment to programs in the Soviet Union of technical experts on whom we set great store.

This statement was promptly derided by the Asian Wall Street Journal in its editorial review of October 17, 1991, which in part stated the following criticism:

> The least dignified sight at the World Bank - International Monetary Fund meeting in Bangkok this week has been that of developing nation finance ministers waxing jealous over the attention lavished on the new kids on the block--Eastern Europe and the Soviet Union. Representatives of countries ranging from India to Indonesia to Chile have complained that they fear getting short weight in developed world aid allotments they have come to regard as rightfully theirs.

As it now turns out, and as clearly reflected in the Managing Director's recent statements, our concern has not only been proven correct, but the implications of our involvement in the U.S.S.R. are even more wide-ranging than what we originally expected.

Nevertheless, we are prepared to support the Managing Director's proposal on the temporary changes in Article IV consultation cycles. Under the circumstances, it represents a sufficiently satisfactory grouping of the membership.

However, we feel that more, not less, attention should be given to the smaller member countries which will now be placed on a 24-month cycle. These small, nonproblem, nonprogram economies will be deprived of a highly valued opportunity for an annual exchange of views with the Fund on their macroeconomic policies. This loss has to be compensated; the proposed staff visits should be geared toward filling this void.

In addition, those countries which are nonusers of Fund resources but dependent on technical assistance, or in need of technical assistance, should continue be given the opportunity to receive Fund technical assistance.

Finally, redeployment of staff resources should be done carefully and in a balanced manner. All these organizational adjustments should not lead to the crippling of departmental operations and the sacrifice of the quality of Article IV consultation missions.

Mr. Che made the following statement:

I would like to thank the Managing Director for the comprehensive and detailed information on the work program for the period up to the next meetings of the Interim and Development Committees in late April 1992. I am in broad agreement with the work program proposals.

In general, I can go along with the proposed work program as it relates to the U.S.S.R. From the number of visits Fund officials have made, and will make, to Moscow and the republics, and the extensive contacts already established between the various Fund departments and both the union and republic authorities, the Fund has indeed moved very rapidly, and this is in line with the recent Interim Committee communique. While I can concur that work priorities need to be reset and staff resources redeployed in order to meet work demands related to the U.S.S.R., some caution should be exercised. Consistency in our work, including the world economic outlook, debt and trade issues, and country-related activities, is of paramount importance and should not be interrupted. Every effort should be made to ensure that any short-term fine tuning does not damage our medium-term perspective and long-term objectives. I believe that a well-balanced work schedule will be of great help, and, therefore, that it needs to be worked out as soon as possible.

With regard to the work program directly related to the U.S.S.R., I recall that last Wednesday (EBM/91/147, 11/6/91), Mr. Fukui asked whether the "first-come, first-served" approach had been adopted in the Fund in meeting requests from the union and the republics. I am also of the impression that the Fund has taken a kind of passive stance in this respect. It is essential and desirable, to our mind, that the Fund work out its own framework and set priorities for the work related to the U.S.S.R. Resources for funding the work program, particularly technical assistance related to the U.S.S.R., are another cause for concern. I hope that additional resources can be identified and confirmed as soon as possible.

Regarding country-related activities, I notice from the Managing Director's statement that changes in Article IV consultations will fall more heavily on the European Department. At the recent Interim Committee meeting, many members expressed their concern about the trend of economic developments, especially the trend in the industrial countries. I am therefore of the view that any changes in Article IV consultation arrangements should not negatively affect the consistency and continuity of the Fund's surveillance role.

My authorities are very much concerned about the possible changes in the Article IV consultation arrangements with China, where economic development and reforms are gathering greater momentum. They hold that the present consultation cycle should be maintained. I also wish to emphasize that, regarding consultations with other countries, whatever changes have to be made should be of a temporary nature, and Fund work should return to normal as soon as possible.

I fully endorse the Managing Director's proposal on the world economic outlook, and the debt and trade issues. I believe that these issues will be of great concern at the 1992 spring meeting.

As this chair stated at the last Board meeting on the work program in May (EBM/91/69, 5/24/91), we support the proposed studies and reviews on the international monetary system, the SDR, and other systemic issues. I also wish to stress that when the Board reviews the issue of the SDR, due attention should be given to the important role played by the SDR and the wide support from member countries for the resumption of SDR allocations.

I agree with the Managing Director's proposal to revisit the quote increase issue. It is indeed our sincere wish that the Ninth Quota Review could become effective as soon as possible, considering its implications for a number of important issues. We have found very helpful the Secretary's circulars on progress regarding consents to quota increases and acceptances of the Third Amendment by member countries. We believe that, in addition to the regular issuance of the circulars, they might be issued in a more timely fashion when necessary.

The Chairman, responding to Mr. Che's reservations regarding the proposals to move China and some other countries temporarily to the bicyclic consultation procedure, said that he appreciated the concern of the Chinese authorities that China not be denied the opportunity for close cooperation with, and advice from, the Fund, by way of the standard Article IV consultation procedure. China was an important country from the perspective of the international monetary system, not only because of its obvious demographic weight--with a population more than three times that of the U.S.S.R.--but also because of its recent efforts at economic reform. While his proposals to change temporarily the cycle of Article IV consultations presupposed flexibility in their implementation on the part of the Fund, he was certain that the Chinese authorities would bear in mind the Fund's tight staffing and heavy work load situation at present. It went without saying that the periodic staff visits to China, along with the senior Fund officer assigned recently to China as resident representative, would ensure that the quality of the exchange of views between China and the Fund would be preserved. In that connection, he feared that if an inappropriate degree of flexibility in the implementation of his proposals were allowed--in respect of countries perhaps less systemically important than China, for example--the door might be opened to a flood of requests for exceptions, thus defeating the aim of the proposals.

Mr. Kyriazidis stated that he was in full agreement with the outline of the Fund's response to the requests of the U.S.S.R. and the republics at the current historical juncture. Of course, additional pressures would thus be placed on the institution's resources, and he agreed with the general approach proposed to deal with them.

All the ways in which the pressures could be faced in the immediate future had been enumerated by the Managing Director, Mr. Kyriazidis observed, including an adjustment of the Fund's activities and the redeployment of staff resources; the hiring of additional staff and secondment of staff from other institutions; and the recruitment of outside consultants. On that point, he came closer to Mr. Evans's view. The Fund's work in the U.S.S.R. and in its republics should be considered as a more permanent, rather than a strictly temporary, development. As Mr. Evans had said, the republics would not go away, even though the union might. He welcomed the upcoming discussion in the framework of the medium-term budgetary outlook on the budgetary and recruitment implications of the expansion of the Fund's responsibilities and activity. While such activity might well peak at some stage, as Mr. Goos had noted, it was unlikely to disappear. The quantum addition to the responsibilities of the Fund that had materialized would have to be planned for in the budgetary outlook.

The second major proposal was the adjustment to the consultation cycle for a number of countries, Mr. Kyriazidis continued. Although he agreed with the immediate measures suggested, the Fund should take the opportunity to revisit the consultation cycles. His chair had repeatedly said that it would be in favor of returning to the cycle that had prevailed in the early 1980s--a two-year cycle, with an update on the basis of questionnaires. That could speed up considerably the work of the institution and save staff time, which, as Mr. Posthumus and Mr. Peretz had pointed out, was not saved under the bicyclic procedure, as well as considerable Board time. That principle could be applied with flexibility in cases in which countries wished for specific reasons to have more frequent consultations. With the exception of the major industrial countries and the program countries, where more flexibility would be required, the two-year cycle should be the rule.

He agreed with the proposed work on the world economic outlook and on debt and trade issues, Mr. Kyriazidis went on. He considered particularly useful the emphasis to be given to the reform issues in Central and Eastern Europe and the U.S.S.R.; the mix of expenditure and tax measures in fiscal consolidation in industrial countries as a means to raise savings; and the factors affecting medium-term growth and employment in the major industrial countries. An interesting short analysis had been provided in the last WEO on the employment problem in industrial countries, mostly in Europe. He believed that that would be worth pursuing further.

On systemic issues and the role of the SDR, he strongly supported the work proposed on international liquidity and the SDR, Mr. Kyriazidis commented. He would be particularly interested in the evaluation of proposals for possible modifications to the SDR mechanism itself, including the ideas put forward by Japan. He joined Mr. Goos in expressing doubt about the usefulness of the work on the determinants of equilibrium exchange rates.

With respect to policies on the use of Fund resources, he could agree to the postponement of the review of the CCFF, which was a difficult and complicated compromise, Mr. Kyriazidis continued. A review of the CCFF would not necessarily produce anything better, and a postponement was thus entirely appropriate in the current situation.

With regard to the design of Fund policy advice and the work of the Research Department, he joined Mr. Goos in expressing some doubts about the usefulness of the paper on economic implications of unproductive public expenditure, Mr. Kyriazidis remarked. The conclusion of such a discussion could already be foreseen; it reminded him of the anecdote of someone who, returning from church, was asked to describe what the preacher had said in his sermon. "He had spoken about sin," said the man. "For how long?," asked another. "For about two hours," came the reply. "What did he say?," said the other. "He was against it," said the first.

He did not see much usefulness in holding a seminar on burden sharing, Mr. Kyriazidis observed. He would propose that the discussion of burden sharing should be taken up in combination with the review which would have to be carried out in any case.

The Board should consider the budgetary outlook in the medium term on the basis of realistic projections of the amount of work that the Fund would have to face, and the quantum change in its responsibilities that had taken place over the current year, Mr. Kyriazidis noted.

He joined Mr. Evans in drawing attention to the burden that could be placed on the Board if important papers were bunched in the period just before the Interim Committee meeting, Mr. Kyriazidis concluded. He supported Mr. Evans's proposal in that connection.

The Deputy Managing Director stated that the staff would be working at both the central and the republican levels in the U.S.S.R., and with each of the Baltic states. It was clear that all those entities would require significant resources, judging from the Fund's experience with those of its current members in similar circumstances.

For the second half of financial year 1992, that work would require about 150-160 additional staff, the Deputy Managing Director continued, including about 45 economists in the European Department and about 20 economists in the functional departments, particularly the Exchange and Trade Relations and Fiscal Affairs Departments. It was the general practice to have representatives of those two departments participate in area department missions. Over the succeeding 5-6 months, about 70 staff years would be needed for technical assistance, of which 40-45 staff years would represent Fund staff, and the rest experts and consultants. About 20 additional support staff would also be needed in the European Department and the technical assistance departments. The supplementary budget for financial year 1992 would include a request for additional staff years that would allow the recruitment over the following six months primarily of experts and consultants, but also of a few new staff members.

The Administration Department had been working intensively on recruitment since the spring of 1991, and it appeared to be on target in filling the new positions that had been created in the financial year 1992 budget, the Deputy Managing Director related. There were a large number of candidates in the pipeline, ready to be interviewed and considered by the departments. Management concurred that the need to increase staffing should not lead to a relaxation of the Fund's standards, or to an expansion of staff that would be difficult to reverse if necessary later on. The management had developed a number of safeguards in order to avoid those problems, including the hiring of a part of the additional staff on the basis of fixed-term appointments for two or three years. Also, some of the additional staff, particularly in the near term, would be seconded from member countries or other institutions. Part of the staffing would consist of experts and consultants who were generally hired on a relatively short-term contract basis in any case. Flexibility would thus be built into the system over time to avoid the risks that could come about when any institution had a bulge in its recruitment of staff.

Having said that, it was nevertheless apparent that the Fund would not be able to recruit the necessary number of staff to do the work in the period ahead, which had led management to look at a variety of ways of using existing staff through redeployment, the Deputy Managing Director pointed out. In practice, there was a limited degree of freedom in suddenly cutting staff in one area in order to move it to another. For example, even in the case of surveillance, most countries would not be affected by the proposed changes in consultation cycles, because they were either program countries, near-program countries, or leading industrial countries, so that the number of staff that could be redeployed in consequence was not great. Shifting to the bicyclic consultation procedure on a country-by-country basis also would not save many staff resources, although the two-year cycle would save a bit more. In any case, about 20 staff years would be freed up if the proposed changes in the consultation cycles were approved.

Other changes that would free up additional staff included the postponement of some technical assistance assignments to current Fund members in order to make available staff for the technical assistance requirements of the U.S.S.R., the Deputy Managing Director related. In some cases, the postponement might mean a fairly long period of delay. Some Directors had noted that they had already experienced that in their regions. Management would attempt to limit the impact of the technical assistance requirements of the U.S.S.R. on the rest of the membership, but it was unavoidable that some countries would be affected by the postponements.

Significant numbers of staff from the Research Department, and some from the Treasurer's Department, would be shifted to work on the U.S.S.R., the Deputy Managing Director continued. A variety of steps would be taken to scale back work in the area of policy design and research, as indicated in the proposed work program. The work that had been planned in the immediate future, which management had been postponing for the previous year, reflected the need to maintain contacts with aid agencies and export credit agencies, which was important in making judgments about the financing prospects of individual countries.

Within the Statistics Department, the focus would be shifted away from the maintenance and collection of data for the Fund's external publications, toward work on statistical issues in the U.S.S.R., the Deputy Managing Director stated, thus saving about five staff years. Management would also be considering ways of reducing to some extent the effort made on the world economic outlook exercise--especially in the area of responding to requests for data related to that exercise. In the area departments, and within the European Department, in particular, a redeployment of country economists for work on the U.S.S.R. had already taken place.

Management had also been making efforts to reduce the amount of lost leave time and improve training and personnel management, the Deputy Managing Director pointed out. Unfortunately, the current work load prospects suggested that those objectives would not be met, and that pressures on some staff would become greater, especially on those staff at the managerial level who would have to participate in missions to the U.S.S.R. while overseeing other work as well.

Notwithstanding management's intention to redeploy staff and hire additional staff and consultants in order to meet the work requirements of the

Fund's involvement in the U.S.S.R., it might be necessary either to postpone some of the missions planned for the U.S.S.R., or to staff them at very minimal levels, the Deputy Managing Director considered.

In financial terms, 150-160 additional staff working on the U.S.S.R. would imply an additional cost to the Fund of about $20-25 million, probably closer to the latter, the Deputy Managing Director concluded. Every $15 million in increased expenditure translated into an increase in the rate of charge on the use of the Fund's resources of about 0.1 percentage point, ceteris paribus. Therefore, an added cost of $20-25 million would imply an increase in the rate of charge of 0.15-0.20 percentage point. For financial year 1992, the impact would be smaller, because it would apply only for the second half of the financial year. The staff hoped to develop more precise estimates of the effects of staff redeployment and the hiring of additional staff on the cost of using Fund resources in the future, and the staff would return to the matter in the context of the midterm review of the budget.

The Chairman commented that he wished to draw the attention of Directors to the tentativeness of the information which the Deputy Managing Director had just provided. For example, the staffing profile included staff for a Fund office in Moscow, but not for any offices in the capitals of the U.S.S.R.'s constituent republics, the establishment of which was becoming increasingly likely, especially in the more important republics. In that connection, at least in the beginning, staff working in the republics would be under the aegis of, and would be coordinated by, the Moscow office, not least because the Fund could not presuppose the independence of the republics. Even so, an additional 20 people would be a conservative estimate of the number of staff needed for offices in the republics--in addition to the number that the Deputy Managing Director had mentioned. In any case, management was attempting to limit the number of new staff it would have to hire.

The Deputy Managing Director, responding to a question from Mr. Fukui, said that the estimate of an additional 150-160 staff members needed for work on the U.S.S.R. included 10 new positions that had already been included in the budget for the current financial year. The rest of the positions would be filled through recruitment and redeployment.

Responding to a question from Mr. Posthumus, the Deputy Managing Director explained that the 20 staff years to be saved by the change in the consultation cycles would be reallocated to the work on the U.S.S.R.

Replying to a question from Mr. Fernando, the Deputy Managing Director noted that the added cost of $20-25 million was a gross, not a net, figure. It did not include any possible reimbursements from the UNDP or the Government of Japan for technical assistance expenditures, for example, which might amount to an offsetting $2-3 million. Also, it needed to be borne in mind that to the extent that the Fund was successful in redeploying its staff, the added cost would be reduced. For that reason, the short-run impact of the work on the U.S.S.R. on the budget for financial year 1992, and on the budget for the early stages of financial year 1993, would be smaller; only once the additional recruits actually came on board would the full budgetary impact be felt. It was important that the budgetary cost to the Fund of its work on the U.S.S.R. not be underestimated, but by the same token, neither should it be overestimated.

Mr. Peretz observed that for the following few years the additional cost to the Fund would therefore be a good deal less than $20-25 million, because of the offsetting effects of the reduction of other activities and the reallocation of current staff.

The Deputy Managing Director added that while he did not wish to anticipate the supplementary budget, he hoped that, with sufficient recruitment and budgetary support, the temporary redeployment of staff could be unwound by the end of financial year 1993 or the beginning of financial year 1994, so that the activities that were to be cut could be restored.

The Chairman commented that the secondment of high-quality staff from member governments and other organizations would help enormously in defraying the cost to the Fund of the work on the U.S.S.R., and in assuring that its other essential activities were continued. Nevertheless, the Fund might have to reconcile itself also to the possibility that, once the situation in the U.S.S.R. was fully assessed and the magnitude of the country's needs became fully apparent, the Fund's involvement might have to be even greater than the management anticipated at present, and the cost to the Fund commensurately greater as well.

The quadripartite study of the U.S.S.R. that Mr. Végh had referred to had heavily influenced the experts and consultants who were now working most intensively in the U.S.S.R., the Chairman observed. Indeed, he had been amused to notice that many of the so-called fresh ideas they had come up with had already been included in the study one year before. Indeed, the study had influenced the 500-day plan for the conversion of the U.S.S.R. into a market economy that had been put forward by Mr. Yavlinsky. Although much had happened in the U.S.S.R. since the publication of the study, its basic conclusions were still valid, and its orientation remained accurate.

The Secretary observed that Directors had shown a general willingness to go along with the Managing Director's proposals regarding changes in Article IV consultation cycles, although there had been many notes of caution in that connection as well. Several Directors had suggested that the question of the revised cycles be reviewed in one year's time, rather than by May 1, 1993.

On the basis of the present consultation cycles, area departments had projected that in the six months through April 1992, about 83 staff reports on Article IV consultations would be brought to the Board, including five on interim Article IV consultations, the Secretary continued. Taking into account the Managing Director's proposals, the number of staff reports on consultations in the same period would be reduced to 67, of which 10 would be interim Article IV consultations--a saving of up to 21 consultation discussions. For the period May-October 1992, the savings would be somewhat larger. On the basis of the present consultation cycles, 71 staff reports would come forward, including five interim reports. With the new cycles, there would be 51 staff reports on consultations and 10 on interim consultations, suggesting a saving of up to 25. For 1992, therefore, given that there were about 45 Board weeks in a year, a saving of up to one consultation a week was implied under the new consultation cycles, depending on how the interim Article IV consultations were treated.

Several Directors had commented on the proposals for dealing with the applications of the Baltic countries, the Secretary recalled. The idea put forward in the Managing Director's work program was that there would be one membership committee to deal with the three applications. How they would be dealt with would be left to the committee to decide; it could take the three countries together, or one after the other, for example. Having one committee, with one group of Executive Directors, dealing with the three would serve to ensure equality of treatment in the three cases. He understood that that procedure was acceptable to Directors, and something along the same lines would be done with regard to the applications from Micronesia and the Marshall Islands as well.

The staff would do what was necessary to bring together the Committee on Rules for the 1992 Regular Election of Executive Directors somewhat earlier than usual, as a number of speakers had recommended, the Secretary stated. He also recalled Mr. Dawson's views on the size of the Board in that connection.

Directors had generally supported the Managing Director's suggestion to return to the matter of the coming into effect of the quota increase in early December 1991, the Secretary noted, and he would suggest that the item be added to the Board's agenda for December 4.

With regard to systemic issues and the role of the SDR, the Secretary continued, there had been quite different perceptions of the appropriate priorities on the part of individual Directors. Mr. Posthumus had noted that the work program had not given prominent attention to issues in the international monetary system and to surveillance, for example. The paper on international liquidity and the role of the SDR would be prepared for discussion in February 1992. The paper on international capital markets would be available for discussion in March 1992. The staff would look into the question of whether it would be possible to advance the Board's discussion of the paper on exchange arrangements of formerly centrally planned economies to a date earlier than March 1992. He recalled that Mr. Posthumus had made the suggestion that the Managing Director deliver a speech on the important and timely subject of currency unions between sovereign republics.

