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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 90/105

10:00 a.m., July 2, 1990

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

Executive Directors	Alternate Executive Directors
G. K. Arora	S. Gurumurthi, Temporary
F. Cassell	C. Enoch
	G. C. Noonan
Dai Q.	
T. C. Dawson	C. S. Warner
J. de Groote	J. Prader
	J.-P. Schoder, Temporary
	L. B. Monyake
	M. J. Shaffrey, Temporary
E. V. Feldman	R. J. Lombardo
	R. Marino, Temporary
	J. Basiuk, Temporary
M. Finaish	O. A. Himani, Temporary
M. Fogelholm	I. H. Thorláksson
M. R. Ghasimi	O. Kabbaj
	B. Goos
J. E. Ismael	T. Sirivedhin
A. Kafka	L. M. Piantini
	J.-F. Cirelli
	G. Serre, Temporary
Mawakani Samba	
	Z. Iqbal, Temporary
	J.-C. Westerweel, Temporary
	S. Yoshikuni

J. W. Lang, Jr., Acting Secretary
B. Burton, Assistant
D. J. de Vos, Assistant

Also Present

IBRD: F. D. Levy, Economic Advisory Staff. African Department: G. E. Gondwe, Deputy Director; P. Dhonte, I. C. Lienert, P. H. Mathieu, O. J. Nnanna. Asian Department: B. Abdullah, J. E. Ceglowski, D. J. Goldsbrough, U. R. Gunjal, L. M. Koenig, J. Lin, B. Nijathaworn, J. Somogyi, J. E. Zeas. Exchange and Trade Relations Department: L. A. Whittome, Counsellor and Director; J. T. Boorman, Deputy Director; G. Begashaw, E. Brau, B. Christiansen, M. E. Edo, J. H. Feldman, G. R. Kincaid, A. Lopez-Claros, C. Puckahtikom, J. P. Pujol. External Relations Department: V. R. Khanna. Fiscal Affairs Department: W. R. Mahler. IMF Institute: O. B. Makalou. Legal Department: W. E. Holder, Deputy General Counsel; H. Elizalde, P. L. Francotte, A. O. Liuksila. Middle Eastern Department: E. B. Maciejewski. Research Department: J. A. Frenkel, Economic Counsellor and Director. Secretary's Department: C. Brachet, Deputy Secretary; G. Djeddaoui, B. J. Owen, A. Tahari. Treasurer's Department: K. Boese, D. Gupta, C. A. Hatch, K. M. Kenney. Western Hemisphere Department: S. T. Beza, Counsellor and Director; L. Duran-Downing, M. E. Hardy, P. Neuhaus. Office of the Managing Director: A. K. Sengupta, Special Advisor; E. A. Milne. Advisors to Executive Directors: M. A. Ahmed, M. B. Chatah, J. M. Jones, M. J. Mojarrad, A. Napky, B. S. Newman, J.-C. Obame, D. Powell, S. P. Shrestha, S. Rouai. Assistants to Executive Directors: T. S. Allouba, G. Bindley-Taylor, C. Björklund, B. A. Christiansen, S. B. Creane, E. C. Demaestri, T. T. Do, S. K. Fayyad, B. R. Fuleihan, M. A. Ghavam, J. Gold, M. Hepp, J. Heywood, K. Ichikawa, C. J. Jarvis, M. E. F. Jones, P. Kapetanovic, M. Mrakovcic, Y. Patel, D. Saha H.-J. Scheid, D. Sparkes, C. M. Towe.

1. MALAYSIA - 1990 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1990 Article IV consultation with Malaysia (SM/90/110, 6/7/90). They also had before them a background paper on recent economic developments in Malaysia (SM/90/117, 6/18/90).

Mr. Ismael made the following statement:

My authorities are in broad agreement with the thrust of the staff report. In my statement, I would like to highlight recent developments and the outlook for the Malaysian economy, and to comment on the prospective stance of policies.

After a severe recession in 1985/86, Malaysia rebounded through the rest of the 1980s with remarkable success in its economic performance. Another year of robust growth was again recorded in 1989, with an increase in overall real GDP of 8.5 percent, almost matching the 8.7 percent growth in 1988. What was even more remarkable was that this was achieved in an environment of stability. Inflation was generally low and no undue strain was detected on the balance of payments. Sustained fiscal consolidation and a robust economy had, as expected, produced a very satisfactory outturn in the Federal Government's financial position. A strong rise in revenue made it possible for the Government to realize a surplus in its current account two years in a row, that is, since 1988.