The Chairman remarked that he would wish to have the contributions of Directors on the delicate question of currency unions before he delivered a speech on it; perhaps the topic might be discussed at the Executive Board's forthcoming retreat.

The Secretary stated that the other papers under the heading of systemic issues and the role of the SDR in the Managing Director's statement on the work program, including the paper on the determinants of equilibrium exchange rates, would be handled as had been proposed in the statement.

Speakers had generally agreed to postpone, as proposed, the review of the CCFF, the Secretary continued. He had taken note of the differing views of Directors on the usefulness of the papers mentioned under the design of Fund policy advice, as well as of the comment of some Directors as to the usefulness of clarifying better the work program of research in the Fund.

There were a number of views on the issue of burden sharing, the Secretary recalled. Some speakers questioned whether it would be useful to discuss the issue at all, given the delicately balanced nature of the compromise and the risks in upsetting it. Other speakers had noted that in the current environment of the increase in the cost of Fund credit, such a discussion would be indispensable. One speaker had called for identifying better ways of running the institution financially, and another had drawn attention to the need to share the costs of the organization more equitably. Yet another had noted that the policy of adding to the Fund's reserves might need to be re-examined. Perhaps those and other specific comments could be taken up in the context of the forthcoming Board retreat in December. One Director had also recommended looking into ways of simplifying and amalgamating Fund facilities at some point in the future.

The staff would try to accede to Mr. Goos's request that documentation intended for the Interim Committee be discussed by the Board no later than April 10, 1992, the Secretary continued. Of course, in the week thereafter, the administrative budget and certain operational country items might still have to be dealt with, because the staff would try not to have other country items come to the Board in the weeks immediately before the Interim Committee meeting, as Mr. Evans and some other speakers had suggested.

The desirability of further reviewing the Board's procedures at the forthcoming retreat of Executive Directors had been noted by Mr. Peretz, the Secretary concluded. The paper on the attendance of outsiders at Board meetings that he had referred to would be put in train. Mr. Peretz had also called attention to the need for better reporting by the staff on programs that had gone off track; that matter would be taken up with the staff. Finally, he had noted Mr. Fukui's suggestion that there be more frequent reporting to the Board on technical assistance activities, in view of the sharp increase in such activities.

Mr. Al-Jasser commented that there had not been much enthusiasm for discussing the paper on energy pricing. However, since the Fund had no established policy on energy pricing and taxation issues, and the Board had not provided the staff with any guidance in that connection, he wondered how the staff intended to address those issues in its discussions with national authorities; would the staff refrain from giving advice, for example? Moreover, he recalled that there had been long debates on the subject in the Board; certainly it merited a discussion, accordingly.

The Chairman replied that the staff would respond, as in all policy matters when no formal guidelines had been given by the Board, on a case-by-case basis using its accumulated experience as a guide.

Mr. Finaish said that he had requested that the paper on energy pricing policy be discussed by the Board at an early date.

Mr. Mirakhor commented that although he had not mentioned the point in his intervention, some countries in his constituency were very interested in energy pricing policy. Since he had heard nothing to the effect that the paper would not be brought before the Board, he had assumed that it would be.

The Chairman responded that he had understood Directors to have agreed that somewhat less priority could be attached to considering the paper on energy pricing policy in a Board discussion at an early date. Moreover, he did not wish to overburden the Board's agenda in the February-March 1992 period, which was the earliest opportunity the paper could be discussed at present, given the heavy work load.

The Special Adviser to the Managing Director was currently working on the subject of an independent evaluation unit, the Chairman continued. The work had been delayed, however, because of the redeployment of staff in connection with the Fund's work on the U.S.S.R. and the consequential unavailability of staff to provide the necessary contributions. Although the paper would be delayed beyond the end of 1991, the work remained a priority.

Mr. Prader asked whether the Fund would continue to undertake regional reviews of Eastern Europe outside of the format of country and program reviews, as a way of demonstrating its particular interest in the region.

The Chairman replied that it was his intention to continue such reviews, and that the previous regional discussion had provided the Fund with valuable guidance. However, the question of the availability of staff needed to produce such a comprehensive review obliged him to be conservative in that connection. That notwithstanding, it was clear that the Fund would need to continue to monitor closely developments in Eastern Europe, in a regional context.

Mr. Posthumus remarked that Directors should be allowed to discuss with their authorities the issue of the introduction of temporary changes in the consultation cycles. Fully one third of the membership would be affected by those changes. He was concerned that the temporary changes would prove to be not so temporary, especially as a reorientation away from annual consultations for some countries appeared to be one of the cheapest and easiest routes to achieve staff savings for work on the U.S.S.R. His concern was all the stronger when he combined those considerations with the fact that a number of major countries were reluctant to finance additional staff. That was not to say that he opposed the changes in the cycles, but Directors should have time to consult their authorities about them. He agreed with the Managing Director that the degree of flexibility in allowing exceptions to the proposed changes in cycle should be limited. Finally, the Board should formally set a date for the introduction of the temporary changes in cycle.

The Managing Director made the following concluding remarks:

Directors have underscored the need to take exceptional measures to cope with the demand presented by the historic challenge of bringing the U.S.S.R. into the world economy and to deal expeditiously with the membership applications that are now pending--with the Baltics, in particular. Even with the redeployment of staff, some expansion in the size of the Fund, and improved mission planning, additional measures are required on a temporary basis to alleviate the pressure on already strained staff resources.

Directors endorsed the shifts in Article IV consultation cycles which I proposed on a temporary basis, that is, from November 22, 1991 until November 22, 1992, or until such time as I can affirm that a return to more normal consultation schedules is feasible.

While recognizing the need for these measures, Directors reaffirmed the central role of surveillance in the Fund's responsibilities, and they noted that these temporary, across-the-board changes do not diminish that role. These changes, in fact, are intended to ensure that the Fund can remain vigilant and flexible to respond to the needs of the membership while rising to meet the immediate challenges facing it.

2. REPORT BY MANAGING DIRECTOR

The Managing Director made the following statement:

Communications from the Fund to Cambodia have been suspended since 1979, and there have been no other official relations, as the Fund had not recognized any of the competing factions in Cambodia's Government. Aside from the recognition of a Government, the main pending issue is Cambodia's normalization of its financial relations with the Fund.

Recently, there have been encouraging developments that have raised hopes for peace in that war-torn country. In particular, a U.N.-sponsored agreement on a comprehensive political settlement of the Cambodian conflict was signed on October 23, 1991 by the four factions in the civil war and representatives of 18 nations. The agreement has established a United Nations Transitional Authority in Cambodia (UNTAC) in order to ensure that the elections--now expected in mid-1993--will be fair and free.

The United Nations will send a fact-finding mission to Phnom Penh in early December 1991 for the purpose of facilitating the task of UNTAC. Specifically, the U.N. mission will identify control mechanisms within government financial agencies and draw up guidelines and directives for their operations to avoid the abuse of these agencies in the pre-election period by any faction. The Fund, the Bank, and other organizations have been asked by the United Nations to participate in the mission. I have accepted this invitation.

The Asian Development Bank plans to send a fact-finding mission later in November 1991 to review the economic situation of Cambodia and to assess technical assistance needs. The Asian Development Bank is interested in cooperating with the Fund in technical assistance projects at a later stage, and has asked for Fund participation in this mission. I have responded positively to this request as well, which prepares for the normalization of our relations with Cambodia.

For the first mission, we are in the process of finding suitable participants, who very likely will be technical experts from outside the Fund. For the second mission, we will be sending a few staff members from the Central Asia Department. Both missions will be for about two weeks.

Mr. Landau commented that his chair welcomed the first move to reestablishing a working relationship between the Fund and Cambodia. He hoped that it could be followed by progress toward the establishment of normal relations between Cambodia and the Fund, as the situation allowed. His country stood ready to participate in any concerted effort to that end.

3. ALGERIA - REVIEW UNDER STAND-BY ARRANGEMENT

The Executive Directors considered a staff paper on the review under the ten-month stand-by arrangement for Algeria in an amount equivalent to SDR 300 million approved on June 3, 1991 (EBS/91/171, 10/1/91).

Mr. Mirakhor made the following statement:

At the present time, Algeria is going through a most difficult phase of its economic and political transformation resulting from a program of wide-ranging reforms. The economic reforms are aimed at opening the country to foreign competition and investment, and at allowing the private sector to play a major role in an economy with a greatly increased reliance on the market mechanism. The reforms, which had been launched in 1986, gradually built up speed through the late 1980s and culminated in the bold and comprehensive program embodied in the request last April for a stand-by arrangement. The system of central planning had left the Algerian economy with pervasive rigidities and distortions, but the many economic reforms which were implemented in the agriculture, services, and the public enterprise sectors have markedly improved the performance of the economy. Beginning in 1989, pricing, exchange, and trade policies became more active and flexible. The fiscal deficit was substantially reduced with the retrenchment of the Treasury from financing the investments of public enterprises, while its own recourse to central bank financing was dramatically curtailed.

The 1991 program was implemented under adverse external conditions, when international oil prices were returning to their pre-Middle East crisis levels, international reserves were declining, and heavy debt amortization levels were putting severe pressures on external debt management. The decision to implement the program under difficult conditions indicates the firm determination of the authorities to transform the economy. Concurrently with the major economic reforms, the authorities took up a further challenge in the political arena by announcing plans for general elections to be held on June 27, 1991. Convinced that meaningful and long-lasting economic transformation must be accompanied by the reform of the political process, the authorities embarked on implementation of an orderly program of political liberalization. Fast unfolding political events in May and June, however, not only pre-empted the elections but also interrupted the normal operations of the economy via work stoppages, strikes, and civil unrest. The large shortfall in foreign financing to the tune of $1.1 billion, higher than programmed debt-service payments, and continued slow disbursements, combined with political events, led to a sharp decline in imports and output levels. In turn, unavoidable slippages occurred in public finance, credit performance, and in the implementation of trade and exchange liberalization measures envisaged in the program. As the staff paper indicates, however, the authorities have taken firm steps to put the program back on track and enhance the medium-term policy measures.

To address the financial and structural imbalances, the authorities implemented bold measures in reforming the exchange system and prices. Since the reform process began in 1986 and up to 1989, the Algerian dinar depreciated by 55.6 percent; it depreciated by a further 29.6 percent in 1990, by 50 percent to February 1991, and most recently by 22 percent to September 1991. To illustrate the impact of exchange rate adjustments, it is worth noting that the official exchange rate, which was DA 9 to US$1 in October 1990, is now DA 22.50. These repeated depreciations, while improving the competitiveness of the export-oriented and import-competing manufacturing sector, did nonetheless increase import costs and debt servicing for public enterprises, which in turn led to a worsening of their financial situation. Furthermore, price increases in the manufacturing sector effected in order to pass through this large depreciation resulted in a heavy buildup of inventories and contraction of industrial output.

The large currency depreciations have substantially reduced the enterprises' financial capacity to import raw materials and intermediate goods. This has resulted in compression of imports and reduced production that worsened the financial situation of the enterprises, leaving them no recourse but to seek increased credits from the banking system. This was the main reason for the slippages in the monetary sector. In a sense, the overruns in the monetary area were inevitable, given the sensitive social situation in the country and the authorities' attempt to avoid any further disruptions and disturbances. Indeed, the only alternative policy left to the authorities, if credit requests were to be rejected, was to accept substantial layoffs, which would have triggered general strikes and unrest in the country, as the large declines in economic activity would have exacerbated the problem of high levels of unemployment.

In the fiscal area, the slowdown in the economic activity was the main cause of the poor performance in non-oil tax revenues, especially in the "taxe compensatoire" revenues. In the event, the financial situation of the "Fonds de compensation" worsened despite the measures taken in the 1991 Law of Finance to increase its revenues. This, in turn, led to the slippages in the fiscal sector despite the fact that overall budget situation was satisfactory in a number of respects. To reform the tax and tariff systems, the authorities intend to implement in 1992 new codes that would simplify the existing procedures and strengthen the fiscal situation by expanding the revenue base and stimulate public savings. In addition, expenditures will be streamlined so as to enhance the efficiency of public investment.

In the external sector, higher than expected debt-service payments, and a shortfall in external financing due to protracted negotiations with commercial banks, compounded by complicated technical procedures for mobilizing bilateral lines of credit, constrained foreign exchange availability. These constraints have delayed somewhat the implementation of the comprehensive trade system reform package. Despite the pressing financial needs of the economy, strains on the balance of payments, and import compression and its adverse effects on output, external financial obligations have been met in a timely and orderly manner.

Firmly committed to reforms, the new Government, which took office in July 1991, is also implementing additional measures to correct the pressures on the balance of payments and promote employment. The authorities have implemented a further 22 percent depreciation of the dinar. Reduction in the "surtaxe compensatoire" and in the "taxe compensatoire" for machinery and equipment and raw materials for industry, especially the construction and textiles sectors, was introduced in the supplementary Law of Finance adopted by the Parliament in August 1991. Furthermore, measures are being implemented to encourage wholesalers, concessionaires, and qualified enterprises to import raw materials and intermediate products necessary for the expansion of output.

Despite the precarious social situation and the upcoming elections--set for December 26, 1991--the authorities have decided to increase energy prices (except for gasoil) between 96 percent and 183 percent and basic consumer goods prices by up to 300 percent in order to reduce the "Fonds de compensation" subsidies as well as to improve its financial position. The items with sharply lower subsidies include sugar, cooking oil, powdered and pasteurized milk, and corn. The higher fuel prices are expected to yield budgetary revenue estimated at more than DA 1 billion for the fourth quarter of 1991. The price increases in essential consumer goods have permitted a substantial reduction in subsidies from the compensation fund, and it is anticipated that for the fourth quarter of 1991 it would be equivalent in terms of annual savings of over DA 8 billion. In total, the reduction in implicit and explicit subsidies under the initial program adopted on June 3, 1991, plus the measures implemented following the first review, exceeds DA 21 billion for 1991. Put differently, the total adjustments in 1991--for the subsidized items only--are expected to amount to more than 2 percent of the GDP, a massive adjustment by any standard.

The authorities also intend to allow greater flexibility in the pricing policies by removing existing restrictions. In addition to substantial price liberalization implemented thus far (40 categories), further measures will remove restrictions on 15 other categories. To mitigate the adverse effects of this liberalized pricing policy on the more vulnerable segments of the population, the authorities intend to put in place a social safety net with technical assistance from the Fund. The process of reforms in the industry and services sectors will be further enhanced with a comprehensive restructuring and rehabilitation of the public enterprises beyond the 22 firms and commercial banks addressed by the present program. To make these enterprises accountable only to market forces, a new "code de commerce," to be introduced in early 1992, will include provisions regarding bankruptcy and judicial liquidation similar to those existing for private enterprises. This will rationalize the public enterprise sector and enable the viable firms to become competitive on a market basis.

In order to enhance the effectiveness of exchange rate and pricing measures, a tight monetary policy consisting of imposition of credit ceilings on banks and the 22 public enterprises and increases in the discount rate, the money market rate, and the rate for credits above ceiling will be strictly implemented. For instance, policies aimed at imposing ceilings for each bank and each public enterprise under restructuring and rehabilitation will be reinforced. Furthermore, prudential and accounting regulations in conformity with international standards will be introduced to improve supervision and make banks more efficient. Finally, the market rate of interest will become the instrument of monetary policy, and reliance on direct credit controls will be gradually reduced.

To strengthen the external position, foreign financing is being secured, mainly with Italy. A loan was recently extended to Algeria by the EC and an agreement was reached with the commercial banks, led by Crédit Lyonnais of France, with the objective of reprofiling the debt service. In addition, mobilization of bilateral lines of credits is being pursued by the Algerian commercial banks. Furthermore, the Eximbank of Japan has informed our authorities that its management has agreed to co-finance two sectoral adjustment loans with the World Bank. Moreover, the opening of the oil sector to foreign investment is beginning to produce positive results, and significant new external resources are expected to materialize in the near future.

Structural reforms are viewed by the authorities as essential to the revitalization of the domestic economy. The main objective would be to revitalize economic activity, as the low levels of output have had negative effects on the standard of living of the population, employment, and the financial situation of the enterprises. The financial restructuring of the banks and the 22 public enterprises is being pursued and the audit contracts signed; it is expected that the restructuring will be completed by the end of December 1991 and extended to other public enterprises in 1992. Furthermore, the authorities are well advanced in discussions with the World Bank on a sectoral adjustment loan concerning the fiscal and tariff areas as well as the trade system; completion of these discussions is expected shortly. The private sector has been allowed access to hard currency and trade and encouraged to play greater role in the economy. Further incentives are planned by the new Ministry of Medium and Small Enterprises in order to boost the private sector's activities in the medium term.

The authorities have also prepared a program of new investments, especially in the oil sector. The first step in this program was to revamp operations on existing industrial sites, the second was to encourage foreign investment in the oil production as well as exploration activities, and the final step will be the opening of the gas industry to foreign investment. In this respect, legal provisions have already been introduced in the Supplementary Law of Finance of 1991 to remove restrictions on foreign participation. Furthermore, the Investment Law concerning the oil sector will soon be reviewed in order to encourage further involvement of foreign investment in the oil and gas industry. Additional provisions will be introduced with the aim of removing restrictions on domestic and foreign investment and introducing incentives, such as tax exemptions, in order to increase foreign direct investment in the economy. These initiatives can be expected to foster further growth of domestic production and increase employment in the medium term.

In the pricing area, the authorities are committed to pursuing the pace of reforms implemented so far with the objective of allowing the full play of market forces. In this regard, it is expected that all energy prices will be allowed to reflect their economic costs by 1992, except for the price of gasoil which will be adjusted gradually. Furthermore, all subsidized prices will be phased out as soon as a comprehensive social safety net is effectively in place. However, bread, semolina, and milk will continue to be subsidized further until the social safety net is stabilized; but prices of these items will be adjusted gradually. In order to allow the economy to become less dependent on hydrocarbons, exchange rate policy will play a greater role to boost non-oil exports.

As regards the debt management policy, the authorities' objective is to continue to discharge their external financial commitments while seeking additional external financing. The opening of the economy to foreign direct investment should induce capital inflows, thereby reducing substantially recourse to external bank borrowing, cushioning the economy against external shocks in the short run, and strengthening the balance of payments situation in the medium term. Since the medium-term economic program will alleviate the financial imbalances and increase the diversification and efficiency of the Algerian economy, the authorities are convinced that the program will also strengthen external creditworthiness and improve access to international capital markets. In this regard, it is important to note that while the debt stock of Algeria is about $25 billion, the value of proven oil reserves alone are estimated at $150 billion. Clearly, the problem for the Algerian economy is one of liquidity and not solvency. This is why the authorities are determined to pursue their strategy of debt reprofiling rather than seeking to reschedule external debt.

All medium-term policies mentioned above will be implemented with the ultimate objective of enabling the Algerian economy to actively participate in the process of regional integration of the North African economies in the framework of the Maghreb Arab Union. In launching and implementing sound economic reforms, complemented by a medium-term program to fully utilize all the potentialities of the country's resources, Algeria expects a positive response from the international financial community in terms of better access to international capital markets than has been possible thus far. Given the strategic importance of Algeria, its enormous hydrocarbon resources, and the fact that the country has continued to honor its international financial obligations despite enormous social and economic costs, such expectations should be realizable.

Mr. Finaish made the following statement:

During the period that elapsed since Algeria embarked on the adjustment and reform program with the support of the Fund, the authorities' resolve has been seriously tested. Given the substantial shortfall in external financing on the one hand and the domestic social disturbances on the other, what is remarkable is not that the financial framework as originally envisaged had to be revised somewhat but that the authorities have been able to maintain the policy momentum to the extent they have. If anything, the experience so far this year should strengthen outside confidence in the authorities courage and determination to see their economic program through. It is also noteworthy that as a result of the authorities' prudence and the additional policy steps they have taken recently, as well as the agreement on financing packages with official and private creditors, the thrust of the economic program for 1991 is likely to be achieved.

It is of course unfortunate that the exogenous factors I referred to earlier have forced a reduction in the levels of imports and investment, which in turn led to output stagnation compared to a growth rate of 4.5 percent targeted in the program. Now that these factors have largely disappeared, it is hoped that a more balanced path of adjustment will be restored.

It was clear when the authorities embarked on their economic program that on the broad macroeconomic level the problem facing Algeria is basically one of liquidity. The balance of payments scenario presented in last May's paper, which is again confirmed in the paper before us, points to a strong external position in the coming years, which will allow a significant degree of reduction in Algeria's external indebtedness. This does not mean that the structural reform process should not be pursued with vigor. Quite the contrary. The prospects for rapid growth in the non-oil sector will depend on the authorities' persistence in transforming the economic environment into one that is conducive to private sector investment and efficient allocation of resources. But Algeria's financial outlook does suggest that a proper balance should and could be struck among the various policies and objectives, including those relating to external indebtedness macroeconomic adjustment, and structural reform. Given Algeria's current domestic circumstances, it will be crucial that structural reform policies, and in particular those relating to public enterprises and pricing of essentials, be complemented by mechanisms that mitigate their impact on employment and the standard of living. Reform will have to be sustained, and the risk of insufficient popular support should be avoided. The staff report does refer to the social safety net, but it appears to us that progress on this score could be faster, particularly in light of the fact that prices of foodstuffs have already been increased substantially and the chronic problem of unemployment, especially youth unemployment.

On a somewhat related matter, we noticed that the revised program incorporates revenues generated by external investments in the hydrocarbon sector but up to a certain amount. Any revenue beyond that amount is to be excluded from the fiscal target. It would be useful if the staff could elaborate on this matter and whether this particular formulation of the fiscal performance criterion would preclude the use of revenue beyond the amount stipulated for such purposes as the social safety net or to facilitate reform in public enterprises. It seems to me that such use of excess revenue, so to speak, may well be justified, given the desirability of moving ahead on structural reform.

Turning to other policy areas, I would like to mention in particular the authorities' efforts on the fiscal front, which will help minimize the deviation from the surplus originally targeted in the program. This fiscal prudence, as well as the recent substantial increase in the prices of essential commodities at the eve of the parliamentary elections scheduled for next month, are particularly noteworthy.

I agree with the staff that monetary policy requires special vigilance, particularly in light of the experience in recent months. Whether interest rate action will be needed is open to question. What is important, however, is for the macroeconomic situation in general, and credit to enterprises in particular, to be consistent with a downward path for the underlying rate of inflation. This will also be a prerequisite for an effective exchange rate anchor, as is envisaged for the 1992 macroeconomic program. Such an anchor, supported by appropriate demand management, can play a significant role not only in macroeconomic stabilization but also in enhancing the environment for structural reform.

To conclude, the authorities should be commended for their policy performance since the beginning of this arrangement, particularly when viewed against the particular difficulties they have had to deal with. On the basis of the authorities' actions and planned policies, there is good reason to be optimistic about Algeria's prospects, both immediate and longer term.

Mr. Landau made the following statement:

During the first five months of its program with the Fund, Algeria has experienced very difficult circumstances that have included, on the economic front, a number of negative external shocks, such as the consequences of relatively low oil prices earlier this year. As is very clearly described in the staff report and in Mr. Mirakhor's statement, these developments, as well as an accommodating stance of monetary policy prior to the agreement with the Fund, have led to some slippages and unmet targets under the program.

The authorities must therefore be especially commended for having resisted what the staff rightly calls the "considerable pressure" on the external accounts. On the contrary, they have reaffirmed their determination to pursue the adjustment and reform process. Concrete and sometimes additional measures have been taken. And this attitude has been recognized by the international financial community, which will contribute to the financing of the program. The authorities' stance will thus permit them to take full advantage of the somewhat brighter prospects on the oil markets.

We are in broad agreement with the analysis and recommendations of the staff. I will limit myself to some comments on the different areas of public policies and on the financing of the program.

Developments in the fiscal accounts in 1991 have been mitigated but, on the whole, rather positive. On the revenue side, there have been, as noted by the staff, slippages in tax collections. In this context, we welcome the authorities' intention to proceed with their plans to introduce a major tax reform next year. As the staff rightly stresses again in the supplement to its report, particular attention will have to be paid to the usual transitory effects of such reforms.

As far as expenditures are concerned, further progress is certainly needed in view of the scheduled rise from 29 percent to 33 percent of GDP this year, a rise that was due mainly to increases in current outlays. There have been lengthy delays in the adjustment of some administered prices, which have exacted a heavy toll on budgetary expenditures. But encouraging signs can be found. Indeed, the budget surplus will increase from 3.4 percent of GDP in 1990 to 6.8 percent this year. Very substantial adjustments were finally made on the administered prices of many staple items in September and October. This will help to improve the difficult financial situation of the Fonds de Compensation. As noted by the staff, a degree of effective financial constraints on the largest public enterprises has also been introduced, and active consideration is being given to the definition of a proper safety net, the reform of health care financing, and the modification of the price support system. We would join the staff in urging the authorities to try and give the maximum cost-efficiency impact to social programs by targeting them to the most impoverished part of the population.

Similarly, the stance of monetary policy has turned from accommodating in the first part of 1991 to more constraining during the past few months, especially with the introduction of limits to refinancing and the increase in several key central bank rates. We fully agree with the staff that the authorities must continue to pay full attention to monetary developments if Algeria is to maintain favorable--i.e., stable--macroeconomic conditions for the implementation of its structural reform program. In this regard, and as noted by the staff, improvements in the monetary data and reporting systems are certainly needed.

The exchange rate policy can also help in Algeria's endeavor, especially if it is geared toward fostering stability in the economic agents' expectations. It is encouraging to see that the gap between the parallel and official exchange rates of the dinar has been reduced from 54 percent in June to 47 percent this November. We fully agree with the staff that, after the gap has been further reduced and taking into account the forecast increase in foreign reserves, the authorities will be in a position to use the exchange rate more and more as a nominal anchor. This will be particularly useful in the current transitional process to a new mode of economic management.

As far as structural reforms are concerned, the substantial progress registered so far in this area is a key factor for the success of the program. Recent developments include increased flexibility of the price system, the consecutive reduction of price differences between the parallel and the official markets for goods, proposals for easing rules limiting or prohibiting foreign investment, and last, but not least, progress toward the definition of a policy on the restructuring of public firms. On the latter point, we look forward to the conclusion, to be published early next year, of the studies on the main public firms in need of restructuring. We also welcome the authorities' intention to expand the policy beyond the original group of 22 companies and to introduce in early 1992 a new "code de commerce."

All these structural reforms will play a key role in leading public enterprises to adjust to international competition, in facilitating technology transfers, and in accelerating the much-needed process of diversification of the economy. Over the medium term, they will also be instrumental in solving the acute problem raised by the approximately 25 percent unemployment rate and by the projected increase in the population.

The authorities have also made significant progress in ensuring the financing of the program. In the process, they have corrected one of the major weaknesses of the economy, i.e., the heavy concentration of debt repayments over the 1991-1993 period.

First, the current account should register a surplus of \$1 billion this year instead of the programmed deficit of \$300 million. This is essentially due to the severe contraction of imports. Second, various sources of financing have been mobilized. In particular, the EC approved an ECU 400 million loan linked to the continuation of the agreement with the Fund. Even more significantly, commercial banks have also agreed on the term sheet of a \$1.5 billion refinancing operation leading to the reprofiling of Algeria's commercial debt. If confirmed, we certainly see this decisive step as a sign of renewed confidence in the future of Algeria's economy. Finally, the already mentioned new policy on foreign investment should also help, on a longer-term basis, to provide Algeria with efficient, non-debt-creating capital.

My authorities are of the opinion that the efforts made, the results achieved, and the determination shown by Algeria under sometimes very difficult circumstances merit the continued support of this institution. We thus agree with the proposed decision.

Mr. Ismael made the following statement:

It is to be regretted that the implementation of the economic stabilization program initiated by the Algerian authorities was delayed for reasons partly beyond the authorities' control. Consequently, this has brought about a number of slippages in the area of fiscal and monetary policies. However, I am encouraged by the authorities' firm action to restore the program. The program does rightly place the emphasis on further liberalization of domestic prices, strengthening of monetary policy, economic and financial restructuring of the public enterprises, preparation for the implementation of tax reforms, and improvement of the social safety net.

As I am in broad agreement with the staff's appraisal, I will confine my comments to two major issues: the urgent need for positive interest rates, and the need to avoid the use of central bank financing in view of the existence of a budget surplus.

Regrettably, due to persistent inflationary pressures, interest rates continue to be negative despite the recent measures taken to increase the interest rates and impose limits on the Central Bank's credit expansion. In order to stop further occurrence of disguised bank loan subsidization and a sharp decline of domestic savings, it is imperative that the interest rates be made positive as soon as possible. I wonder whether there is a constraint faced in doing this, namely, that setting the interest rates above the present inflation rate would be considered as usury. If this is the case, how could it be overcome? I also wonder whether reduction of inflationary pressures and attainment of positive interest rates could not be facilitated by encouraging the public enterprises--which are the largest borrowers of the Central Bank--to have their financing needs met by commercial institutions instead of the Central Bank. Would the staff care to comment on these two questions?

I note from Table 5 that for the rehabilitation of the public enterprises a fund of about DA 16.9 billion will be needed. I also note that an overall budgetary surplus of DA 44.4 billion is projected for 1991. The authorities have in the meantime succeeded to achieve a budgetary surplus of DA 42 billion. In view of these facts, I wonder why the public enterprises' rehabilitation fund still has to be funded by the Central Bank; why is it not funded by the budgetary surplus, which should be less expansionary in its effect? I would be interested in hearing from the staff why this option has not been chosen.

Mr. Fukui made the following statement:

When the Board discussed the stand-by arrangement for Algeria last June, this chair commended the authorities for their adjustment efforts that had been carried out since 1989 and encouraged the Algerian authorities to continue persevering with the effort to reach the targets in the program.

However, it is disappointing to know that the performance in the first half of this year fell short of the targets and that the review, which was to be completed in September, has been delayed. Although, as the staff paper notes, the reasons for this include to some extent exogenous factors, it is undeniable that the major element that put the program far off track was the policy slippage of the authorities. In particular, I read the staff paper with more than usual concern with regard to the monetary developments.

Since the challenges for the authorities are well depicted in the staff appraisal and I can endorse most of them, I would like to concentrate my comments on price reforms, monetary policy, and exchange rate policy.

Although some important steps have already been taken toward price liberalization, the remaining rigidity in the price system in Algeria was responsible for the rapid increase in domestic credit in the first half of this year. Enterprises that faced the increased cost of inputs, most of which are imported, triggered by the substantial exchange rate depreciation since last year, were unable to fully pass the increased costs in higher prices and instead resort to financing from the banking sector. The accommodating stance of monetary policy is most to blame, but the price rigidity was surely the determinant of the conduct of the enterprises.

In this sense, this chair welcomes the recent Government's action to further liberalize 15 groups of products. Also, the elimination of the minimum waiting period required of enterprises to change their prices is welcome as a measure to allow quick response of the prices to the market developments.

In the same vein, price increases for subsidized commodities are warranted. In addition to the increase in the retail price of gasoline, which was included in the Supplementary Finance Law, the authorities have decided to increase prices of diesel fuel and other petroleum products and basic food items. In particular, the political decision of the price increases for the latter is very courageous, considering that the authorities face a general election that is planned for the end of December. Nevertheless, further adjustment and liberalization of prices, in particular those of subsidized items, should continue to be the first priority for the authorities in order to foster a dynamic private sector based on market discipline.

On monetary policy, it is clear that the policy slippage that put the program far off track occurred in the monetary field. Although the need for a tighter monetary policy was strongly urged by many Directors at the previous discussion on Algeria, it is regrettable that the measures for that purpose have fallen well behind.

I certainly welcome the measures taken by the Bank of Algeria in recent months. However, I cannot help but have strong doubts as to whether this is enough. Taking into account the fact that the consumer price index is now projected to increase by about 35 percent a year, the average money market rate, or the rate applied to commercial bank overdrafts at the Central Bank, still seems to be low. Moreover, the real interest rate is projected to remain negative for a while this year. I would welcome staff comment on the possibility of further tightening monetary policy. In particular, I would like to know the staff's assessment of the effectiveness of the limits imposed on central bank intervention in the money market.

With the further liberalization of prices and the already high rate of inflation, which is now restrained by the remaining rigidity of the price system, this chair has a strong concern about the future inflationary trend of the economy. To minimize the cost of adjustment, the urgent need to tighten monetary policy cannot be overemphasized.

The aim of the flexible exchange rate policy that the authorities have followed so far is rather vague. Since more than 95 percent of Algeria's exports are hydrocarbons, which are traded at an international price and in dollar terms, the purpose of the exchange rate could not be the maintenance of external competitiveness. Given the high potential for accelerated inflation, the time is ripe to consider the adoption of a more transparent exchange rate policy. In this sense, I welcome the suggestion in the staff appraisal of the adoption of a nominal anchor in the succeeding Fund program. I believe this judgment is correct, given the unusual structure of the external sector of the Algerian economy, which heavily depends on imported inputs and the bulk of whose exports are traded at international prices.

As the staff explains, the balance of payments financing for this year envisages a financing gap of about $1.1 billion. Although the staff suggests that this gap will be more than financed from the various resources, it is a matter of concern that uncertainty still remains, in particular regarding its disbursement. Among those resources, the most important is the rollover of the syndicated loan from commercial banks. It is encouraging to know from the supplementary paper that an agreement has been reached with the core group of the commercial banks. I strongly hope that the procedure of the rollover will go smoothly and will not cause further delay.

In this connection, I am pleased to be able to announce to that the Export-Import Bank of Japan recently decided to extend two loans to Algeria--cofinancing with the World Bank's SAL and a project loan to SONATRACH. The total will amount to about $380 million. The Bank will soon start negotiations for loan agreements with the Algerian authorities. I hope that these loans help the authorities to further deepen their adjustment efforts.

I support the proposed decision.

Mr. Spencer made the following statement:

The staff paper makes it clear that Algeria has suffered a serious lapse of performance during the initial period of its stand-by arrangement. Most of the June performance criteria were effectively breached, with a particularly bad overrun occurring on domestic credit. The staff had put these failures down both to exogenous factors--such as the shortfall in financing--and to delays in implementing policies agreed in the initial program. On the basis of more recent corrective measures and promises regarding future actions, the staff is recommending that we (1) grant waivers for the missed end-June performance criteria and (2) ease the subsequent performance criteria for end-September and end-December.

I do not feel, however, that the staff has made a very convincing case. In particular, I do not consider that Algeria has done enough to justify the release, on schedule, of a full half of the originally approved amount of SDR 300 million. There would seem to be real grounds for concern both about actual policy performance to date and about the prospects for successful implementation of the remainder of the program. In our view, to maintain the original access in these circumstances would inadequately signal the Fund's concern about recent policy lapses. It could also be considered to represent an unwarranted financial risk.

Our concerns relate to all of the main elements of the program. The first area I will touch on is monetary policy, where a large part of the slippage has occurred. At the original June Board meeting, I expressed doubts about the strength of the monetary policy framework, and I must say that I still have doubts whether it is capable of delivering the revised program objectives.

To try and bolster the monetary framework, the authorities have done two things: they have increased the cost of central bank funds; and they have promised to implement the original proposal to impose ceilings on central bank lending to the commercial banks.

However, as noted by the two previous speakers, there is still have an effective cap on interest rates of 20 percent, despite an inflation rate currently running at around 35 percent and likely to persist at high levels next year. The call by the staff for interest rates to be set high enough to ensure that the quantitative limits are not reached would therefore seem to be a vain hope. There is little doubt that the quantitative limits will in fact be tested, and this is certainly worrying, given the Central Bank's lack of commitment to date in this area. Indeed, if anything, the political and financial incentives facing the Central Bank may now be even less conducive to the effective enforcement of the credit ceilings. There would therefore seem to be a good case for testing the Central Bank's resolve before agreeing to the release of further funds under the stand-by arrangement.

On the fiscal side, actions again have been far from impressive. First of all, about half of the fiscal policy slippage in 1991 (even after adjusting for the exchange rate change) will now be accommodated in the form of lower treasury surplus targets. To cover the balance, the authorities will be relying for the greater part on extraordinary sales of petroleum access rights and capital expenditure cuts. Only about a third would be coming from current expenditure cuts and price subsidy reductions. However, the completion of the sale of petroleum access rights this year is still subject to considerable uncertainty, since complex negotiations are involved and Parliament will still have to approve it. Furthermore, the authorities have sought to soften the impact of price adjustments by reducing compensatory taxes on key imports with a consequent adverse effect on the budget through greater transfer requirements to the Compensation Fund. As a consequence, the fiscal benefits arising from recent price adjustments--now totalling DA 3 billion--will be more than offset by compensatory tax reductions totalling DA 3.8 billion.

As a further point, fiscal actions to adjust prices appear to have only partially dented existing significant price distortions, especially on oil products. Also, actions to substantially reform the system of consumer subsidies, involving a closer targeting of needy groups, is only due to be introduced early in 1992--beyond the end of the program. Similarly, significant tax reforms--including the proposed value-added tax--are also not expected to eventuate until after the present program is fully drawn.

Turning briefly to the restructuring of public enterprises I am concerned that delays in implementing reforms will worsen the potential conflict between the financial restructuring of enterprises and the enforcement of enterprise budget constraints. In this respect, it is important that the enterprises be rationalized and, where appropriate, liquidated as soon as possible--and preferably before re-capitalization occurs. In the absence of such action, enterprises will have little incentive to perform and losses will continue to flow, thus putting further pressure on both the public finances and the planned domestic credit ceilings. Unfortunately, Mr. Mirakhor tells us that legal provisions to allow bankruptcy will only be introduced early next year, and from the staff paper it is apparent that a comprehensive program of restructuring and closure will be even further off.

The difficult circumstances facing Algeria at present suggest that some flexibility in the application of the program is warranted. But in view of the stark underperformance to date and the considerable uncertainty surrounding the authorities' ability to bring the program back on track, we do not find it possible to support the proposed decision in its current form.

We would, however, support a revised decision that included a rephasing of the scheduled SDR 75 million second purchase. This would bolster incentives for the full implementation of program commitments and also reduce the Fund's financial exposure in the event of continued weak performance.

The intended second purchase could either be spread over the scheduled third and fourth drawings, or, alternatively, it could be added on to the back of the program. I must say that, in view of the obvious difficulty that the authorities are having in taking strong policy actions ahead of the December election, the latter alternative of a lengthened payments schedule would seem to be the more appropriate course. This approach would have the benefit of allowing the Board to assess progress on a number of important reforms scheduled for early in 1992, before approving the final drawdown under the stand-by--and before being asked to consider any proposal for a new, and possibly extended--Fund arrangement.

In the past, the Fund has frequently made phasing adjustments of this sort when confronted with disappointing performance and a high degree of uncertainty over future policy implementation. I see no reason why this approach should not also be employed here. If the proposed decision is approved, I would abstain from supporting it.

Mr. Bossone made the following statement:

When we discussed the approval of this stand-by arrangement with Algeria a few months ago, this chair praised the comprehensiveness of the underlying program and deemed the latter appropriate to address the fundamental problems of the Algerian economy. This chair warned, however, that such comprehensiveness would at the same time be at the origin of significant difficulties and risks for the success of the program. Dealing with such difficulties and risks required extra efforts of the authorities both to coordinate their action on the many fronts involved by the program and to act swiftly in implementing the agreed reforms.

Unfortunately, the occurrence of events in part beyond the control of the authorities has since led to critical slippages in policy performance as well as in the implementation of important reforms. The redressing of such events should now allow the authorities to correct the slippages. No less important than the effect of the exogenous factors, however, is the fact that slippages in public finance and credit performances have also been observed and have been caused by the authorities' implementation delays, especially in the monetary policy area. It is in this respect that I wish to join previous speakers in urging the Algerian authorities to take all necessary measures to make up for the delays and to reaffirm their full commitment to the program's policy package. In this connection, it is reassuring to learn from the staff that the Government has indeed resolved to take firm action to restore the program substantially to the course originally set, and I express this chair's agreement with the recommendations in the staff appraisal.