An important feature of the economic outturn in 1989 was the broad-based nature of the economic expansion. On the supply side, all sectors recorded buoyant growth, from agriculture to mining, manufacturing, construction, and services. Growth in manufacturing production moderated to 12 percent from the peak level of nearly 18 percent in 1988. Nevertheless, it was still the fastest growing sector, accounting for a share of over 25 percent of real GDP. By comparison, the share of the agricultural sector was reduced to below 21 percent.

The strength of external demand for Malaysian manufactured exports was especially pronounced last year with a record 36.5 percent growth (in ringgit terms) to account for 54 percent of total export proceeds, or a significant M$36.6 billion. Two other components of demand also deserve special mention. The first was the growth in private consumption and the second, private investment. Private sector demand staged a vigorous recovery beginning in 1988. Rising disposable incomes helped to push private consumption upward by nearly 16 percent in 1989 and for this and other reasons, private investment recorded a spectacular 36 percent growth in real terms. The strong growth in private

investment which was realized for the second successive year is indeed the boost needed to carry the economy over the medium term, when very little stimulus, if at all, is projected to come from the public sector.

Against this background, the balance of payments outturn in 1989 shifted in strength from the current to the capital account, owing mainly to the increasing importance of private investment. The surge in foreign investment was translated into a record level of M$5 billion in net inflows of private long-term capital last year. After netting out an outflow of official capital of M$2.7 billion to meet the repayments and prepayments of the public sector's external debt, the surplus realized in the long-term capital account was M$2.3 billion in 1989. This surplus represented a sharp turnaround in the capital account from a deficit of M$3.4 billion in 1988. After taking into consideration a small deficit of about M$400 million in the current account, the net result was an increase in central bank reserves of M$3.3 billion, enabling accumulated reserves to reach M$21.7 billion at the end of 1989, equivalent to about 4.6 months of imports.

The positive developments in the Malaysian economy are expected to continue to prevail in 1990. The forecast is for growth in real GDP in Malaysia to reach 8.3 percent this year. There is a possibility, based on the first quarter performance, that the actual outturn could well exceed the forecast. A large part of it would be supported by sustained domestic spending. Private investment should continue with a double-digit growth of around 16 percent given the large number of new projects that were approved in 1988 and 1989, and the schedule of implementation that is expected in the course of the coming year or two.

My authorities' assessment is that the economy is heading forward, steady and on course. Their evaluation is already borne out by an expected first quarter GDP growth of slightly over 10 percent. During the quarter, overall agricultural production rose by 9 percent, owing to sustained growth in palm oil and saw log output while mining output was also up by 3.6 percent. In response to the continuing favorable domestic economic conditions and strong external demand, the manufacturing sector is expected to achieve a higher rate of output growth in 1990. For the first three months of 1990, manufactured output remained buoyant expanding at an annual rate of 16.3 percent. The electrical and electronic products industry and the transport equipment industry continued to lead growth with marked annual increases of 37.7 percent and 49.7 percent, respectively. For the whole of 1990, manufacturing output is projected to expand by 13 percent. Over the medium term, output growth is expected to be sustained at 13-14 percent based on the recent sharp increase in investment in

Malaysia including proposed investments in petrochemical and gas, steel, and electrical and electronic projects. The only downside risk facing the economy is the poor performance of commodity prices. Except for timber, prices of the other major commodities remain uncertain.

Sentiment on the stock market remained bullish, indicating continued investor confidence in the economy. Private sector investment, which had reached a record level in 1989, gathered further momentum in the first four months of 1990. Both domestic and foreign investment continued to be buoyant as reflected in the Malaysian Industrial Development Authority statistics. The value of manufacturing investment proposals approved by the Authority amounted to M$17.1 billion in the first four months of 1990, which is already higher than the amount approved for the whole of 1989 (M$12.2 billion). As there are no signs of abatement in investor interest, expectations are for private investment to attain new heights in 1990.

On the balance of payments, the staff projections are broadly in line with official medium-term projections. The only significant difference is the projection of the current account balance for 1990. Latest data show that growth in imports stabilized at a high level of 35 percent as of February 1990. As expected, higher imports consisted mainly of purchases of investment and intermediate goods. However, the increase in exports of manufactured goods also remained significant at 42 percent as of February. Despite reduced earnings from commodities, overall export growth was 23 percent. Since official forecasts are conservative for both imports and exports, my authorities believe that the merchandise surplus projection for the year as a whole, of M$9.6 billion, is still achievable. Taking into account the higher net payments for services, the current account of the balance of payments will show a deficit in 1990. However, my authorities are of the view that the deficit would be equivalent to 1.8 percent of GNP, compared with the staff forecast of 2.8 percent.

The strength in the balance of payments in the medium term will be determined, in large measure, by developments in the capital account. Indications are that inflows of direct foreign investment are expected to remain substantial as economic fundamentals remain upbeat and infrastructural and support services are being upgraded. After netting out the outflows of official capital for repayments and prepayments of the external debt of the public sector, the long-term capital account is expected to continue to record a strong surplus in 1990. The overall balance of payments would, therefore, still be in significant surplus, which will be reflected in some buildup of reserves.

In the area of public sector finances, my authorities intend to continue to pursue their policy of fiscal consolidation over the medium term aimed at containing the role of the Government. In particular, they will actively implement the program to privatize the major public enterprises, including the National Electricity Board. For 1990, the Government is expected to achieve another sizable surplus in its current budget, largely through better revenue collection with improved tax administration and further expansion of the base of indirect taxes, as well as continued prudence in operating expenditure. For the second successive year, significantly higher allocations were again provided for development programs in the 1990 Budget, especially for the eradication of poverty and for the much needed expansion of investment in physical and social infrastructure so as to alleviate bottlenecks and provide support for private sector activities. Consequently, the overall deficit of the Federal Government is expected to widen to about 6 percent of GNP from 4.8 percent in 1989.

Reflecting the ample liquidity in the system, the financing of the larger public sector overall deficit is not expected to pre-empt resources needed to support private sector growth, nor will there be increased recourse to external borrowing. As in the past, the Employees Provident Fund (EPF) will continue to provide noninflationary financing for the Government.

The thrust of monetary policy in 1990 will continue to focus on concerns of low domestic interest rates and the threat of inflationary pressure, while ensuring sufficient bank liquidity to sustain domestic economic expansion. On an annual basis, growth in M3 was 18.6 percent at the end of March. The growth in the money supply was backed to a large extent by sustained demand for credit by the private sector. On the liquidity front, the first quarter saw tighter liquidity conditions. Money market interest rates moved on an upward trend. In mid-April, the Central Bank actively intervened in the money market when its borrowings increased to a total of M$4.1 billion at end-April. This intervention effectively moved the daily weighted average interbank rates--overnight to 3-month--from a range of 3.9-5.5 percent prevailing on April 13, to 6.7-7.4 percent by April 19. The Central Bank's contractionary operations have been successful in mopping up liquidity and raising the level of interest rates in the interbank market and for fixed deposits.

The Malaysian capital market is undergoing dynamic changes at this point in time. The authorities will actively continue to introduce new measures to add greater depth and breadth to the financial and capital markets. Among the measures are the proposed establishment of an independent credit rating agency and a

study--with technical assistance from the Fund--on the feasibility of launching a financial futures market to augment the growing market in commodity futures. A third area is a review of the future role of the EPF in the context of further capital market developments and the downsizing of the role of Government in the economy.

In the area of external debt, the public sector will continue the strategy of prepaying and refinancing its more expensive loans in 1990, albeit on a much reduced scale compared with the preceding two years. The authorities' debt initiatives have led to a significant reduction in debt, which is expected to fall below 40 percent of GNP by the end of 1990 from a peak of 75 percent in 1986. The debt-service ratio is also expected to moderate to below 9 percent of exports of goods and services from 18.9 percent during the same period.

In concluding, I would like, on behalf of my Malaysian authorities, to express our appreciation to the staff for their excellent work done for the 1990 Article IV consultation with Malaysia.

Mr. Schoder made the following statement:

It is all too rare that this Board has the chance to analyze economic performances of the type Malaysia has displayed for several years. Indeed, Malaysia's economic performance is truly impressive, and reminds us that a successful debt strategy not only can be found in the economic literature but also implemented in reality. Against this remarkable background of sound adjustment policies, any critical remarks we may make on Malaysia's policies are of secondary importance. Malaysian economic policymakers now have two tasks. First, they should continue the economic adjustment that they conducted so well during the 1980s, including leading Malaysia out of external indebtedness, which still requires a substantial transfer of resources abroad. Second, Malaysia should now enter a different phase of its development in which the challenge to economic policymakers consists of stabilizing the economy along a sustainable growth pattern. By following this course, the Malaysian economy could avoid the pitfalls of constraining bottlenecks and disruptive inflation, and the contractionary policy measures that are their inevitable consequences.