I would like to add, though, a few comments on a number of important policy issues. On the fiscal front, it is disappointing to note that expenditures for certain subsidies have even increased under the program. In order to restore healthy public finances and to establish a system of correct signals to domestic producers and consumers, it is necessary that the ongoing price liberalization reform be progressively extended to cover the items whose prices are currently subsidized. To this end, I hold it essential that the authorities' intention to reform the subsidy scheme for basic consumer commodities, to adjust their prices to economic costs, and to subsequently liberalize such prices be effected by the mid-1992 deadline, as indicated.

Reasons for concern arise also from noting that the overall public spending target has been observed with ample margins through reductions in capital outlays. Although such reductions seem to have so far reflected transitory circumstances rather than precise policy directives, it would seem that the reviewed fiscal package designed to achieve the new treasury surplus target relies exclusively on a capital spending squeeze, while it allows a relevant increase in current expenditures. I wonder whether this really is in the interest of Algeria, given the economy's strong need at this juncture to create the infrastructure necessary for long-term growth.

On the revenue side, the authorities are said to remain committed to introducing a major tax reform in 1992. In fact, comparing the tax revenue projections for 1991 to last year's results confirms that this is a priority objective. I am therefore concerned that a detailed outline is not yet available of what the tax reform package is going to look like. My concern is further heightened by the staff's latest comments on the complexity and inadequacy of the proposed VAT structure, said to be leading to a potential shortfall in revenue.

Regarding monetary policy, notwithstanding the recent increase in interest rates, the rates remain administratively controlled and are still negative in real terms. I am concerned about the undesirable allocative consequences that negative real rates could engender by sending wrong signals to investors, especially at a time when the economy needs large capital restructuring, possibly with a predominant involvement by the private sector. Wrong signals could well lead to investments that would otherwise be unprofitable under "correct" prices.

Administered interest rates also mean insufficient incentives for the domestic financial system to operate efficiently and according to commercial principles. This runs counter to the need--particularly strong at this point in time--for dynamic financial operators that would assist in the process of capital accumulation in the private sector. The authorities should therefore be urged to speed up and accomplish the process of financial liberalization.

The authorities have continued to hold on to a flexible stance on exchange rate policy by letting the rate further adjust to a more appropriate level. Although I recognize the need to set the exchange rate at a level that more closely reflects the underlying market forces, I wonder whether pursuing such an adjustment gradually could not cause counterproductive consequences by triggering large import flows and/or speculative operations in the foreign exchange market in response to anticipation of new devaluations. I would hold that a one-off, perhaps even consistent, adjustment of the exchange rate, combined with strict monetary and fiscal stances, would set the stage for a policy that would aim more explicitly at the stability of the nominal exchange rate. I would appreciate staff comments on this issue.

To conclude, in view of the serious commitment of the Algerian Government to persevere in the comprehensive reform effort undertaken amidst non-negligible difficulties, I believe it is important that the Fund and the international financial community at large be forthcoming at this time in assisting Algeria in its delicate endeavor. I can endorse the revised proposed decision.

Mrs. Hansen made the following statement:

Algeria's performance under its stand-by arrangement has been rather mixed. On the positive side, the transition to a more market-oriented economy has begun, bringing with it some important reforms, including significant exchange rate adjustment, price liberalization, and a serious attempt to liberalize trade. On the other hand, there have also been important slippages in both monetary and fiscal policy, which have been aggravated by an unfortunate shortfall in external financing. We recognize that the brevity of this ten-month program makes it difficult to devise and implement convincing measures to bring the program back on track. The approaching elections and difficult political climate clearly complicate the authorities' task as well. Nevertheless, we would have liked to have seen the request for waivers and program modification accompanied by more tangible evidence that the program was heading back toward its original path.

On the fiscal side, we note that there has been a large deviation from the original program. It appears that without additional measures, the treasury surplus would fall about 5 percentage points of GDP short of the original target. Under the revised program, Algeria would evidently make up only about half of that slippage. We have some questions, however, as to whether even this amount of fiscal correction can be achieved with the measures envisioned. As noted by Mr. Spencer, nearly 40 percent of the correction under the revised program is to come from exceptional petroleum revenues associated with new foreign investments in the hydrocarbon sector. It is encouraging that a draft law permitting foreign participation in the development of existing structures is now before the parliament. However, the staff appraisal points out that the hoped-for investment still depends on complex negotiations with the foreign oil companies, as well as no doubt a number of other factors. Even if these exceptional revenues do materialize before the end of the fiscal year, one may also ask whether the sale of access rights to foreign oil companies really constitutes fiscal adjustment.

With so little time remaining before year-end and the final set of performance criteria under this program, the major focus of attention must be on 1992. For the future, the authorities need to adjust expenditure patterns and look for new, stable sources of revenue. In this connection, we welcome the recent increases in administered prices and encourage the authorities to carry through with the planned overhaul of the subsidy program so that assistance will be appropriately targeted to the most needy and future budgetary costs will be contained. We also note that government wages and salaries represent nearly half of current expenditure, and we wonder whether there is not some scope for budgetary savings here. On the tax side, we welcome indications in the supplementary paper that the authorities are proceeding with a series of tax reform measures. We would join the staff in recommending measures that are simple, easily enforced, and universally applied. The information at hand suggests that the authorities intend to move in the right direction, but at the moment it is not entirely clear how or when these policy intentions will come to fruition.

Regarding monetary policy, we welcome steps to tighten the very accommodative stance in the first half. However, we consider the use of quantitative limits at best a temporary expedient and share Mr. Spencer's doubts about their effectiveness. At the same time, we are disturbed to see how little importance seems to be attached to moving to interest rates that are positive in real terms. Indeed, we were surprised by the staff's apparent willingness to go along with current interest rate policy as long as the quantitative restrictions are observed, although perhaps this again has to do with the limited policy alternatives available during the brief remaining time under the arrangement. We agree wholeheartedly with an earlier statement in the staff appraisal to the effect that enterprises and consumers need to face prices that accurately and quickly reflect market forces in order to make rational decisions in a market-oriented system, and we think this principle should not apply equally to the price of credit. Quantitative credit limits might allow the authorities to control the credit expansion, but they will do little to ensure that credit is allocated efficiently. In an economy that is supposedly moving away from central planning to a market system, interest rates should, in our view, play an important role in resource allocation. In this connection, Mr. Mirakhor's statement that market interest rates will become an instrument of monetary policy is encouraging, although the timeframe for this is unclear.

With regard to structural reform, we would like to encourage the authorities to open the economy to investment, both domestic and foreign, and to encourage competition. This would go a long way toward alleviating employment pressures, creating a more dynamic domestic economy, and reducing dependence on the hydrocarbon sector. In this connection, we welcome indications in Mr. Mirakhor's statement that the financial restructuring of banks and 22 public enterprises is expected to be completed by the end of this year and that a new "code de commerce" will be introduced in early 1992. These steps should help ensure that public enterprises operate according to market principles. Are there any additional plans to move beyond this financial restructuring to privatize public enterprises and/or demonopolize the functions they perform? With regard to foreign investment, we welcome the authorities' intention to review the Investment Law with a view to encouraging foreign investment in the oil and gas sectors, and we hope they will also eliminate barriers to domestic and foreign investment in other sectors as well.

Turning to the external sector, Mr. Mirakhor makes an interesting point in noting that Algeria's problem is one of liquidity, not of solvency. While this is reassuring, we hope that this fact will not dilute the authorities' commitment to adjustment and structural reform. With regard to the financing of this program, we welcome Algeria's agreement with the core group of its commercial bank creditors. Indeed, it appears that Algeria stands to receive more external financing through this facility in 1991 than is estimated in the main staff paper.

In conclusion, we are sympathetic to the political and external financing problems that the Algerian authorities have encountered during the first months of this stand-by arrangement. Nevertheless, we are disappointed that the program has veered so far off track, and we regret that so little time remains under the arrangement to undertake meaningful adjustment. In this connection, we are interested to know whether Algeria has even met its substantially eased end-September performance criteria other than the NIR target, which I understand will be met. Looking to the future, we hope that the policy intentions outlined in the review paper will be carried out expeditiously. However, as noted earlier, it is not clear at present how or when these policy intentions will be translated into action.

Under the circumstances, we can see considerable merit in Mr. Spencer's proposal for rephasing the arrangement, preferably his suggestion that the second purchase based on end-June performance criteria be added to the end of the arrangement. This would provide an opportunity for Algeria to demonstrate that it can adhere to the revised program before a substantial further disbursement is made.

Mr. Moss made the following statement:

It is particularly difficult to assess the relative contribution of the exogenous factors and the implementation delays in explaining the divergences between Algeria's performance and the objectives of its stand-by arrangement in the first half of this year. The staff paper seems to leave the impression that both explanatory factors are more or less of equal weight. A careful reading of the document before us strengthens my belief that a major part of the implementation delays was directly caused by exogenous factors, such as the shortfall in external financing and the social disturbances. It is therefore the latter elements that primarily explain the nonobservance of several of the performance criteria for end-June and the impossibility for the Algerian authorities of coming fully back within the previously envisaged financial framework for the rest of the year. Here I feel I must disagree with Mr. Spencer's analysis.

Let me illustrate this point briefly by referring to three parts of the staff paper. First, it is noted that the authorities, notwithstanding the low level of reserves, carried through an extensive liberalization of the trade and exchange system in April of this year. It was only because of the uncertain financing and the higher than programmed debt-service payments, both of which negatively impacted on the level of reserves, that this liberalization could only be in place de jure and not function de facto, as the staff paper phrases it. Second, while current budgetary expenditure exceeded the expected level, this was accounted for by substantially higher social outlays, not unrelated to the social disturbances. The same factor explains the lower than expected capital spending level. More important, I believe, is the fact that the expenditure on wages and salaries remained below the envisaged level. Third, with regard to monetary policy, it is quite easy to blame solely the Central Bank for its too accommodating policy stance. The extent of the overshooting of the original targets may also have had to do with data problems, however, causing an information lag, as well as with the time required for the design of a new system for central bank credit provision to commercial banks, resulting in a long implementation lag. The staff paper also mentions the difficulties in changing the lending behavior of commercial banks, a systemic problem that cannot be overcome overnight. Moreover, given the limited financial room for maneuver available to enterprises, to which Mr. Mirakhor's statement referred, the banking sector had no incentive at all to start changing its lending behavior.

I wanted to stress these elements to help dispel an otherwise lingering impression that the Algerian authorities are not firmly and fully committed to the implementation of the stand-by arrangement. As Mr. Mirakhor's statement highlights, the authorities' determination is evidenced by the firm action that the new Government has undertaken in response to the slippages of the first half of this year, notwithstanding the difficult social situation and the perspective of political elections. The staff supplement paper even mentions that price adjustments implemented in October not only made up for the earlier delays but in some instance even went beyond the measures envisaged last April. It is regrettable, of course, that these actions will start paying off only toward the end of this year or even in 1992. Let me therefore urge the Algerian authorities to continue their line of action into 1992 along the five axes of broad policy priorities outlined in the staff appraisal.

I am confident that, in doing so, they will achieve a virtuous circle of increasingly positive economic results, increasing confidence at home and abroad, increased availability of financing, and, therefore, an increasing willingness to further adjust. Such a virtuous circle of events will only be the mirror image of the vicious circle in which Algeria seemed to get trapped earlier in the year. Thanks to the EC loan as well as to today's Board approval of the second purchase under the stand-by, Algeria should be comforted to know that the international community continues to support its genuine efforts at economic stabilization and structural reform. It will provide an incentive to commercial banks to conclude rapidly the process of syndication and come forward with external financing, thus further reducing the risk of slippages for the program. This chair, therefore, supports the revised proposed decision, as it currently stands, as a vote of confidence in the economic reform program of Algeria, extending the position that my country took at the time of the approval of the EC loan.

This stand-by arrangement can indeed be looked upon as an encouragement of Algeria's drive for structural reform and perhaps also as a stepping stone for a future extended arrangement. As we said at the time of the Board discussion on the role of the Fund in the Middle East, the extended Fund facility should not serve only heavily indebted or Eastern European countries. Perhaps we in this Board have been fortunate to be able to discuss programs of countries, such as the ones in Eastern Europe, where a strong political consensus, based on democratic elections, was forged to carry through a massive stabilization cum restructuring effort. Today we have to deal with a country where strong commitment to economic change is still awaiting the outcome of the political elections. Nonetheless, the authorities have clearly demonstrated their commitment to carry on and deepen the process of economic reforms into 1992, a point already emphasized by Mr. Finaish. We commend them for that and wish them all the best in their future endeavors.

Before ending, I have a question for the staff. As was the case in the original document dealing with the request for the stand-by arrangement, today's staff paper again refers to the parallel market exchange rate and its relation to the official rate. Mr. Landau also touched upon this point. In commenting on a reduction in the gap between the two rates, the staff compares the September official rate, that is after the devaluation, with the parallel rate in July. In a footnote, however, mention is made of a subsequent depreciation of the parallel rate. I would like to return, therefore, to the question that this chair asked at the time of the Board discussion on the stand-by arrangement request: how significant is this parallel rate and does it constitute an appropriate reference point for action by the authorities or for advice by this institution, especially in view of the very substantial depreciation of the official rate already undertaken?

The staff representative from the African Department remarked that there were three separate issues concerning the authorities' exchange rate policy: whether the exchange rate mattered, as Algeria exported only oil and imported only intermediate inputs and raw materials; whether the exchange rate should be adjusted to the right level immediately or gradually; and the importance of the parallel exchange rate.

With respect to the first issue, he strongly disagreed with Mr. Fukui, the staff representative continued. At present, Algeria was exporting exclusively oil and importing only intermediate inputs and raw materials because of the exchange rate policy that had been maintained for many years. Algeria would not be able to solve its various economic problems--certainly not the huge unemployment, let alone the external imbalance--as long as it exported exclusively one product. In sum, the exchange rate did matter very much in the case of Algeria.

It was true, the staff representative went on, that an adjustment of the exchange rate would not lead to a complete restructuring of the Algerian economy in the immediate future or ensure that within several years Algeria would become a major exporter of manufacturing products. However, unless the authorities took the first step, they would never reach that goal--and the problems facing Algeria's economy could not be solved unless that goal was reached.

On the second issue, the pace of exchange rate adjustment, the staff representative said, one year ago the official rate had been 8 dinars per U.S. dollar and the parallel rate 35 dinars. At that time, the staff recommended moving immediately to a reasonable exchange rate, and then, perhaps not immediately, but at a very early stage, to use the rate as an sumer. However, for political and social reasons, the Algerian authorities did not agree. They very strongly preferred a gradual adjustment.

As to the third issue, the importance of the parallel exchange rate, the staff representative continued, there were roughly $1-2 billion a year in private transfers corresponding to workers' remittances. At present, there were few if any flows through the official market. That situation mattered a great deal, because it had led to a huge parallel market in Algeria for nearly all products, and it had serious implications for the conduct of economic policy in general, and for the budget and import liberalization in particular. That did not mean that the long-run equilibrium exchange rate was equal to the parallel market rate. But the authorities could not succeed in unifying the exchange market unless the gap in the rates was eliminated.

There were also a number of issues in the area of monetary policy, the staff representative noted. It was true that real interest rates were not positive. At the same time, the problem with respect to interest rates probably was not as severe as it appeared. The rate of increase in the consumer price index was 20-25 percent. However, a significant part of the increase was due to the fact that a major share of the index consisted of administered prices, which, after having remained unchanged for many years, had recently been adjusted by a relatively large amount. Hence, it was not clear what was to be learned about the real interest rate by simply looking at the rate of change of the CPI. In many case, interest rates above 20 percent were in violation of the usury law, and in the current political and social situation in Algeria, changing that law would not be easy.

He fully agreed with Mr. Spencer that the quantitative limits on access to central bank resources would undoubtedly be tested in the coming months, the staff representative said. Therefore, in the short run, the expansion of the monetary aggregates would not depend on interest rates, but rather on the ability of the Central Bank to say no to the commercial banks. That situation arose largely because there were fundamental problems with the banking and enterprise sectors. The World Bank's restructuring program for both of those sectors was just beginning; the banking sector had not yet been restructured, and its ability to collect new deposits was extremely limited. As a result, financing of the commercial banks took place through the Central Bank. Because of the problems with the enterprise sector, interest rates would not play a role in limiting the demand for credit. Enterprises would respond to interest rate policy once they had more freedom to adjust their staffing requirements; at present, their freedom in that area was extremely limited. The only way for enterprises with a large staff and a low level of activity to pay the staff was to use bank credit.

As Mr. Finaish had observed, the target for the overall surplus of the Treasury was adjustable upward and downward for deviations of the price of oil from the price projected in the program, the staff representative remarked. Under the program, the surplus resources were supposed to be placed automatically to the restructuring fund, and those resources could and should be used. The relevant performance criterion in the program referred to the overall surplus of the Treasury before transfers to the restructuring fund. It was true that the surplus from the budget was used for the restructuring fund, and the amount was substantial--DA 16.9 billion; that was, in fact, the main source of financing for the fund.

The staff was not yet certain whether or not the September performance criteria were going to be met, the staff representative from the African Department said. Preliminary monetary data up to the end of August indicated that the performance criteria could be met. However, the data typically were revised several times before becoming fairly firm. As to the plans for privatization, they had not been discussed extensively in Algeria; nothing concrete had been agreed thus far.

Mr. Spencer said that he understood the staff's argument in favor of a flexible exchange rate strategy at present in Algeria. But the staff had also referred to the possibility of shifting to an exchange rate anchor at some point in the future. In the paper, the staff had referred to 1992 as a possible time for introducing an exchange rate anchor. He wondered what the staff saw as the preconditions for shifting from the present flexible arrangement to the use of an exchange rate anchor, and whether the staff felt that those preconditions would be met in the foreseeable future, or at least in 1992.

The staff representative from the African Department responded that the staff had in mind two prior conditions. The first was that the external financing problem must be resolved. In that connection, the agreement with the commercial banks, the financing agreement with Italy, and the loan from the EC were major factors. If, in addition, the law allowing international oil companies to invest in existing oil fields was approved by Parliament, there would undoubtedly be a relatively large amount of foreign exchange resources in a very short period. The second prior condition was a willingness to set the exchange rate at a reasonable level. The exchange rate could be used as an anchor only if it had first been moved to a realistic level. Owing to the relatively large adjustment over the past 12 months, the official rate had moved from 8 dinars per U.S. dollar to 22.5 dinars per U.S. dollar. The parallel rate had fluctuated between 30 and 40 dinars; it had not shown any tendency to depreciate. Hence, the authorities were not far from being able in early 1992 to set an exchange rate that could be used as an anchor.

Mr. Spencer said that he wondered what the staff meant in its reference to pegging the exchange rate. Presumably that step would cause considerable problems for the traded goods sector, particularly from the effects of domestic inflation. In his view, before shifting to a peg the authorities needed to have both a firm hold of domestic monetary policy and some confidence that domestic monetary policy was going to be effective in containing inflation.

The staff representative from the African Department commented that he agreed with Mr. Spencer. However, it was important to bear in mind that the rate of inflation in Algeria was not very high. Even with the recent substantial adjustments in administered prices, the inflation rate in terms of CPI was of the order of 20-25 percent. In the past, the inflation rate have been very low, partly because of administered prices. If the authorities wished to have a nominal exchange rate anchor and augment foreign exchange reserves and control credit growth, they would have to be willing to move to a reasonable exchange rate and they would have to rely for some time yet on firm quantitative control over access to central bank money, possibly with an adjustment of the interest rate. It should not be assumed that in pegging the exchange rate the authorities could keep it pegged at the same level indefinitely; that would be excessively ambitious. But in those conditions the exchange rate conceivably could then rather quickly be used as a firm anchor.

Mr. Posthumus remarked that the staff had indicated that real interest rates probably were not very negative, given the current rate of increase in the consumer price index. However, the real issue was the expected price inflation. The staff paper suggested that an inflation rate of 35 percent was expected in 1991, which probably meant that the rate had been accelerating in the final few months of the year. If that was the expectation in the market, then real interest rates were really substantially negative.

The staff representative from the African Department commented that the estimate of 35 percent had been made at the beginning of the current program. The staff had not subsequently revised that figure downward even though the current inflation rate was substantially below that figure. At present, two factors were at work--the adjustment of the administered prices, particularly the prices of key foodstuffs and energy products, which could be quantified, but at the same time decontrol of the prices of most products. Despite the huge parallel market, some goods were still traded in the official market. The substantial adjustment of the official exchange rate was bound to have an impact on the rate of inflation. For all of those reasons, the staff had not changed the inflation target. The staff guessed that the inflation rate would probably be around 30 percent by about the end of December 1991. Therefore, it was probably true that interest rates were negative in real terms.

Mr. Towe made the following statement:

> Algeria's performance during the first half of 1991 can only be described as disappointing. Fiscal policy slippages were substantial, monetary policy was lax, and the effective implementation of many structural reforms, including the import liberalization, was delayed. As a result, we found it difficult to agree with the staff's suggestion that substantial progress had been made towards a market-oriented price system.
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> Indeed, given the scope of policy slippages so soon after the Board's approval of the stand-by arrangement, the staff report's relatively mild assessment of performance was somewhat surprising, as was the modest policy adjustment and the relatively generous access recommended by the staff under the modified program.

In particular, on the fiscal side, one cannot help but be alarmed at the scope of the slippages in current and subsidy expenditure that are to be accommodated. For example, current expenditures are now projected to be 3 1/2 percentage points of GDP higher than originally programmed, while net subsidy outlays by the Compensation Fund are expected to be over 1 percentage point higher. In this context, I note that, according to Table 5, the increase in projected current outlays largely relates to the other current expenditure category, which has been revised upwards by over 300 percent. Could the staff provide some further elaboration?

As regards subsidy expenditures, I recall that this chair expressed surprise in our June discussion regarding the lack of transparency in the fiscal accounts, especially as regards fiscal subsidies, given the large amount of technical assistance that has been provided to Algeria in the past. The staff report's reference to higher than expected payments from this account for subsidies incurred last fiscal year, as well as to delays in effecting payments to enterprises, highlights the importance for enhanced fiscal monitoring. As we had expressed the hope, in the June discussion, that the forthcoming technical assistance mission treat would this issue as a priority, could the staff indicate what progress has been made on this front?

On monetary policy, the staff report suggests that the breach of the credit targets was largely the result of delays in implementing a system for restricting central bank credit to the banking system. This seemed curious, since I presume that the authorities have operated a system of direct credit controls for a number of years, including during the period of their previous stand-by arrangement. Thus, one could not help but wonder whether it was a weakness in the authorities' resolve, rather than a lack of effective instruments, that led to the breach of the targets.

This concern is elevated by the fact that while the June program contained reference to the authorities' commitment to raise interest rates to positive levels by the end of the year, the latest staff report suggests that the maximum lending rate remains at negative 15 percent in real terms, and no significant commitment from the authorities to raise interest rates was obtained. In view of these observations, as well as the substantial deviations from the program ceilings during the first half of the year, I wondered why a firmer commitment from the authorities to raise interest rates was not obtained as a precondition for the revision to the program targets. Could the staff elaborate?

Finally, given the magnitude of the slippages and the uncertainties surrounding performance for the latter half of the year, we found the access proposed by the staff somewhat surprising. In particular, the waivers for the end-June criteria would permit the authorities to purchase one half the total access envisaged under the stand-by arrangement without having met a performance criterion. For the same reason, it is also somewhat troubling that the Board is being asked to approve a purchase based on performance criteria for end-September, over a month after the fact.

In light of these concerns, I wonder whether the staff could indicate whether consideration was given to either reducing total access, or to rephasing the purchase related to the end-June performance over the latter two test dates.

Mr. Mirakhor considered that the authorities' record showed that there was no weakness in their commitment to the program. It was important to bear in mind that the program had been approved in April, and that in May and June there had been an exogenous shock in the form of political unrest, which for all practical purposes had interrupted the basic economic life of the society for a considerable time. Indeed, the shock waves had still been vibrating through the economy in July. The authorities had subsequently mounted a massive effort and had brought the program back on track. There had been no weakening of the authorities' resolve to achieve the needed structural reforms, including price adjustment. The authorities had taken substantial action in a short period.

The suggested rephasing of the purchases under the stand-by arrangement would send the wrong signal, not because of what the authorities had done so far, but rather because of what the Board thought they might not be able to do in the future, Mr. Mirakhor continued. To appreciate that point, one merely had to look at the record: over the past 25 effective working days, the authorities had made massive adjustments to bring the program back in line, which clearly indicated that their resolve had not weakened. The authorities still had a financial sector reform program with the World Bank. As to the privatization of the banking system, private banks were able to operate. The authorities intended to continue discussions with the World Bank to undertake all the reforms necessary in order to be able to continue with privatization of the banking system in 1993-1994.

There were a number of ways in which to achieve positive real interest rates, Mr. Mirakhor noted. Obviously, the authorities could try to reduce the rate of inflation. At present, the magnitude of the supply response to all the adjustments that had already been taken was unknown. To be fair, the Board should give Algeria somewhat more time to see how it would perform--including the supply response.

Mr. Peretz made the following statement:

Let me say straightaway that while I have a great deal of sympathy for the position in which the authorities find themselves--and while I do not question their present resolve for the future--I do have considerable doubts about the decision we are being asked to endorse this afternoon. And I have not been reassured by what we have heard this afternoon.

Mr. Spencer, Mrs. Hansen, and Mr. Towe have expressed concerns about the financial risks to the Fund of an early disbursement. I agree with all the concerns they expressed. But what I am as concerned about is the signal we will be sending to others, if we decide to complete this review today, that the Fund considers Algeria's performance under the program to be satisfactory; that the program approved earlier in the year has largely been on track; and that we have confidence that it will remain so. The Fund's seal of approval will unlock something like a $300 million first tranche drawing under a European Community loan to Algeria and, it is hoped, further help from private sector creditors as well. We owe a duty to all Fund members, including those that hope to benefit from it in future, to ensure that the quality of the Fund's seal of approval is not devalued by being given on occasions when it is not fully warranted.

There has certainly been some commendable progress in implementing economic reform in Algeria since our last discussion. I am thinking of the reductions in administrative controls over some prices; some limited increases in interest rates; the reduction in the gap between the official and parallel exchange rates; and the provision in the supplementary finance law for reductions in the levels of the "tax compensatoire." These are all welcome developments.

On the other hand, nearly all the performance criteria under the program have been missed, in some cases by large margins. And although there were external factors, I believe the failure to meet the specific targets very largely reflects failure to implement the proposed policy measures. I do not want to enter into an argument about the reasons for the that. I understand the reasons for the failure to implement them. It is of course true. as the staff points out, that to some extent it also reflects a shortfall in external finance. But here we would like to point out that the attitude of providers of external finance is, in general, closely linked to the implementation of reform and adherence to Fund programs.

There have been serious policy slippages in both fiscal and monetary policy, as others have pointed out. On monetary policy, I have to say that the staff assessment does not inspire in me a great deal of confidence. It says that "the authorities should be prepared...to further adjust interest rates towards levels that are positive in real terms, should this prove necessary." But surely it is necessary. Indeed, from what we have heard today, I find it very hard to believe that the staff do not also believe, as I do, that positive real interest rates are a basic requirement for bringing the continued excessive credit growth back under control. It seems to me this should be a specific requirement of the program, with prior action required.

On fiscal policy, others have discussed the slippages, and the paper of course only gives rather sketchy information about the measures to be taken by the authorities. Additional measures saving some DA 18.9 billion will be needed beyond the provisions of the Supplementary Finance Law. The supplementary note circulated this week identifies implementation of further welcome reductions in subsidies that will save about DA 3 billion. However, the supplementary note also informs us that the authorities have been unable to implement planned further price increases which had been assumed to save a further DA 1.3 billion.

Instead, expenditure will now be reduced by DA 1.3 billion in some other unspecified way. This cut will need to be in addition to a rather vague commitment to reduce current and capital spending by about DA 9 billion. On top of this, the timing of the expected DA 7 billion of exceptional petroleum revenues in connection with new foreign investments looks rather uncertain, as the staff points out in the appraisal. And I assume that we would have been told by now if the staff could give any further details about what specific capital and current spending cuts the government has in mind to implement.

Of course, I agree with the menu of policy priorities identified in the staff appraisal: further price liberalization will be essential if resources are to be allocated efficiently; much tighter monetary policy will be needed--by which I mean positive real interest rates; public enterprises need to be rationalized; early implementation of tax reforms is crucial, but, as the staff makes very clear in the supplementary note, revenues will only increase if new taxes are properly administered; and improving the quality of economic statistics also should be a priority. Implementation of a program like this would certainly warrant the Fund's seal of approval. But we are not there yet. Of course, I welcome the authorities' restatement of their commitment to the program. But I do think it would have been more appropriate for the staff to delay recommending the disbursement of the second drawing until a stronger record of implementation had actually been achieved.

In case there is any doubt, let me make it clear that none of this is intended as criticism of the Algerian authorities--whose situation I well understand--nor, indeed, am I questioning their present resolve for the future. I have very great sympathy for the difficulty they see in implementing further specific measures in the period immediately before an election. But the lesson I would draw from this is that it would have been better to delay this review until after the election.

In the circumstances, I would like to be recorded as abstaining.

Mr. Mirakhor said that he was most surprised at the suggestion that Algeria's creditors would commit themselves to supporting the Government's program and then turn around quickly and say that, as the authorities could not implement the program, the committed financial assistance would not be disbursed.

Mr. Goos stated that he shared the concerns that had been expressed by Mr. Peretz and Mr. Spencer. Like them, he was greatly concerned about the slippages that had occurred so shortly after the approval of the program in important policy areas, especially as the problems could be traced largely to the accommodating monetary and exchange rate policies and the failure to implement crucial structural reforms. Equally worrying was the renewed acceleration of external arrears. In that connection, he had noted a contradiction between the staff paper and Mr. Mirakhor's opening statement: Mr. Mirakhor had indicated that Algeria had punctually serviced its debt-service commitment, but the staff had referred to a renewed accumulation of arrears. Some clarification of that point would be helpful.

He also shared the concerns expressed by previous speakers about future economic policies, particularly the appropriateness of monetary policy, Mr. Goos went on. It was striking to note that domestic credit and monetary aggregates were expected to grow at roughly the rates originally contemplated under the program, even though the rate of overall economic growth had been reduced from 4.5 percent to zero. Therefore, it appeared that the expansionary stance in the first part of 1991 would not be reversed; nor did the authorities seem committed to interest rates that were sufficiently positive in real terms.

He greatly sympathized with the authorities, who faced the difficult political circumstances that Mr. Mirakhor had described, but the policy mix envisaged for the remainder of the program period was a recipe for destabilization rather than stabilization, Mr. Goos said. The authorities' policy mix was characterized by a combination of expansionary monetary and fiscal policies together with negative real interest rates. That combination, and the continued floating exchange rate, was bound to undermine stability. On previous occasions he had repeatedly commented on the negative repercussions of exchange rate policy in a nonsupportive financial environment. The difficulty with such an approach was borne out by the footnote on page 15 of the paper, which explained that, after the recent devaluation of the official rate, the parallel market rate had depreciated more or less to the same extent. Moreover, Mr. Mirakhor had noted the adverse impact of currency depreciations on the financial situation of enterprises and the ability to control domestic liquidity. Therefore, the authorities and the staff would be well advised to reconsider the stance of exchange rate policy, especially as by August 1992 the real effective exchange rate had already decreased by about 55 percent from mid-1990. The staff had referred to the need to strengthen external competitiveness in order to stimulate export diversification. However, in view of the real depreciation of

55 percent, Algeria's external competitiveness should have improved significantlly. Therefore, he could not understand why the staff had again explicitly recommended further devaluation of the exchange rate. In the absence of tight financial policies, that recommendation was tantamount to an invitation to shift the burden of adjustment to trading partners through competitive devaluations.

The Fund should not be seen as endorsing such a policy approach, which was detrimental to Algeria's best interests, Mr. Goos considered. Nor should the Fund associate itself with such a policy stance for the reason explained by Mr. Peretz, namely, the misleading signal that would be sent with respect to the seal of approval given by the Fund. Therefore, his position was the same as that of Mr. Peretz, and he would like to be recorded as abstaining from the proposed decision. At the same time, he was intrigued by Mr. Spencer's proposal, which appeared to have considerable support, to reschedule the envisaged drawings.

The staff should comment on the role it saw for the Fund after the expiration of the present arrangement, Mr. Goos stated. As the staff expected no need for further exceptional financing in 1992 and beyond--which seemed highly unlikely--presumably it would therefore be appropriate for the Fund to discontinue new financing at the end of the current stand-by arrangement.

Mr. Landau said that it was not fair to criticize the depreciation of the real exchange rate, which had been an objective under the program. The program was based on the assumption that the exchange rate had been overvalued; indeed, the main stumbling block in the negotiation of the program had been Algeria's reluctance to depreciate the exchange rate. There was cause for some concern about the future path of the exchange rate in relation to monetary policy. The Board's approval of the current stand-by arrangement had been based on the assumption that the authorities would liberalize prices and establish a realistic exchange rate; both of those objectives had been accomplished. The problem was the monetary slippages, which lent uncertainty to the future path of the rate of inflation and the exchange rate. The staff paper gave the impression that those slippages were a thing of the past and that no more slippages in monetary policy were anticipated in the program period. As a result, the readjustment of the performance criteria for the future was designed only to take into account developments in the past--there was no question of tolerating additional slippages in the future.

Mr. Goos said that his concern about monetary policy was not based only on past developments. He was concerned mainly about what might well happen in the coming months under the authorities' current policy stance, although at the previous discussion on Algeria he had expressed dissatisfaction about the continuous devaluation of the exchange rate. His main point was the disastrous consequences to expect from insufficient financial discipline combined with a floating exchange rate. He had also taken into account what appeared to be the negative real interest rates; in that connection, he, like Mr. Posthumus, was not fully convinced by the staff's explanations. It was true that the CPI included a considerable component of administrative price adjustments, but many more such adjustments were likely to take place in the future, and continuous inflation would probably feed back into expectations; with negative real interest rates, the situation could be expected to destabilize.

As to the future, he had not projected slippages in monetary policy, Mr. Goos. He had said that monetary policy was not sufficiently restrictive. To substantiate that point he had referred to the fact that the monetary target was much higher than before even though real growth was projected to be zero and, therefore, considerably lower than in the original program.

Mr. Landau said that he agreed with Mr. Goos that it would be preferable to have a one-step adjustment of the exchange rate rather than the kind of gradual slide that had been evident since the start of the program. Apparently, however, that preferred approach had not been possible.

For the future, the key question was the monetary policy under the revised program, Mr. Landau considered. There was no need to pay too much attention to the negative real interest rates, given the way monetary policy was operating in the present context--mainly by quantitative restrictions on the supply of money. In those circumstances, the negative real interest rates were not a good indicator of the stance of monetary policy. The main issue was whether the performance criteria in the revised program were designed to accommodate further slippages in monetary policy or reflected the past slippages.

The staff representative from the African Department said that it might be helpful to comment further on the slippages in the first half of 1991. The $1.1 billion shortfall in external financing had in fact had nothing to do with the performance under the program. Half of that shortfall was due to the fact that the external debt service for the first half of 1991 had been underestimated by the authorities because of weaknesses in the statistics on external debt. The other half of the shortfall was due largely to two sources. First, Algeria had suddenly found itself cut off from its main source of foreign credit, namely, trade credit, because of the slow negotiations with the commercial banks. Second, some of the official credit lines were not renewed as envisaged during the first half of the year. These two latter factors had resulted in a loss of about $500 million.

The impact of the shortfall on the budget and on monetary policy was substantial, the staff representative continued. In all likelihood, if when faced with the shortfall the authorities had decided in February-March 1991 to request a debt rescheduling, and had--in accordance with normal practice--stopped payments on principal while waiting for the meeting of the Paris Club, instead of substantially reducing imports, by $1.16 billion, over six months, all the performance criteria for the end of June would have been met except possibly for the one on external arrears, because most of the shortfall in the budget was traceable to the sharp decline in the customs duties. It was important to bear in mind that the financing of the Compensation Fund was based mainly on revenue from import duties. The large shortfall in the Compensation Fund was due to the fact that the resources from imports going to the Compensation Fund had declined enormously. Similarly, to a large extent, the difficulties facing the autonomous parastatal firms were due to the fact that the firms had not been able to import inputs of intermediate products and raw materials, and production had fallen well below capacity. Of course, in theory, the firms could have adjusted by firing workers, but they could not do so in the current political and social circumstances; therefore, they had had to keep paying all the workers, and that outcome could be viewed as a slippage. But that outcome would not have occurred if the authorities had not had to reduce imports substantially and had asked for debt rescheduling instead.

The program was based on the expectation that there would be no additional slippages in the second half of 1991, the staff representative said. In fact, additional measures had been taken in the second half of the year to cover roughly half of the deviations from the initial program that had developed during the first half of the year. The extent of the genuine slippages was not clear, but to some extent clearly the program for the second half of the year was based on the view that, as far as monetary policy was concerned, there would be no problem whatsoever--the Central Bank would be able to limit exactly as envisaged the volume of credit to the commercial banks, and, therefore, there would be a sharp decline in credit expansion.

The exchange rate issue was closely related to the question of slippages under the program, the staff representative said. Despite the slippages, the rate of growth of money was about 20 percent at a time when the rate of inflation was about 25-30 percent. Initially the rate of growth of money was envisaged to be 10 percent, and he wished to stress that that target had not been agreed because the staff had pushed the authorities toward such a low rate. From the outset of the program, the authorities had favored an extremely tight credit policy, because they wanted to reduce as much as possible the amount of adjustment they would have to make in the exchange rate. The staff had told the authorities from the outset that the credit growth target was probably too ambitious at a time of significant adjustments of administered prices, some of which had not been changed in 30 years. The staff had not revised the projection for the inflation trend, because in the circumstances of Algeria the link between the rate of growth of money and the rate of inflation was extremely tenuous in the short run, and because recent information indicated that currently the inflation trend was substantially lower than targeted.

Responding to a point made by Mr. Goos, the staff representative said - that it seemed unfair to look at the amount of real devaluation; at the time of the adjustment, the official rate had had no meaning whatsoever, and the amount of change in the official rate was irrelevant. The important point was that the authorities should have an idea of where they wished to see the rate go. At the beginning of the current program, just 10 months ago, the official rate was just 8 dinars per U.S. dollar. Except for exports of oil and imports directly controlled by the authorities, all transactions had been taking place at a rate of about 35 dinars. Hence, an adjustment in the official rate from 6 dinars to 22 dinars did not mean much in absolute or percentage terms.

Technically the authorities did not have a floating exchange rate policy, but rather a pegged exchange rate policy, the staff representative from the African Department commented. The exchange rate had been pegged in nominal terms at about 18 dinars per U.S. dollar beginning in February 1991 until the latest discrete adjustment to the current rate of 22.5 dinars. The adjustment of the rate was the result of the Central Bank's decision to change the peg of the parallel rate. Over the past 12 months the parallel rate had fluctuated without any major net change. The parallel rate had depreciated in August 1991, before the change in the official rate, and once the change in the official rate had taken place there had been no depreciation of the parallel rate. The depreciation of the parallel rate had occurred before the adjustment of the official rate on a month-by-month basis. The adjustment of the official rate had been quite recent. The depreciation of the parallel rate on a very short-run basis was probably related more to the fact that there had been problems with respect to the external payments position: there had been some accumulation of external arrears following the difficulties in reaching an agreement with the commercial banks. There had been a small depreciation of the parallel rate in the recent past, but over the past three years or so there had been no basic change in the parallel rate.

Mr. Goos commented that the main issue he had raised was whether the authorities should float or continuously adjust the exchange rate. The staff representative had suggested that the official rate was originally irrelevant, and that the most important factor in exchange rate policy was to know where the rate was heading. It would be helpful to have an indication of the staff's view of the equilibrium exchange rate. The staff apparently felt that the faster the authorities could depreciate the rate the better. In his view, that approach posed dangerous risks in the circumstances of Algeria, particularly with the current financing policy mix.