Malaysia's striking economic growth performance can, of course, be documented by a whole list of statistics. For instance, Mr. Ismael's introductory statement is filled with references to the quite staggering growth rates for various

relevant variables. Mr. Ismael does not, however, refer to one variable I found very impressive, namely, Malaysia's GNP per capita figures. As Malaysia's economy grows, so does its young population. In 1975, the population growth rate reached an impressive 2.6 percent, and leveling off only slowly, it was most recently estimated at 2.4 percent. Such dynamic population expansions are too often associated with falling per capita incomes. That is definitely not the case for Malaysia, where per capita income did not fall, but instead jumped from US$820 in 1975 to US$2,074 at the most recent estimate. I even wonder whether this already staggering result is not substantially underestimated. Indeed, the quoted figures were in U.S. dollars, which appreciated vis-à-vis the ringgit during the period I referred to, and at the same time Malaysia experienced an overall low rate of inflation. This outcome leads me to the conclusion that Malaysia's income per capita figures in local purchasing power must have more than tripled over the period concerned. Could the staff or Mr. Ismael elaborate on such a conclusion?

During the past couple of years, domestic consumption and investment have increasingly fueled Malaysia's growth performance, previously largely the result of external demand. Such a welcome broadening of demand is not surprising since it is primarily the product of the ongoing diversification of Malaysia's supply factors. It would indeed be quite wrong to attribute Malaysia's achievements entirely to the mushrooming manufacturing sector because the dynamism witnessed in other sectors--for instance, the primary sector--is most encouraging. For example, Malaysia has become one of the major cacao exporters. Diversification can only be encouraged because it is most instrumental in rendering the economy less vulnerable to external shocks, as is clearly demonstrated by the medium-term alternative scenarios presented in Annex I of the staff report.

The transformation of Malaysia's economy has gone hand in hand with its massive integration into the world economy. During the second half of the 1980s, exports and imports as a proportion of GNP have continued to rise, reaching their current levels of 70 percent and 60 percent, respectively. Those figures are very high and they represent Malaysia's "transformation economy" whose productive structures are dependent on inputs and outputs from abroad. However, these are aggregate figures and again I wonder whether they do not substantially underestimate Malaysia's dependence on the world and in particular on the regional Asian economy. The manufacturing sector, for which foreign direct investment was crucial--and still is--could be a case in point. Could the staff elaborate on the manufacturing sector's degree of dependence on foreign markets in terms of inputs and outputs? In other words, is the high integration of Malaysia's manufacturing sector

into the world economy synonymous with a lack of integration into the national economy? If so, are there signs that this geographic integration can be coupled with a vertical integration into the domestic manufacturing sector and what is the authorities' industrial policy in that regard?

With regard to their policy of promoting foreign direct investment, the Malaysian authorities assess the massive flow of direct investment from abroad as a response to the good general economic conditions in Malaysia; they are therefore of the view that the specific incentives structure has played only a marginal role. That assessment raises two questions. First, if specific incentives play only a minor role, what justifies their continuation? This question appears particularly relevant in the present circumstances where Malaysia seems to be experiencing some "digestion" problems caused by the abundant flow of foreign direct investment, which--far from ebbing--is even accelerating, as Mr. Ismael tells us. Now, an incentive structure is justified when foreign direct investment is lacking, but not when it is overabundant. In that case, the maintenance of an incentives structure is a waste of resources. The second question concerns the authorities' management of incentives. In the cases where incentives are no longer justified, they are to be removed at the discretion of the authorities. I wonder to what extent it is in fact possible to remove incentives by means of policy decisions, and whether it would not be advisable to manage the incentives system more on a statutory basis, deciding at the outset that a given incentive would lapse automatically after a specified time. Such a system could, in my view, better ensure that the authorities' intention to remove incentives becomes more than a mere intention. What is actually the authorities' record in this matter and how do they assess the need to continue the established incentives in the present context?