He did not agree with the staff's argument that the official exchange rate was irrelevant, Mr. Goos continued. Either the rate was relevant, in which event it should be depreciated in order to prepare for the massive liberalization of trade, or it was irrelevant, as the staff maintained, and no depreciation was needed, as it would have no effect on the country's economic position when the borders were opened to freer trade.

The staff representative from the African Department responded that he had meant to say that the initial level of the official rate was irrelevant in assessing where the exchange rate ultimately should go, because in the past foreign exchange receipts from oil exports were allocated to importers according to administrative criteria. The price set for foreign exchange transactions in such a system provided no information whatsoever on what the price should be once the administrative allocation of foreign exchange was abandoned, as was happening in Algeria. The official rate itself would be relevant once the centralized control of the allocation of foreign exchange was eliminated.

The staff and the authorities had known from the outset where the exchange rate policy was going, the staff representative from the African Department noted. The exchange rate had been adjusted from period to period not because that had been the only alternative available to the authorities. The staff and the authorities had started the program period knowing what should happen to the exchange rate. The authorities had done what they were supposed to do--no more, no less--under the program in the area of exchange rate policy.

Mr. Posthumus made the following statement:

At this stage in the discussion, I should like to focus my remarks on an area where substantial slippage has taken place--monetary policy. As a starting point, I will take the precarious external situation in which Algeria finds itself. Algeria has tried to find a way out of its balance of payments problem by inter alia resorting to a flexible exchange rate policy. But for such a flexible exchange rate policy to be effective in addressing balance of payments problems, it is necessary for the economy to be responsive to exchange rate changes.

Therefore, I will now elaborate on the sensitivity of Algeria's export and import volumes to exchange rate changes. First, on exports. More than 95 percent of Algeria's exports consists of hydrocarbons. In my view, it is fair to say that a dinar depreciation will not lead to noticeably higher hydrocarbons export volumes. Hence, any effect of exchange rate changes on the current account will have to come from changes in import volumes. It is my impression, however, that Algeria's economic agents have little room for adjusting prices and respond rather to the availability of credit. In this connection, I would argue that the recent import compression was due not so much to the dinar devaluation, but rather to the limited availability of external credit.

But what then was the effect of the dinar depreciation? According to the discussion on page 9 of the staff paper, the depreciated exchange rate relative to 1990 increased the cost of imports. Rather than fully passing through such increased costs in higher prices, enterprises sought bank financing. Similarly, the output slump led to increased demands for credit rather than to adjustment. Normally, if markets are allowed to function, increased demand for anything, including credit, will raise the price. But the price of credit is severely distorted in Algeria.

Interest rates are substantially negative in real terms, and in the first half of this year any sort of brake on credit expansion seemed to be lacking.

In this light, I am not surprised that inflation is expected to be high even though changes in government-controlled prices have been delayed and a good crop lowered price pressures on food items not subject to controls. I note that the expected inflation for the whole of 1991 has remained unchanged at 35 percent (as shown in Table 2) under the revised program. Since there was very little inflation in the first half of 1991, am I to assume that the bulk of inflation is expected to take place in the second half of 1991, and that inflation on an annual basis is expected to run at 60 percent as measured by the CPI?

That brings me to real interest rates. The maximum interest rate chargeable on bank loans is set at only 20 percent. I note that the Government has not so far expressed its readiness to raise interest rates to positive levels in real terms but has chosen to limit credit by making marginal lending unprofitable for the banks, notably by raising the rate charged on central bank interventions in the money market to about 17 percent. This is not a good way to restrict credit, as it will eliminate the allocative function of interest rates. Everyone will want to borrow money at such low real rates, but the banks cannot profitably provide it to anyone. I am not satisfied by this policy. At the least I would have liked to see a commitment of the authorities to raise interest rates to positive levels in real terms within a certain timeframe.

I began my statement with the balance of payments, then commented on exchange rate policy and finally got to monetary policy. Now let me briefly work my way back. If depreciation leads to more credit rather than to adjustment, then the effect will be increased inflationary pressures, arising from the depreciation itself as well as from the increase in credit. These inflationary pressures will in turn fuel further depreciations. Meanwhile, the ultimate limit on the balance of payments will continue to be the availability of external credit.

I will not comment on fiscal policy or on structural policies, such as pricing policies, but I agree with what most Directors have said about them. But although I understand the authorities' position, I note that in this review waivers must be given and future performance criteria adjusted by a rather substantial amount. The suggestion is that we should finance first, thus helping to create confidence, and let Algeria adjust later, taking advantage of the better climate. That approach is certainly innovative, but with all the slippages that occurred and the lack of compensatory measures at this time, I think that the Board should follow its normal approach.

I do not understand why, under these circumstances and with elections just a few weeks off, this review has been brought to the Board, and why it is so positive. Like Mr. Peretz, I do not doubt the commitment of the authorities. I wish to be recorded as abstaining.

Mr. Rodriguez said that he was worried about the evolution of Algeria's commitment to adjustment; it was his impression that comprehensive fiscal and monetary measures should have been introduced. The present request for a waiver was the result mainly of the postponement of those measures and the laxity of financial policies. The slippages were due mainly to the delays in structural adjustment--for example, decisions defining the role of different public sector agents and introducing harder budget constraints in public enterprises and a new tax system. The staff paper showed that there had been higher than expected carryover subsidies for the Compensation Fund in the current fiscal year and that public expenditure in 1991 would be substantially higher than projected. In addition, the end-June performance criterion of the Treasury's surplus was observed because of the accumulation of arrears.

The authorities' decisions would be credible only if they were perceived as being consistent, Mr. Rodriguez continued. There seemed to be little consistency in what the staff had called the still ballooning cost of subsidies or the continuation of studies of the 22 large public enterprises in need of fundamental restructuring without a simultaneous legal framework to define the modalities of the dissolution of those enterprises. In that connection, however, Mr. Mirakhor's reference to the new "code de commerce," with new definitions of bankruptcy and judicial liquidation, was welcome.

There were also inconsistencies in the authorities' monetary decisions, Mr. Rodriguez noted. For instance, he had difficulty in understanding the authorities' decision to implement continuous devaluations while maintaining an accommodating monetary policy and the provision of bank financing of enterprises to prevent price increases. Given those facts, he doubted whether the Central Bank's responsibilities for conducting exchange rate and monetary policy had been properly defined.

The prolonged data problems noted by the staff merited special attention, Mr. Rodriguez considered. Correct and timely data were a basic precondition for sound macroeconomic management. He wondered whether some of the inconsistencies that he had noted were the product of the data shortcomings. He was inclined to support prompt technical assistance to improve the banking and public finance statistics. He would refrain from making such requests, as 20 technical assistance missions had visited Algeria over the past four years. He hoped that future technical assistance would prove to be more fruitful to Algeria and other present and future members He wished to abstain from supporting the proposed decision.

Mr. Fuleihan made the following statement:

Beginning in 1989, the Algerian authorities intensified their efforts to transform the economy from one based on centralized government control to one guided more by market forces. At the outset, it was recognized that this would not be an easy task, and that the path of progress was marked by considerable uncertainties. Accordingly, success in this endeavor will require a strong commitment and perseverance on the part of the Algerian authorities.

The 1991 program envisaged an acceleration in Algeria's move towards a market economy. In particular, a substantial liberalization of the trade and payments system and an overhaul of the public enterprise sector were programmed. These measures were to be complemented by the liberalization of domestic prices, a reorientation of the banking system towards the private sector, as well as adherence to restrictive financial policies. While some progress was made, notably with regard to the liberalization of domestic prices, the first half of 1991 witnessed a divergence from the program's objectives. Exogenous factors, including a shortfall in external financing and a rise in social tension, contributed significantly to this divergence.

At this juncture, the task at hand is to restore the program to the course originally intended. This will require firm measures, and the actions that are now being undertaken by the authorities are a step in the right direction. It is important that, while these measures ensure that the financial targets of the program are met, they also help promote sound growth. Obviously, measures that achieve the same financial ends may not be of equal merit in terms of enhancing economic efficiency. In this respect, the Government's continued commitment to a major tax reform, to the further liberalization of the price system, and to the rehabilitation of the public enterprise sector is essential. The promotion of domestic price liberalization will have important financial ramifications for the budget, and will also ensure that the de facto liberalization of imports promotes an appropriate allocation of resources. In addition, greater efficiency in the public enterprise sector will allow for a greater share of bank credit to be channelled to private sector agents at a time when they need resources to respond to the realignment of relative prices.

In view of the considerable initial uncertainties that surrounded the external financing of the stand-by program, the recent progress in this area is particularly welcome. Indeed, the special loan from the EC and the agreement with commercial bank creditors will help ensure the success of the program. As regards prospective payments for hydrocarbon ventures, like previous speakers, I note that there is still some uncertainty concerning their timing. Could the staff elaborate further on this issue? Also, if there were delays in the receipt of such payments, what would be the likely consequences for the program?

With these remarks, I support the proposed decision and wish the authorities every success in the difficult but worthwhile task that lies ahead.

Mr. Toé made the following statement:

At this late stage in our discussion, I shall be very brief. I would like to associate myself with previous speakers in commending the Algerian authorities for the courageous steps taken to bring the program back on track in a very difficult domestic and external environment. The measures taken, particularly the substantial adjustments in administered prices, including the exchange rate and the comprehensive price liberalization implemented thus far, are indeed bold considering the precarious social situation prevailing in the country. If I may offer a comment in this connection, I would urge the Algerian authorities to move expeditiously in setting up the new social safety net system, in order to broaden public support for the adjustment process.

As to the exchange rate, I agree with the views expressed by Mr. Finaish, Mr. Landau, and Mr. Fukui. Indeed, in view of the sharp cumulative depreciation that has been already achieved, it would be advisable for the Algerian authorities to reconsider their exchange rate policy stance and use the nominal exchange rate as an anchor for price stability.

We have no difficulty in supporting the request for a waiver for the missed performance criteria at end-June and in acceding to the request for a modification of the performance criteria for end-September and end-December 1991 as specified in the table attached to the authorities' letter of September 30, 1991. The circumstances that led to the nonobservance of the performance criteria at end-June are well explained in Mr. Mirakhor's informative statement and in the staff paper. In our view, there is no doubt that these were beyond the authorities' control.

In supporting the proposed decision, we wish to encourage the Algerian authorities to persevere in their adjustment efforts and to express our confidence in their ability to steer the economy through these difficult times. The measures taken in September and October have, no doubt, improved the prospects for achieving the authorities' medium-term objectives. The policies they are following are broadly appropriate, and their sustained implementation should go a long way in restoring external viability in the context of balanced, noninflationary economic growth.

Mr. Fridriksson made the following statement:

While I sympathize with Algeria's situation and note the comments of Mr. Mirakhor, like several previous speakers I am disappointed with the evolution of the Algerian program, and I agree with those who have expressed dissatisfaction with the prospect of Algeria being able to draw half of the amount committed under the program without having demonstrated sufficient resolve to implement it. I would also like to echo the comments of those who have drawn little comfort from the discussion this evening.

First, without going into detail on policy implementation, let me just mention that the slippages are most disappointing. In the monetary policy area, interest rate action has been anything but convincing, and the staff appraisal modestly suggests that the authorities should be prepared to further adjust interest rates towards levels that are positive in real terms, should this prove necessary. Positive real interest rates should be established as quickly as possible and the usury rate abolished, or at least modified, so as to allow for a sufficiently flexible interest rate policy. Moreover, the authorities do not appear to have broken with the past practice of easy access of enterprises and banks to credit on favorable terms.

Second, the fiscal side appears to have been badly deficient at the beginning of the program. In addition, the slippages were such that the supplementary measures introduced in August--two months after the approval of the program--were insufficient to render the program objectives achievable. The supplement circulated yesterday does not provide much comfort; rather, it raises serious further doubts about the authorities' ability to implement the policies agreed under the program.

Third, in the structural area, price liberalization should be completed rapidly and the restructuring of public enterprises given high priority. Incidentally, I failed to see a reference to privatization in the paper, and wonder whether it plays any part in the policy of the Government.

Finally, let me repeat that I am concerned about disbursements being made from the Fund without Algeria having accomplished much of what would normally be expected. Perhaps it would not be unreasonable to suggest that Algeria establish a track record before being allowed to draw further on the Fund. Consequently, I have sympathy for Mr. Spencer's proposal to rephase the drawings. In any case, Algeria must show that it really intends to carry out its adjustment policy. Without it, the otherwise comparatively favorable balance of payments outlook may worsen substantially.

Mr. Mirakhor said that some speakers appeared to have questions about authorities' ability to implement the program. The authorities had shown that they were capable of bringing the program back on track, despite the major shocks to the economy, and that they were capable of continuing to implement the program in the future as well. The authorities were clearly committed to the program, which they had designed with the help of the technical assistance provided by the Fund. The World Bank staff was currently in Algeria, and the authorities would continue to liberalize prices and restructure the economy.

The Executive Directors then turned to the proposed decision.

Mr. Spencer recalled that he had suggested rephasing the proposed purchases under the stand-by arrangement, which would entail moving the second drawing to the end of the stand-by arrangement period; that drawing could be associated with performance criteria for, say, the end of March 1992, assuming that the arrangement could be extended beyond its present period.

The staff representative from the African Department noted that the current adjustment program would end in December 1991. The next review under the stand-by arrangement was to be completed by mid-March 1992 and would be linked to the performance criteria for the end of December 1991. The arrangement was supposed to end in mid-March 1992, and the last economic targets under the arrangement were for the end of December 1991.

Mr. Spencer said that he preferred to extend the stand-by arrangement. A number of policy actions were to be taken in early 1992. As the next performance criteria were for the end of December 1991, the second review under the arrangement would not put Directors in a position to assess the authorities' performance in terms of the implementation of the various reforms early in 1992. If the option he favored was not possible, the currently scheduled second purchase could be spread over two purchase periods.

The staff representative from the Legal Department said that one way in which to proceed on the basis of Mr. Spencer's approach would be to make the next purchase available on the basis of the end-December 1991 ceilings and the completion of the February 1992 review. In that event, no purchase would take place immediately upon the completion of the ongoing review, and a purchase of SDR 75 million would be available upon meeting the end-September ceilings as originally contemplated, and an additional purchase of SDR 150 million would then be available at the time of the February review based on the end-December ceilings--that amount being the original SDR 75 million plus the SDR 75 million based on the end-June performance criteria.

The staff representative from the African Department noted that, as a consequence of accepting Mr. Spencer's proposal, the program for 1991 would no longer be fully financed with the postponement of the purchase from the

Fund of SDR 75 million. In addition, the loan from the EC might not be available, as it was linked to the stand-by arrangement.

Mr. Landau said that he did not see the rationale behind Mr. Spencer's proposal. The next elections were scheduled to take place on December 26, 1991, but in a number of previous cases the Board had approved arrangements with members in the weeks before an election; in those cases, the Board had considered that its duty was to strengthen the reform process by supporting the programs precisely in the period prior to elections. Hence, there seemed to be no reason to delay a purchase by Algeria until several days after the coming election. In any event, as he understood it, if Mr. Spencer's amendment were adopted, the financing from the European Community would be held up, which would make it very difficult for the authorities to implement their adjustment program. Furthermore, his overall assessment of the authorities' track record was that there had not been any significant slippage under the current program. Indeed, important liberalization measures had been implemented, including price liberalization, and exchange rate adjustments had been made. Moreover, control of current expenditure--including the public sector wage bill--had been fairly good. The Government was clearly committed to financial discipline. It would have been very easy to let the wage bill slip, especially in the current difficult period.

Mr. Mirakhor said that he agreed with Mr. Landau that Mr. Spencer's approach would not be helpful to Algeria's program; indeed, the program would be undermined, further destabilizing the Algerian economy. It was important to have in mind not only a standard of fairness but also the fact that Algeria had met all its external debt obligations up to the present. If the program was rejected and external creditors were sent the signal that, as Mr. Posthumus had put it, the Fund's seal of good housekeeping had not been given to Algeria, and if the expected external financing was not made available to Algeria, the country might well be forced into the difficult position of having to review its principle of not needing any rescheduling of its external debt. Every effort should be made to avoid that outcome.

Mr Bossone stated that he wished to associate himself fully with the position of Mr. Landau.

Mr. Moss said that he had not meant to suggest that the case of Algeria was one of finance first and adjustment afterward. There seemed to be general agreement among Directors that the authorities were committed to pursue the program in the months ahead and deserved financial support. The main question at hand was whether more weight should be accorded to the past slippages by withholding the next purchase, or to the wish to avoid undermining other sources of financing, which could put the whole program at risk.

Mr. Spencer commented that the intention of his proposal was not to cast doubts on the intent of the authorities or to upset their overall economic program, but rather to send a clear signal to all members regarding the need to prove policy performance in order to have programs continue. He agreed that it would be preferable to change the phasing so that there would be a review following the coming election and the final purchase would be made in 1992 rather than in 1991. But if that was not possible, then, at least by adding the second purchase to the end of the year, the authorities would have a further opportunity to prove that their intent to implement the intended fiscal and monetary policies had substance; thus far, the performance had not been adequate. The staff had noted that the source of some of the slippage had been external shocks--the fall in imports and the excess debt-service payment--but such shocks would likely continue in the future, and the main question at hand was whether the authorities' policies could hold up under such shocks. In that connection, a monetary policy with a fixed interest rate cap was essentially asking for trouble: it would almost certainly create an inflationary shock that would test the monetary credit ceilings. The performance to date did not suggest that those ceilings would hold.

Mrs. Hansen said that she agreed that there was no doubt about the authorities' intentions and commitment. However, normally the Board required a track record in order for a program to continue, as Mr. Spencer had stressed. If would be helpful to know more about the relationship between the planned EC loan and approval of the next purchase under the stand-by arrangement.

Mr. Landau noted that Mr. Spencer had implied that the authorities' record thus far cast doubt on what they would be able to do in the future. That comment clearly cast doubt on their intentions, not on their record; it was clearly a forward-looking remark--and not a positive one. The Algerian authorities already had a track record that, while not perfect, was comparable with the track record of other members that had been permitted to make purchases. Some of the performance criteria for Algeria had not been met, but all the performance criteria affecting the government balance, treasury balance, and outstanding short-term debt of the Government had been met, and the authorities had recently made significant price adjustments that were not reflected in the performance criteria.

Mrs. Hansen remarked that the staff paper noted that the end-June performance criterion on the treasury surplus would not have been observed but for some temporary accumulations in another account.

Mr. Landau noted that, according to the staff paper, the arrears in question were to be eliminated in two months.

In response to Mr. Landau's earlier comment, Mr. Spencer considered that the authorities did intend to observe the credit ceilings, but experience, both in Algeria and in many other countries, showed that such ceilings were difficult to observe, particularly if a nominal interest rate ceiling was creating very negative real interest rates. There was no question of the authorities' intent; rather, the question had to do with the mechanism for ensuring that the credit ceilings could be adhered to.

Mr. Towe said that he agreed with Mr. Spencer and Mr. Peretz that the issue under discussion was not the authorities' intentions, but rather the consistency of Fund policy. It would be helpful to know whether the planned EC loan was contingent on the next scheduled purchase under the stand-by arrangement.

The staff representative from the African Department remarked that the first disbursement under the EC loan was certainly contingent on the completion of the ongoing review and a suitable agreement with the commercial banks. The staff was not certain whether the EC would consider that the review had been completed if there were no purchase at the present stage. The agreement with the commercial banks was in the final phase of negotiation.

Mr. Towe commented that if the EC loan disbursement was not contingent on a waiver being provided for the end-June performance criteria, and a purchase was not made at the conclusion of the ongoing review, the issue then was whether the delay of the next purchase would jeopardize performance vis-à-vis the international reserve target.

The staff representative from the African Department responded that a delay in the scheduled purchase of SDR 75 million would clearly have an impact on the net external asset position. At the level of the budget, the impact of delaying the purchase of SDR 75 million would probably be relatively small. Of course, the most important question was whether the delay in the purchase from the Fund would lead to delays in financing from other sources.

There seemed to be two separate issues under discussion, the staff representative continued. One was based on the performance of the first half of the year and whether the ongoing review should be completed. While some of the performance criteria had not been met, some of them had been observed, and most of the measures that were supposed to be implemented had in fact been implemented, such as those affecting the exchange rate and interest rates. The second issue was whether the program, as revised, would be on track at the end of September 1991. If all the end-September performance criteria were met, there was no reason why the purchase would not take place. If the end-September performance criteria had not been met, the Board could decide whether or not it wished to grant a waiver.