The continued economic expansion Malaysia experienced during the past decade can be largely attributed to its liberal policies toward trade and investment flows. These policies have definitely been successful during the past several years and Mr. Ismael's statement reminds us that the expansionary momentum is still building. In that regard, the challenge to the Malaysian policymakers now is in stabilizing the economy along a sustainable growth pattern and thus avoiding the disruptive effects of intensifying bottlenecks and inflationary slippages. The question then arises as to what is the appropriate course of economic policy--and in particular fiscal and monetary policy--at the present juncture.

In 1989, fiscal policy took a more expansionary course and the same holds true for the 1990 federal budget which targets an

increase in the deficit in terms of GDP. The authorities justify their course of action by noting that the projected size of the deficit is compatible with their goals of fiscal consolidation. Although this may be the case in the context of the present quite extraordinary growth rate, much depends on whether one can forecast such growth rates over the medium term.

One must also determine whether it might be more advisable to take advantage of the present high growth period in order to achieve fiscal consolidation earlier, thus avoiding a procyclical fiscal stance. However, the Malaysian authorities are in a dilemma here because one can argue that the continuation of the economic boom period requires an increase in government expenditures to accommodate a thriving private sector by addressing emerging bottlenecks. Moreover, in structuring public expenditures, priority must be accorded to public investment expenditures--in infrastructure and education, for example--that strengthen the economy's potential for growth, unlike expenditures purely for public consumption. The authorities have indeed emphasized public investment expenditures that will support private sector growth, although more could have been done; however, the reining in of public consumption does not receive the highest priority in a time of extraordinarily high growth.

If the overall aim of fiscal policy is fiscal consolidation, the question then is whether the current period--when overexpansion is more dangerous than recession--is the best occasion to lower taxes, thereby reducing public revenues and further adding to an already rapid expansion? It is hard for me to comprehend why the current tax burden constitutes a serious handicap for the private sector with such an expansionary economy. Although I would not have precluded shifts in the tax structure, I would have preferred that those shifts be more revenue neutral. Such a course of action would accelerate the quest for fiscal consolidation in a period of high growth. Taxes could then be more appropriately reduced during a period of lower growth. I would be interested in the staff's view, especially because it sees no need "to alter the thrust of the long-term tax reform efforts".

Monetary developments in 1989 reflected the booming real economy, with total liquidity expanding some 25 percent. Here also one can question the appropriateness of the monetary policy stance. Even if it is true that this vigorous monetary expansion has not resulted in a significantly higher rate of inflation, repeated liquidity expansions of equivalent magnitudes would definitely trigger and fuel inflation. Therefore, should the principal aim of monetary policy still be "to support the strong growth performance while preserving stability and external competitiveness," or should the precedence accorded those aims be

reconsidered, with the preservation of stability coming first, followed by support for the strong growth performance? In my view, the need for stability should prevail from now on because--and there is ample evidence of this--economic growth can best be achieved in a long-term perspective if inflationary pressures are reined in early, thus avoiding painful contractionary policies later on. Emphasizing stability is also preferable because capacity utilization is now reaching its limits as a result of the high economic growth Malaysia is already experiencing. The monetary authorities should therefore continue and intensify their efforts to mop up excess liquidity.

Their desire for a smooth implementation of monetary policy should not hinder them in a more flexible management of interest rates. Raising low interest rates would improve the quality of investments by discouraging the financing of projects based on unrealistic expectations, always a danger when economic expansion reaches high levels. Should higher interest rates be precluded because they might exert an upward pressure on the exchange rate, as the authorities fear? It would probably not be justified to make the appreciation of the exchange rate an explicit aim of monetary policy. However, because a more restrictive monetary policy preserves internal price stability, a moderate appreciation of the nominal exchange rate, if it were to occur, would not damage external competitiveness as it would be accompanied by a lesser appreciation or even a depreciation of the real exchange rate.

While placing a slightly different emphasis on certain monetary and fiscal policy issues from the Malaysian authorities, I commend them for their economic achievements in the recent past.

Mr. Iqbal made the following statement:

Malaysia's impressive economic transformation since the mid-1980s reflects principally the steadfast pursuit of sound policies and political stability. Strong economic growth has been achieved with low inflation, a strengthened external position despite a medium-term weakening of the terms of trade, and a reduction in the external debt burden. Major progress has been made toward the alleviation of poverty and dependence on the oil sector has been significantly reduced. Underlying this performance has been a strong fiscal consolidation, a well-developed financial sector, an appropriate exchange rate, a liberal exchange and trade system, and the ensuing stable economic and political environment which attracted private and direct foreign investment. The authorities should be highly commended for this achievement.

I agree with the broad thrust of the authorities' medium-term policy stance for sustaining a rapid rate of economic growth based on export diversification and development of skill-intensive activities. It is to be hoped that this process would not be hindered by protectionism abroad in Malaysia's export markets. A continued consolidation of the public sector aimed at further enhancing the role of the private sector will be crucial to the success of this strategy. Greater attention may also have to be paid to public investment, not only in physical infrastructure, but also in human skills and the establishment of an indigenous research and development capability so that the productivity of private investment can be enhanced. In view of the planned fiscal consolidation, higher public investments may have to be facilitated by restraint on current expenditures. I am happy to note that the authorities are committed to implementing tax reforms over the medium term, and hope that they will be able to develop the consensus needed to introduce a value-added tax. I would appreciate staff views on the precise objectives of the planned tax reforms. Are these aimed at additional revenues or at a better distribution of tax incidence?

An important challenge in the medium term lies in sustaining rapid growth while avoiding socioeconomic difficulties that some other newly industrializing countries have encountered. In this respect, the authorities have shown foresight by following the policy of reducing external debt and encouraging nondebt-creating direct foreign investments. Hence, the potential for a debt-related halt to growth has been effectively forestalled. The continued effective implementation of this strategy will call for a closer integration of the domestic capital market with the global market which might affect the independence of monetary policy. A further deregulation of direct foreign investment may be needed for it to continue playing a major role in the growth process. I would appreciate staff comments on the nature of such regulations relative to those in neighboring countries. Moreover, the tightening labor market, wage determination, income distribution issues, and poverty alleviation would have to be given due attention. The authorities appear to be cognizant of these issues, and I am sure that the inherent egalitarianism of Malaysian society will help in this respect.

However, the successful transition to this medium-term outlook will require short-term moderation of the presently buoyant domestic demand, which has caused some weakening of the external current account and resulted in domestic capacity constraints. Because the short-term internal and external objectives are complementary rather than conflicting, the staff recommendation for a tighter monetary policy is appropriate. Since much of the demand pressure has emanated from the private sector, it would seem

appropriate to let short-term interest rates rise and tighten credit so that consumer demand can be contained. However, I can sympathize with the authorities' desire to introduce monetary restraints gradually, so as to avoid precipitating an unnecessary slowdown or appreciating the exchange rate. The Central Bank's demonstrated ability to regulate liquidity effectively is an adequate guarantee for this purpose. The short-term fiscal policy seems to be appropriate, but caution may be needed, should the current demand pressures persist. Exchange rate policy also appears to be appropriate and care should be exercised to avoid appreciation while countering domestic demand pressures.

Finally, I wish to congratulate the Malaysian authorities for their very able management of the economy. Malaysia is presently poised at the threshold of becoming an industrialized economy which will pose new challenges, both short term and long term. I am confident that the Malaysian authorities will, as always, rise to the challenge.

Mr. Warner made the following statement:

Malaysia's economic policies and performance continue to be highly commendable. Its high growth rate, the substantial improvement in living standards achieved in recent years, the dramatic reduction in its external debt and its increased resistance to external shocks are not happenstance, but rather the results of prudent macroeconomic management and policies which have encouraged the private sector, investment and growth. Against this background, the Fund's policy advice, with which we are in general agreement, concerns questions of degree, not the basic orientation of the authorities' policy stance.

We share the staff's view that inflationary pressures pose the major risk to Malaysia's outstanding performance to date. Malaysia has enjoyed a remarkable degree of price stability in recent years, especially in view of its high rate of growth. Indeed, we are inclined to agree with the staff that the absence of entrenched inflationary expectations in Malaysia has probably been a significant factor in its ability to adjust quickly to external shocks and to attract high levels of investment. Thus, the emerging signs of labor shortages, greater wage demands and high capacity utilization are grounds for the authorities to heig hten their vigilance on price developments and make some moderate policy adjustments, particularly on credit policy.

Since the main component of the surge in domestic demand comes from the private sector, some tightening of credit conditions seems to be warranted. We would agree with the staff that

an early and gradual tightening would be the preferable course. Such an approach would be compatible with continued investment to ease capacity constraints, while nevertheless dampening domestic demand. Fortunately, it does not appear that higher domestic interest rates would have an adverse impact on Malaysia's external sector.