Mr. Peretz said that he did not support Mr. Spencer's amendment but for a different reason from Mr. Landau's. His concern was about not only the Fund's own exposure in Algeria, but also the signal the Board would send to other members by giving its seal of approval in completing the ongoing review at the present meeting in circumstances in which that approval was not yet warranted. It would have been much better not to have brought the review to the Board's agenda until after the coming election, at which point the Algerian authorities would have been able to implement additional needed measures.

Mr. Posthumus commented that the case of Liberia illustrated the danger of linking financing agreements between a country and other parties to approval of a Fund-supported program; speakers at the present discussion had repeatedly made the point that the financing arrangements for Algeria's program would collapse if the next purchase was not permitted on schedule. That situation limited the Board's room for maneuver.

He did not share Mr. Landau's perception that the present case of Algeria was being treated by Directors differently from other comparable cases, Mr. Posthumus said. In considering previous similar cases, he himself had repeatedly abstained from approving the proposed decision, and he saw no reason why he should have acted differently in the present case of Algeria.

The Acting Chairman commented that the case of Algeria was a difficult one, and Directors could easily spend considerable additional time debating it, although without much benefit. It would admittedly have been desirable to have had additional actions by the authorities on record. At the same time, the record that the authorities had established could not be completely discounted. In addition, the Board's decision at the present meeting would influence other sources of financing, although in effect the Fund brought that situation on itself by requiring financing assurances. The Board did not often face as difficult a decision as it did in the present case of Algeria, but on previous similar occasions the Board had decided to go ahead and approve the proposed decisions. Management recognized the risks involved in proceeding with the purchase by Algeria, but it also recognized the costs of a decision not to proceed and had confidence that the authorities would make every effort to deliver on their commitments. The Board discussion had reflected the difficulty in dealing with the proposed decision. On balance, Directors seemed to favor approving the decision.

The Executive Board then approved the following decision, with Mr. Goos, Mr. Peretz, Mr. Posthumus, Mr. Rodriguez, and Mr. Spencer abstaining:

1. Algeria has consulted with the Fund in accordance with paragraph 4 of the stand-by arrangement for Algeria (EBS/91/79, Sup. 2, 6/17/91) and paragraph 50 of the memorandum on economic and financial policies annexed to the letter dated April 27, 1991 from the Minister of Economy and the Governor of the Bank of Algeria, in order to review progress in the implementation of the policies and measures described in that memorandum, and to reach understandings regarding the circumstances in which purchases under the arrangement can be resumed.

2. The letter with its annexed memorandum and table dated September 30, 1991, from the Minister of Economy and the Governor of the Bank of Algeria, shall be attached to the stand-by arrangement for Algeria, and the letter of April 27, 1991, with its annexed memorandum and table, shall be read as modified and

supplemented by the letter of September 30, 1991 with its annexed memorandum and table.

3. Accordingly, the limits for end-September and end-December 1991, referred to in paragraphs 4(a)(1), (2), (3), (4), (5), (6), and (7) of the stand-by arrangement for Algeria shall be as specified in the table annexed to the letter of September 30, 1991.

4. The Fund decides that the first review contemplated in paragraph 4(c) of the stand-by arrangement for Algeria is completed, and that Algeria may proceed to make purchases under the arrangement notwithstanding the nonobservance of paragraph 4(d)(1) and purchases under it up to the equivalent of SDR 150 million until November 22, 1991 notwithstanding paragraph 4(a).

Decision No. 9859-(91/154), adopted
November 13, 1991

4. BURUNDI - EXCHANGE SYSTEM, AND ENHANCED STRUCTURAL ADJUSTMENT ARRANGEMENT

The Executive Directors considered a staff paper on Burundi's request for arrangements under the ESAF in an amount equivalent to SDR 42.7 million and the first arrangement thereunder in an amount equivalent to SDR 12.8 million (EBS/91/167, 10/1/91). They also had before them a policy framework paper for the period 1991-94 (EBD/91/276, 9/30/91), and a statement by the Managing Director, which read as follows:

> There follows for the information of Executive Directors the text of a memorandum that I have received from the Acting President of the World Bank to serve as the basis for my statement on the matter to the Board. This text summarizes the main points covered by the Committee of the Whole of the Executive Directors of the Bank and IDA in their meeting on October 31, 1991.
>
> Executive Directors expressed strong support for the Government's continued implementation of a structural adjustment program and for its efforts to promote national unity and open up the political system. They urged the Burundi authorities to continue the progress toward national reconciliation and to maintain the revitalized pace of reform in order to increase the chances for sustained economic growth in a country which faces severe physical constraints to development. Executive Directors also emphasized the importance of mobilizing broad political support for the reform program and of reinforcing the Government's implementation capacity to assure the success of the macro and sector policy reforms.

The Executive Directors noted with satisfaction that the policy framework paper calls for a reduction in the role of the state in the productive sectors. The Executive Directors also commented that the size of the fiscal deficit was still a problem but that the brunt of expenditure cuts should be borne by a reduction in nondevelopmental expenditure. The Executive Directors stressed the importance of further rationalizing the civil service wage bill and of revenue mobilization; they also urged the Burundi authorities to act promptly to privatize industrial and commercial public enterprises and to restructure those enterprises slated to remain in the public portfolio.

The Executive Directors indicated that insufficient progress had been made in reducing the economy's dependence on coffee. They stressed the importance of accelerated implementation of measures to promote agricultural production and export diversification, including further trade liberalization and divestiture of currently inefficient public enterprises in the agroindustrial sector. The Directors also welcomed the authorities' efforts to promote private sector development. In this regard, they stressed the need for further progress in creating a suitable enabling environment for private entrepreneurs.

Executive Directors commended the Government's record in maintaining a satisfactory level of social sector expenditure during the adjustment process but noted that a continued effort was required to improve the quality of education and to shield vulnerable groups against the transitional costs of adjustment by means of a social safety net. The Executive Directors also noted with satisfaction Burundi's commitment to reduce the population growth. With respect to the environment, the Executive Directors commended the Government for preparing a national environmental action plan. Executive Directors also remarked on the linkages between environmental degradation and rapid demographic growth and commented on the need to introduce a vigorous family planning policy to prevent further pressure on relatively scarce agricultural land.

Finally, the Executive Directors raised a number of other points which merited close attention in the short to medium term such as the role of women in development, the need to improve skill levels in the public and private sectors, and the role which regional integration could play in spurring Burundi's development.

Mr Mwananshiku made the following statement:

Since 1986, when Burundi adopted a comprehensive program of financial and structural adjustment supported by the Fund under the SAF, considerable progress has been made in improving the quality of economic management to achieve enhanced efficiency of performance. Notably, external trade and the payments system have been substantially liberalized, while a more realistic exchange rate has been reached through successive currency devaluation. The thrust of fiscal adjustment has been the strengthening of revenue mobilization while restraining expenditure growth. In the area of monetary policy, administrative control of credit by the central bank has been de-emphasized, while resort to the use of liquidity ratios and interest rates as the principal tools of credit management has gained prominence. Consequently, output growth has rebounded somewhat, averaging 3.7 percent annually between 1986 and 1990, and the annual rate of inflation has moderated, averaging 6.3 percent. Attributable largely to the substantial inflow of foreign loans and grants, an overall balance of payments surplus emerged and has facilitated a buildup of reserves. External financing of budget deficits has also influenced the substantial reduction of the banking system claims on the Government.

Despite these achievements, progress on the structural front was limited. Constrained largely by exogenous factors, including the sharp and persistent deterioration of the terms of trade, the outbreak of civil disturbances and adverse weather conditions during the program period, the structure of the economy has remained largely unaltered and characterized by excessive reliance on coffee and external financing, while the role of the public sector continues to loom large, crowding out private sector initiatives. The debt-service ratio has also shown an appreciable rise.

While recent slippages in the implementation of fiscal and monetary policies that contributed substantially to the widening of domestic and external sector imbalances should be a cause for concern, it is significant to note the resolve of the Burundi authorities in overcoming these lapses by taking strong action, since the beginning of 1991, to stabilize the economy, promote growth, and diversify the economy's productive and export base. It is, in fact, in the recognition that additional and stronger measures need to be put in place and implemented in a consistent and comprehensive manner that my authorities are requesting the proposed three-year arrangement under the ESAF. The program is designed to achieve a reduction in the internal and external imbalances, facilitate the contraction in the size of the public sector in the economy, and set the stage for sustained and balanced economic growth.

The key medium-term macroeconomic targets are the attainment of annual average real GDP growth of 4 percent, lowering the rate of inflation to about 4 percent by 1993, and reducing the external current account deficit, excluding grants, from 19 percent of GDP in 1990 to less than 14 percent of GDP in 1994. In order to attain these targets, the authorities will pursue prudent demand-management policies, adopt structural measures to remove rigidities that hinder economic efficiency, and thereby stimulate the supply response of the economy while giving a boost to private sector activity. Specifically, a reduction of the overall fiscal deficit from the equivalent of 12 percent of GDP in 1990 to less than 5 percent in 1994 is anticipated. The growth of domestic liquidity is to be held below that of the nominal GDP to contain inflation. In the structural area, improvement in the investment climate will be facilitated by the further liberalization of the economy. This is expected to encourage private sector investment, which is cardinal to the growth and economic diversification objectives of the Government. Details of the objectives, policy measures, and targets under the program are specified in the Memorandum on Economic and Financial Policies of Burundi, on pages 42-53 of EBS/91/167.

Consistent with the medium-term framework, the 1991/92 program seeks to achieve real output growth of 3.3 percent in 1991 and 3.6 percent in 1992, contain the rate of inflation at no more than 9 percent in 1991 and 8 percent in 1992, and reduce the external current account deficit, excluding official transfers, from the equivalent of 19 percent of GDP in 1990 to 17 percent in 1991 and 16 percent in 1992. The level of external reserves is targeted to rise to the equivalent of 4 months of imports in 1991 and about 5 months in 1992, based on the expected inflow of foreign grants and concessional loans, including disbursements under the proposed ESAF arrangement.

My Burundi authorities are cognizant of the fact that the achievement of these objectives will require disciplined economic management that will involve tight demand-management measures and an accelerated pace of structural reform. Indeed, as indicated earlier, prior action has been taken in the fiscal, monetary, and exchange rate areas. In addition, the Government has taken necessary legal and institutional steps to facilitate the reform of the public enterprise sector, including the preparation of a detailed timetable for its privatization program. Since October 1991, further action has been taken to free the economy from administrative control of prices, including that of fertilizer, and to reduce the state monopoly in the coffee industry.

Measures to achieve the fiscal targets for 1991 were specified in the revised consolidated budget approved by the Council of Ministers on August 19, 1991. The overall fiscal deficit, on a commitment basis and excluding grants, is expected to fall from the equivalent of 12.2 percent of GDP in 1990 to 9 percent in 1991 and 7.5 percent in 1992. In order to achieve these targets, measures have been designed to enhance the elasticity and efficiency of the tax system. This will be accompanied by expenditure reduction and restructuring that accord priority to economic infrastructure and social services to attenuate the costs of adjustment on the vulnerable groups. More specifically, measures have been instituted to contain the public sector wage bill, reduce subsidies to public enterprises, and limit public investments to ongoing projects that are economically viable or of high social priority.

On the monetary policy front, broad money is programmed to increase by 11.5 and 11 percent in 1991 and 1992, respectively. A restrictive monetary policy stance will therefore be maintained in which credit to the public sector is projected to decline by 16 percent in order to accommodate a 32 percent credit expansion to the private sector. The central bank has also taken steps to promote money market development in preparation for increased use of market-oriented instruments of credit control. In this regard, a unified rediscount rate was attained in May 1991, with the abolition of the preferential rediscount rate. Steps have also been taken to free interest rates and ensure that the level remains positive in real terms in order to enhance the allocation efficiency of the market. The treasury certificates auction mechanism has also been reviewed with the aim of expanding public participation and developing a secondary market for the security. To this end, the unit value has been reduced from F Bu 500,000 to F Bu 100,000, while the frequency of auction has been increased to twice a month.

In the external sector, adjustment of the exchange rate is to be accompanied by further liberalization of the external trade and payments system as a strategy for encouraging the growth of the nontraditional export sector and enhancing Burundi's competitive position in the region.

Notwithstanding the commitment of the authorities to a strong adjustment effort, the external sector of the economy is likely to remain weak for sometime and continue to be vulnerable to external shocks, especially in the coffee sector. The external terms of trade, which deteriorated by almost 50 percent during 1986 to 1990, are projected to improve by only 4 percent annually through 1995. In the event that the anticipated recovery of coffee export prices is not realized or turns out to be weaker than expected, the external financing gap would exceed the projected level. In the worst-case scenario of a simultaneous stagnation of both coffee export prices and volumes, substantial additional external financing assistance would be needed to support Burundi's strengthened adjustment effort. It is in this regard that the Burundi authorities enjoin the Fund and the World Bank to continue to provide necessary financial and technical assistance during the program period and thus catalyze additional concessional support from the international community. For their part, my authorities remain strongly committed to their adjustment effort and have indicated preparedness to further strengthen the adjustment measures as and when necessary. Appropriate machinery has, in fact, been put in place to undertake effective monitoring of the program implementation.

I conclude by conveying the deep appreciation of my authorities to the staff and management of the Fund for their cooperation and valuable assistance in preparing this program.

Mr. Moss made the following statement:

Let me say at the outset that this chair is particularly pleased to note the Burundi authorities' resolve to continue the structural adjustment of its economy and address the widening internal and external imbalances that had emerged earlier on. It is heartening to see that barely nine months after the previous Board discussion on Burundi, the country has responded vigorously to the critical remarks made by Executive Directors in their evaluation of Burundi's three-year SAF-supported program. Policy implementation has improved, as evidenced by the revised consolidated budget for 1991 approved on August 19, the monetary policy reforms undertaken, the devaluation of August 9, the timetable for the privatization of public enterprises, and the several other structural policy measures adopted thus far. All this surely constitutes a credible package of prior actions that provides a solid basis on which the upcoming ESAF-supported program can successfully build.

This chair is convinced that the strength and the comprehensiveness of the program, of which the staff paper as well as Mr. Mwananshiku's helpful statement testify, will succeed in attaining its objectives, contrary to what has happened with the previous SAF program. We therefore fully support the proposed decisions.

Looking at the content of the three-year ESAF arrangement, it is obvious that tight demand management forms the linchpin of the program, and rightly so: the inflation rate will almost be halved in 2 years' time (from 8.3 percent this year to 4.3 percent in 1993 as measured by the implicit GDP deflator), and the authorities have ensured that positive real interest rates will be maintained throughout the program period; and the fiscal deficit will be more than halved over the 1990-1994 period. Especially commendable in this area is the scaling down of nonproductive expenditures, such as subsidies and military outlays. Moreover, wasteful use of scarce resources will be further avoided by the partial withdrawal of the state from productive activities, which will increase the efficiency of the remaining public investment. Finally, the intention to reallocate, within the budget, spending and personnel to such priority sectors as education and health will also contribute to strengthening the productive capacity of the economy in the longer term, as will the focus on infrastructure, whereas in the shorter run such budgetary reorientation is socially very commendable, as it will benefit foremost the poorer rural areas.

Together with an appropriate exchange rate policy, such strict demand management will succeed in bringing down Burundi's large external deficit. One could wonder, however, whether the rate of decrease in this deficit, excluding grants, is sufficiently high, some 5 percentage points of GDP between 1990 and 1994 to a level of some 13 percent in terms of GDP. Such a question gains all the more weight when one considers that, including grants, the external current account deficit is projected to increase from 3.7 percent in 1991 to 4.9 percent of GDP in 1994. Should we conclude from this that the demand-management measures envisaged under the program are not forceful enough ? Or is the staff conservatively underestimating the strength of the intended supply-side measures and, therefore, the buoyancy of such nontraditional exports as agriculture and manufacturing over the medium term?

Some indication of fairly conservative medium-term balance of payments projections by the staff seems to be found in the low level of foreign direct investment inflows over the coming years, notwithstanding, as is noted on page 14 of the staff paper, that "the policies contained in the program are also expected to attract both domestic and foreign private investment." Or are these conservative projections to serve as a motive for further exchange rate action? How else should we interpret the statement on page 27 that the authorities are examining the advantages and disadvantages of various exchange rate regimes, with a view to determining whether a change from the present fixed exchange rate is warranted?

If a regime change is indeed contemplated, as opposed to, for instance, a change in the basket to which the Burundi franc is pegged, I would like to sound a warning against such action. Having in mind the conclusions of two recent IMF working papers, one on exchange rate regime choice and the other on credibility and exchange rate management in developing countries, the credibility of the entire exchange rate policy might be put at risk, and the happy outcome of previous exchange rate adjustments not contributing to a surge in inflation might well be a thing of the past, even under circumstances of relatively tight demand policies.

Coming back to the issue of conservatism in the staff's approach, let me stress that I fully concur with the introduction of a contingency mechanism into the program, in view of the high sensitivity of Burundi's balance of payments situation to world coffee prices. If coffee prices were to increase more rapidly than projected, the contingency mechanism will directly help to mobilize domestic savings and thus make room for additional investment, whereas in other cases the effects of such a positive terms of trade shock for Burundi would only be partially reflected in an increase of savings.

The reference to the contingency mechanism leads me to comment on some of the elements of the first-year ESAF arrangement in particular. I am pleased to note the structural reforms envisaged for the public enterprise sector in general and the close monitoring of a group of public enterprises in particular, a sector which this chair has referred to as a black box and a black hole at the time of the 1990 Article IV consultation. I do agree with the staff, however, that there is no room for complacency in this domain, because reforms in the sector will continue to lag progress in other areas of the economy. In view of the prospect of privatization of state enterprises as well as the expected new investment initiatives by the private sector, commercial bank activity is bound to increase. While I fully endorse the need for closer supervision of banks by the central bank, I wonder whether commercial banks are ready for the new challenge. The last staff report mentioned the establishment of two new deposit money banks, which introduced an element of competition into the financial system. The documents serving for today's discussion do not offer much further details in this respect. Has the staff any additional information here?

Another area of structural policy where reforms have yet to surpass the stage of intentions is that of the liberalization of producer prices other than coffee. If a supply response in terms of higher production of crops such as tea, cotton, palm oil, and sugar cane is sought after, speedy liberalization of their producer prices is warranted. Such a policy would also increase exports, thereby perhaps lessening the need for further exchange rate action, now that the real exchange rate has reached its lowest level since the start of the 1980s. In any event, it would constitute a safer way to expand exports than the one which seems to be contemplated now, which is to promote exports by way of tax incentives.

In conclusion, this chair as well as the Board in general was rather critical at the time of Burundi's last Article IV consultation in its assessment of the economic results of the first country to have terminated a three-year SAF arrangement. I believe we can say today that perhaps the most important accomplishment of the previous SAF arrangement has been that it has laid the basis for a much stronger and sounder ESAF arrangement. The authorities have learned from their past mistakes, as evidenced for instance in the much closer monitoring procedure that has now been set up. At the same time, the new ESAF program is able to build on the progress, albeit limited, under the SAF, as is evidenced in Burundi's external position: notwithstanding a severe terms of trade shock, it has preserved a sound external position. In applying for an ESAF arrangement now, the authorities are demonstrating again that they prefer early action, so as not to run a risk of pressure on the debt front down the road.

Ms. Creane made the following statement:

We share the concerns of others about the current weak economic situation in Burundi as well as their satisfaction that the Burundi authorities have now agreed to take on a three-year comprehensive adjustment program under the ESAF. It is true that the experience of policy implementation under the SAF program does not inspire confidence regarding the success of an ESAF arrangement. However, given the number of prior actions already taken, as well as the degree of specificity in the actions required for the remainder of the first year under the program, in addition to the back-loaded nature of the relatively small financing request under the ESAF, we can support the proposed decision.

We would argue that the cornerstone of the reform effort for Burundi is a fundamental re-orientation of the economy away from one dominated by the public sector to one stimulated by vigorous private sector activity. The appropriate fiscal and monetary policies flow from this adjustment, including a reduction in the excessive dependence on the coffee sector felt in every aspect of economic policy making. We believe that if the ESAF program is carried out as described in the Board documents, the Burundi authorities' efforts should be successful.