Fiscal policy has been quite prudent in recent years, as seen in the Federal Government's current surplus and the overall surplus--including development expenditure--of the nonfinancial public sector. Nevertheless, we see some scope for improving the efficiency of resource use and, at the same time, reducing pressures on domestic resources. One area in which resources could be used more efficiently is in the public enterprise sector. Although the sector's consolidated accounts are in overall surplus, the staff report notes that the bulk of the surplus is generated by a few enterprises, while other major industries continue as loss centers. Improving these operations would provide one means of increasing public savings. Eliminating certain subsidies, such as electricity subsidies to certain companies, and transfers to statutory bodies, would offer another.

We support the authorities' objective of improving living standards and believe that with prudent policies and good management, it can be done without jeopardizing fiscal consolidation. The current survey to identify the needs and location of the poor should help develop an effective assistance program and target those in greatest need.

We are also very supportive of the authorities' efforts to promote structural change. With regard to the labor market, it is somewhat disappointing that the unemployment rate, though not particularly high compared to many countries, has not declined more rapidly in the wake of such rapid economic growth. No doubt the most effective policy prescription is the continuation of the general policy approach that has resulted in such high investment and growth. In addition, the authorities' intention to encourage more job training in the private sector, especially in areas where labor shortages are appearing, seems promising in that it would serve the dual purpose of reducing price pressures and promoting employment. At the same time, introducing greater flexibility into the wage determination system might increase firms' willingness to take on new workers.

We also welcome the authorities' steps to promote financial market development, which we see as an important element in the effort to promote domestic savings and investment. The establishment of a credit rating agency would be helpful in this regard,

although it will be essential for the new agency to be truly independent in order to fulfill its intended role.

In concluding, I would like to register my authorities' high regard for the way in which Malaysia has managed its external debt. As the charts in the staff report indicate, Malaysia has had a large external debt and has been subject to many of the same pressures as other countries which subsequently developed debt-service difficulties. Yet with pragmatic policies Malaysia has managed progressively to reduce its debt and exposure to exchange and interest rate risk--a notable achievement.

Mr. Yoshikuni made the following statement:

The Malaysian economy continued its strong growth in 1989 and 1990, following the previous year's growth of 8.7 percent, the highest in the past decade. The rapid growth was accompanied by a strong external position and remarkable price stability, thanks to the authorities' commendable financial prudence. Unemployment, although still high, has been reduced.

While the driving force of this expansion is no doubt the booming domestic demand, it is worth noting that private fixed investment expanded rapidly, outpacing public investment. It is also evident that sound economic management and economic liberalization in the last part of the 1980s contributed to creating a favorable macroeconomic environment for foreign direct investment, which reached 5 percent of GDP in 1989. As a result, the external balance has shown an overall improvement. While the current account has turned to deficit, owing to a weakening of commodity prices and the rapid growth of capital-goods imports, the capital account has been strengthened substantially, allowing for a further buildup of reserves and the early repayment of external debt. I agree with the staff and the authorities that the strong growth will continue for the remainder of 1990.

At the same time, however, I share the staff's concern about the overheating of domestic demand. In view of the capacity constraints--notwithstanding the recent boom in fixed investment--persistent labor market rigidity and wage pressure, the staff is right to express caution about increasing inflationary pressure. In this regard, the authorities are facing the formidable challenge of maintaining the growth momentum, particularly of making headway toward industrialization, while at the same time securing the sustainability of such strong growth. While the medium-term prospects are bright, economic management this year is critical in many respects if the authorities are to achieve a smooth takeoff for the 1990s.

Turning to specific policies, I note two particular issues. First, private sector development has progressed considerably, and the Government's development strategy has concentrated on the creation of a sound macroeconomic environment. Second, there is an increasing need for the authorities to take initiatives in human resource development in order to sustain the economy's growth and industrialization. However, in no circumstances should financial discipline be put at risk.