Severely reducing the role of the 86 public enterprises is an essential part of the Burundi economic reform program. It was rather disturbing to learn that 17 new enterprises came into being during the SAF years, and that consideration of the creation of additional parastatals is yet included in the PFP. Reduction of the public enterprise sector will be an important factor in meeting the authorities' noble aim of invigorating what the staff refers to as an "embryonic" private sector. Therefore, we welcome the authorities' plan to cut the number of enterprises through liquidation or privatization and to impose a hard budget constraint on remaining enterprises by removing easy credit access--which should allow room for substantial growth of credit to the private sector, albeit starting from a very low base. Given the recognized excessive dependence on the coffee sector, we wonder why the coffee parastatal was not included in the group of public enterprises selected for close monitoring on the basis of their economic or financial importance.

The public enterprises also impose a heavy drain on the fiscal accounts. The staff estimates that direct and indirect subsidies to the public enterprises equal about 60 percent of the fiscal deficit. We note that the staff observes that direct subsidies to those public enterprises that are to be liquidated or privatized in 1991 (the number is not clear) will be eliminated in the current budget. This does not seem to be a remarkable effort. As these enterprises would therefore no longer be part of the public sector, it would have been very disturbing if those subsidies would have in fact continued. We urge the authorities to move rapidly to eliminate direct subsidies to the remaining public enterprises, as well as to complement the introduction of the hard budget constraint on their current expenditures by transferring to them the responsibility for servicing their foreign debt obligations.

The decision to focus the tightening of fiscal policy more generally on cutting back expenditures is on the mark. As a very large chunk of current expenditures is devoted to wages and salaries, the importance given to holding down expenditures on this line item in the program is appropriate. We look forward to the elimination of ghost workers in the second year under the ESAF. However, given the objective just stated, we wonder why any net increase in the number of public sector employees is included in the program. As to projected improvements in tax revenue, we question whether the optimism on "healthy" growth in income and import tax revenues in the current budget is warranted, even given the tax on petroleum products. Growth is not expected to be much different than in 1990, and imports are expected to be significantly constrained under the program, although it is possible that the reduction of exemptions from import duties might be a factor. In any case, it is positive sign that initial returns on the outcome on the fiscal accounts this year look positive, as the new measures already implemented appear to be having an effect.

We are pleased that new official borrowing will only be on concessional terms, and it is much preferred to the alternative of financing budget deficits by recourse to the banking system. Even so, foreign financing should not be a substitute for taking the appropriate financial policy measures. Therefore, it is encouraging that dependence on foreign financing is projected to decline over the program period, even as net credit from the banking system continues to decline.

On monetary policy, it would appear that while the authorities appropriately moved away from direct methods of monetary policy control, they, until now, did not usefully employ those more indirect tools--the liquidity ratio and interest rates--left in their possession. As described in the staff paper, the liquidity ratio was not strictly enforced, and the level of interest rates was little changed. As a means for enforcing the program's tight limits on credit growth, we therefore welcome recent efforts to improve monetary policy implementation by better employing existing tools and introducing new ones. We would note that a higher penalty is not worthwhile unless better enforced than in the past. As to interest rate policy, we note that the authorities plan to regularly review the rediscount rate and hope that that will occur at least on a quarterly basis. Regarding the interest rate structure more generally, we are hopeful that the smaller denominations of treasury certificates will be able to attract more of the private sector, as opposed to the former group of subscribers, with the goal of deepening the market in the effort to make market-based interest rates more meaningful. For the same reasons, we encourage the authorities in the efforts to stimulate the development of the inter-bank market and otherwise promote financial market reforms. These measures should also have an impact on the extremely low level of domestic savings, now hovering around 2 percent of GDP.

The steps to liberalize trade are to be commended, both for their long-term effects, as well as for the result of netting out any inflationary impact of the exchange rate adjustments. In this regard, as the authorities consider new options on exchange rate policy, we hope that they keep in mind the importance of competitiveness to assist in the vital need to diversify their export base. We would certainly agree with the staff that closely following the planned tight financial policies will be the most critical method of maintaining stability of the exchange rate.

In conclusion, we fully agree with the staff conclusion in the discussion of balance of payments prospects that the vulnerable state of the economy makes it essential that the authorities keep on top of scheduled policy implementation and accelerate the introduction of measures wherever possible.

Mr. Dognin made the following statement:

Like previous speakers, this chair welcomes the authorities' intention to embark on a comprehensive adjustment program, the need for which is underscored by the mixed results achieved under the SAF-supported program.

It is worth underlining that the authorities' commitment to address structural impediments to sustainable growth, namely, the State's disengagement from the economy, takes place in a favorable context of the political process of democratization. Nevertheless, it is also clear that the success of the stabilization program through tight financial policies critically depends on the progress made through an overall liberalization of the economy and particularly the streamlining and divestiture of the still predominant public sector. As such a transformation of the economic landscape will require time and fortitude of the authorities, there is clearly no room for complacency, and all the reforms contemplated under the three-year ESAF arrangement should be implemented in a timely manner.

As I broadly endorse the thrust of the fiscal and monetary policies of the program, I will focus my comments on some specific points on macroeconomic structural and external sector issues that deserve the authorities' utmost attention.

First, on the fiscal front, one cannot overemphasize the need for a prudent fiscal policy stance to achieve the overall objectives of sustainable growth while lowering inflation and reducing the external current account deficit. In this regard, the staff rightly focused the fiscal targets on the expenditure side, as the scope for increasing budgetary revenues seems to be limited.

Therefore, the authorities' ability to enhance government savings through a significant reduction in military outlays and in subsidies to public enterprises will be both the test of their commitment to achieve a more market-oriented economy and the prerequisite to dampen pressures on the monetary and external fronts. This underscores the intricate nature of both macroeconomic and structural measures and outlines the need for a close monitoring of the program targets by the Bretton Woods institutions.

As far as monetary and credit policies are concerned, like previous speakers I welcome the quantitative benchmarks set forth in the program on all sources of financing to the public enterprise sector. The elimination of the preferential rediscount rate for coffee is also a welcome step to shift the interest rate policy to a more market-oriented policy.

As to structural reforms, the authorities should devote all their attention to reducing the State's involvement in the economy. Establishing a more market-oriented economy, especially in the agricultural sector, while restructuring the public sector, are critical to achieving sustainable growth over the medium term. In this regard, the removal of price controls and the liberalization of marketing in the agricultural sector are steps in the right direction. Reforms of the regulatory framework, namely, the proposed revision of labor laws and practices, are certainly decisive to create an environment more conducive to private investment.

As for the external sector, the balance of payments is expected to improve significantly with the current account deficit (excluding official transfers) falling from 19 percent of GDP in 1990 to less than 14 percent by 1994. Nevertheless, as outlined by the staff, Burundi's external position will remain very fragile and dependent on coffee production and exports. This is, indeed, a cause for concern, since the fall in world coffee prices is responsible for the current difficult financial situation of Burundi. The staff's helpful balance of payments projections provide a clear insight into the sensitivity to the underlying assumptions concerning coffee.

Given the vulnerability of the external position, I can endorse the authorities' policy to increase foreign exchange reserves to cushion any unfavorable developments in coffee prices or in the follow-up of foreign assistance.

Nevertheless, this chair is not convinced by the efficiency of a more active exchange rate policy for two main reasons. First, devaluation of the Burundi franc will have only a limited effect on coffee exports, given the situation of the world market. Second, the population density (180 inhabitants per square kilometer) is placing so much pressure on available land that diversification of the productive base in the agricultural sector is not likely to occur, at least in the medium term. Furthermore, it is clear in the case of Burundi that the impediments to diversification and private sector investments are mainly related to the structural issues, such as liberalization of trade and prices, disengagement of the State, and streamlining of the regulatory framework.

Therefore, after a correction of the exchange rate, if needed, the exchange rate policy could play an important role in backing the effort needed in fiscal and monetary areas. A policy aimed at a more stable exchange rate would be preferable, so as to provide an anchor for inflationary expectations, such as a framework for financial and monetary discipline.

With these considerations in mind, we are prepared to support the proposed decision.

Mr. Sparkes said that radical adjustments were required to bring about the recovery of Burundi's economy, and, if strictly implemented, the ESAF program would mark a clear break from Burundi's past record of underachievement. The program appropriately focused on consolidating and encouraging the private sector, and in both areas the program targets should be regarded as the minimum necessary. As experience under the previous SAF arrangement had shown, partial implementation achieved little.

The main question was whether the new program could succeed where its predecessor had failed, Mr. Sparkes continued. Much would depend on the authorities' degree of commitment. Nonetheless, he would welcome the staff's assurance that administrative capacity had been strengthened. He wondered what further technical assistance was required.

Despite some misgivings, Mr. Sparkes said, he could support the proposed arrangement, in view of the substantial prior actions, the modest level of access, and the cautious phasing of purchases under the first-year arrangement, as well as Burundi's excellent record of meeting its external obligations and the close involvement of the World Bank.

Mr. Esdar said that, given the internal and external imbalances in the economy, the proposed program, if strictly implemented, would constitute a step in the right direction, and he agreed with the thrust of the staff analysis and policy recommendations. The reorientation of policies seemed to be highly required, as the experience under the preceding SAF arrangement had turned out to be far from satisfying. Apart from substantial policy slippages in monetary and fiscal policy, there was in particular a lack of any comprehensive plan to start the reform of the public enterprises.

It was therefore greatly welcome that the present program addressed the slippages and emphasized the crucial importance of a far-reaching state enterprise reform, Mr. Esdar continued. The first steps in the direction of privatization and rationalization of public enterprises had already been taken. Those steps included the adoption of an adequate legal framework as well as agreement on a detailed timetable. However, it was his impression that concrete reform measures in each case were, to a large extent, still in a stage of planning and preparation. Therefore, the authorities should not delay the necessary reform measures to proceed with the public enterprise reform as fast as possible.

The reform of the public enterprises was essential to reduce the burden on the fiscal budget, Mr. Esdar commented. An improvement in the fiscal position was especially important given the urgent need to raise Burundi's extremely low saving ratios. In that connection, he wished to underscore the need for restraint in public spending and for a broadening of the revenue base, which was still highly dependent on the coffee sector. The improvement in the revenue performance in 1991 was welcome, but the footnote of Table 3 showed that additional measures were needed to attain the program's fiscal targets. Therefore, the authorities should proceed in that respect as soon as possible.

According to the staff projections, it appeared that the substantial current account deficit could be financed, Mr. Esdar remarked. However, that outcome would depend to a large extent on the availability of a rather high level of foreign concessional financing. The envisaged amounts were much higher that the average amount received from 1987 to 1990 and were expected to decrease only marginally over the program period. In addition, and in contrast to Mr. Moss, he felt that the trade projections appeared to be on the optimistic side. In particular, the growth in import volume was smaller than GDP growth, although the program provided for a far-reaching import liberalization scheme. In addition, the still high degree of dependence on coffee as the major export product contributed to the fragility of Burundi's export situation, as highlighted by the staff's alternative scenarios.

In that context, he wondered whether it was appropriate to shield coffee producers from declines in the world market price, Mr. Esdar said. That approach could not only prove to be a major drain on government resources, but also could lead to resource misallocation and prove to become an obstacle to the urgently needed diversification of exports.

He welcomed the authorities' intention to liberalize imports by adopting an open general licensing system, Mr. Esdar stated. However, the staff should provide additional detailed information on the concrete implementation and working of that system--for example, the clearing instruments that were envisaged if the import demand exceeded the available level and international reserves, and the role that was played by exchange rate adjustments. The staff paper referred only to some ongoing examinations of the advantages and disadvantages of different exchange rate regimes.

Despite the disappointing performance under the SAF arrangement, he could support the proposed decisions, Mr. Esdar commented. However, in doing so he urged the authorities to adhere strictly to the program targets and to be prepared to implement additional corrective measures in the event of deterioration in the economic situation.

The staff representative from the African Department remarked that the staff had been cautious in its projections of revenue, and exports and imports. The growth of imports in 1990 had been substantial. For all practical purposes, imports had been liberalized, as the limits on the amount of foreign exchange that commercial banks could provide upon demand had been raised substantially, to about $250,000, and the central bank had been providing foreign exchange liberaly for legitimate purposes. Therefore, the staff did not foresee much of an increase in imports in the coming year; the projected increase was in line with the expected rate of increase in real GDP.

As to exports, the staff had been particularly careful in projecting the price of coffee on the world market and the volume of production, the staff representative continued. In the past, the staff had sometimes overestimated coffee price projections. As a result, the current account excluding grants had been improving much faster than the current account including grants, as the staff had expected that grants would continue to decline and that Burundi's dependence on foreign sources of financing, notably grants, would also decline as the economic situation improved.

The staff hoped that, given the recent 15 percent devaluation, and with strict monetary and fiscal policies in place, there would be no need for further exchange rate adjustments down the road, the staff representative commented. The authorities had requested technical assistance from the Fund, and the staff had recommended moving from the peg to the SDR to a peg based on a basket of currencies and allowing commercial banks to buy and sell in foreign exchange at the rates fixed by the commercial banks themselves in dealing with their clients as well as among themselves as long as these rates were within the buying and selling rate limits announced by the central bank. That was the first step toward the introduction of a completely free interbank market. Nevertheless, the staff did not expect that the exchange rate would continue to depreciate if restrictive fiscal and monetary policy was implemented as envisaged under the program.

As to whether or not the commercial banks were ready for the challenge ahead, some of the banks had been established only recently, the staff representative noted. At present, a Central Banking Department technical assistance mission was helping the authorities both in implementing the recommendations regarding the exchange rate regime and in improving the monetary instruments in place.

One of the authorities' longer-run objectives was to fully privatize the coffee sector and permit prices in the world market to be reflected in producer prices, the staff representative said. In 1991, the marketing of nearly 30 percent of coffee exports was to be carried out by the private sector, and that percentage should increase gradually over coming years. The intermediate steps between the production and exportation had been almost completely liberalized. Regarding the producer price, the Government had announced that the official price would become a floor price rather than a fixed price. There were two coffee parastatals: one was in charge of exporting, although it would handle only a portion of total exports in 1991, with the rest being carried out by the private sector; the second parastatal had been completely privatized.

The reform of public enterprises was admittedly the weakest link in the adjustment effort, the staff representative said. The staff had been concerned about the performance of public enterprises and about how the authorities were going to proceed with the privatization scheme and other aspects of restructuring. The staff felt that having limits on the access of public enterprises to financial resources from various sources would be the best guarantee that the enterprises would live within the means available to them. A World Bank mission was currently in Burundi to agree with the authorities on the implementation of the reforms of the public enterprises.

The net increase in the number of government employees was small--about 650 persons a year in 1991 and 1992, the staff representative from the African Department commented. The increase was concentrated in the social services sector, especially education and health. There were to be no increases in other sectors.

Mr. Nakagawa said that he shared the concerns expressed by previous speakers. The proposed decision on the ESAF arrangement was acceptable, as the program seemed to be comprehensive, strong, and concrete enough. In addition, the new arrangement was based on a very cautious approach to the phasing of the first-year disbursement.

Like Mr. Sparkes, he urged the authorities to commit themselves strongly to implementing of the ESAF program, Mr. Nakagawa commented. The authorities should pay particular attention to the fiscal field and the reform of the public enterprises. As little had been achieved in public enterprise restructuring under the previous arrangement, the authorities should keep their commitments in that field. In the fiscal field, there was a need to further strengthen revenue measures based on a wider tax base, perhaps under the second-year program.

Mr. Gronn made the following statement:

Burundi's recent economic experience has been mixed. Although Burundi definitely has had its share of adverse external developments--with deterioration of the terms of trade, civil disturbances, and adverse weather conditions--the staff points out that the authorities have failed to fully implement and monitor the SAF program. Little progress was made in diversifying the economy, external and domestic imbalances widened, and dependence on foreign concessional financing increased, leading to a large debt and debt service buildup.

Consequently, the results of the SAF program were not at all satisfactory. While I acknowledge that there may be benefits to be derived from a SAF program in terms of preparing the ground for a more aggressive adjustment process, it is quite evident that Burundi needed to embark on a more ambitious adjustment program, with stronger discipline in implementation. Therefore, I welcome the authorities' intention to implement the ESAF arrangement with stronger conditionality and closer monitoring, as a clear step in the right direction.

On fiscal policy, the substantial reduction of the deficit through expenditure restraint as well as the reorientation of expenditures towards more productive use are most welcome. Nevertheless, the tax base will need to be broadened.

In the monetary field, the establishment of positive real interest rates and efforts to establish a money market are steps in the right direction. However, I wonder how deep the financial market is, and whether it is sufficiently developed for regular auctions of government paper. I would also emphasize the importance of a rapid strengthening of the functions of the supervisory authorities.

Privatization and restructuring of public enterprises are long overdue. Their burden on the public finances has been growing, a trend that has to be sharply reversed.

I note that there are still few signs of an expansion of the private sector. Specific changes in the legal and regulatory framework, together with simplification of administrative procedures. should encourage private sector investments. Could the staff or the World Bank representative comment on the prospects of an early private sector response to these measures?

To conclude, it is important that Burundi does not repeat previous policy slippages. Strict adherence to the program is essential, and the authorities should stand ready to undertake further measures if deviations from the program emerge. In view of the prior actions taken, the relatively low access and back-loading of disbursement, the good record on external payments to date, and the fact that financing gaps are not expected to occur, I can endorse the proposed decisions.

Mr. Fuleihan said that he welcomed the authorities' adoption of a full and comprehensive program and urged them to adhere strictly to it. He supported the proposed decisions.

Mr. Toé stated that he supported the authorities' adjustment program and the proposed decisions.

Mr. Mirakhor said that he wished to associate himself with the comments of Mr. Moss and Ms. Creane.

The staff representative from the African Department considered that the fiscal program envisaged by the authorities was a strong one. The current budget had recorded a negligible surplus in 1990 but was expected to show a larger surplus in 1991 of 3 percentage points of GDP--and perhaps reaching 5 percentage points by 1994. The pace of improvement in the fiscal situation as indicated in the tables in the staff paper was based on the measures currently in place. In order to fully attain the objectives of the program further fiscal measures would be necessary to achieve the objectives indicated in the PFP. The staff had tried to be careful not to say that the present structure of revenue and expenditure would enable the authorities to achieve those objectives.

Almost all the revenue measures recommended by the staff had been implemented, the staff representative from the African Department noted. The staff felt that, at the present stage, more emphasis should be placed on containing the growth in expenditure than on introducing additional tax measures, as the private sector had been complaining about the heavy fiscal burden on them. Therefore, with a view to encouraging the private sector, additional tax measures should be avoided. The surplus on government operations would be the major contribution to the increase in domestic savings; at present that share was about 2-3 percent of GDP, and it should be of the order of 8 percent of GDP by the end of the ESAF program.

Mr. Mwananshiku said that the authorities were aware of the weaknesses in past performance, and they were committed to a better performance under the new program. The inclusion of a number of prior actions was an indication of their determination. He would convey to his authorities the emphasis that Directors had placed on the need for reform of the sizable parastatal sector, which the staff had identified as a major area of weakness.

The Executive Board approved the following decisions:

Exchange System

Burundi maintains restrictions on payments and transfers for current international transactions as last described in SM/90/240 and SM/91/7, in accordance with Article XIV, Section 2, with the exception of the limitation on remittances of foreign workers' salaries, which is subject to Fund approval under Article VIII, Section 2(a). The Fund approves the retention of this restriction until end-June 1992, or the completion of the next Article IV consultation with Burundi, whichever is earlier.

Decision No. 9860-(91/154), adopted
November 13, 1991

Enhanced Structural Adjustment Arrangement

1. The Government of Burundi has requested a three-year structural adjustment arrangement under the enhanced structural adjustment facility, and the first annual arrangement thereunder.

2. The Fund notes the updated policy framework paper for Burundi set forth in EBD/91/276.

3. The Fund approves the arrangements set forth in EBS/91/167, Supplement 1.

Decision No. 9861-(91/154), adopted
November 13, 1991

APPROVED: May 18, 1992

LEO VAN HOUTVEN
Secretary