On fiscal policy, while I share the authorities' view on the increasing need for economic and social infrastructure, fiscal consolidation should not be compromised. Having read the staff's explanation, I acknowledge that while there is some similarity between the Employees Provident Fund (EPF) and Japan's postal savings system in that the latter was also instrumental in mobilizing private savings for capital investments during the period of Japan's rapid expansion in the 1960s, it should be noted that the Japanese Government also ran a fiscal surplus during the same period. The Malaysian authorities should also set clear priorities with regard to development expenses so as to secure a high rate of return. Thus, besides prudent expenditure control, I continue to support the staff's recommendation that a value-added tax should be the main element of tax reform. The value-added tax is desirable, not only to maintain a fiscal surplus, but also to avoid the complication and distortion of relative prices through the arbitrary adjustment of specific sales taxes.

I very much agree with the staff that monetary policy should be the centerpiece of financial adjustment as the current boom is driven largely by strong private demand. Although the rapid expansion of liquidity in 1989 resulting from foreign capital inflow did not lead to higher inflation, thanks to counterpart investments, it is time to restrain monetary and credit policies in light of wage pressure and capacity constraints. A monetary target of 12-14 percent seems to be appropriate. However, to this end a more vigilant stance is required on interest rate policy.

On structural policy, a number of issues call for particular attention. The first is the privatization program of public enterprises. I welcome the antimonopoly regulations and openness of privatization to foreign equity participation as a positive indication of the increased competitiveness of the economy. Second, I welcome the investment efficiency, resulting from the policy reorientation toward private sector development, and attesting to the reduction in the capital output ratio. Financial sector reform can also be regarded as a necessary and essential step to underpin private sector development. Third, however, much

remains to be done in the area of wage liberalization. While I understand the political sensitivity of this matter, the continuation of the current wage system would undermine the competitive edge of the Malaysian economy in a regional context. I urge the authorities to introduce a liberalized wage bargaining system as soon as possible.

On external policy, I welcome the increased openness of the trade and exchange system, which has contributed to the export-oriented growth of the manufacturing sector, as well as preserving the competitiveness of the economy. These economic developments would provide a model of successful export-oriented growth, which could be further analyzed by being discussed in a regional context.

Mr. Goos made the following statement:

I share the favorable assessment by the staff and previous speakers of recent economic developments and of the medium-term outlook for Malaysia. The prospects are indeed bright and can be ascribed largely to sound economic management by the authorities over recent years.

This view is borne out quite impressively by the illuminating comparison of economic trends in Malaysia and selected groups of developing countries over the last decade as shown in Table 1 of the staff report. That comparison, together with the staff's analysis, conveys important lessons on how to cope effectively with severe external shocks and high levels of indebtedness; in particular, it demonstrates the critical importance of financial discipline and price stability in keeping the economy on an even keel. It also indicates that rather than pushing short-term growth, growth consideration should be pursued in the first instance through the provision of an incentives framework that is conducive to private sector activity. At the same time, the comparison illustrates that the level of indebtedness per se is not an insurmountable obstacle to a satisfactory economic and financial performance.

Without going into further details, I strongly encourage the staff to advertise Malaysia's example extensively in its country work as a model for successful economic management.

As to the more immediate policy agenda confronting the Malaysian authorities, I can be brief because I agree with the thrust of the staff's analysis and policy recommendations. I share in particular the concern that the recent rates of expansion observed for domestic demand and monetary aggregates are unsus-

tainable. There is indeed a clear risk that those developments have already built up a considerable inflationary potential that should be tackled in a timely and effective manner to obviate the need for a more disruptive adjustment later on.

Against this background, the recent tightening of liquidity conditions by the Central Bank and the accompanying rise in interest rates reported by Mr. Ismael are welcome steps in the right direction. However, in light of continued strong demand for credit by the private sector and accelerating activity in important sectors--also reported by Mr. Ismael--I wonder whether the authorities would not be well advised to take more decisive and comprehensive steps to contain domestic and external financial imbalances. In this regard, I am quite concerned about the growing gap between domestic savings and investment and the corresponding significant weakening in the external current account. Another cause for concern is the declining trend in import coverage by gross official reserves which, if not arrested and reversed, might weaken the confidence of external investors.

Taken altogether, I think that the authorities should err on the side of caution and avoid an unduly gradual approach in the conduct of demand management policy. Moreover, it appears that the adjustment burden should also be balanced more evenly--and perhaps more so than suggested by the staff--between monetary and fiscal policy. This is not to advise fiscal fine tuning; given the expected continued buoyancy of the private sector over the medium term, it is essential that fiscal sector absorption be attuned to the availability of domestic resources. To this end, and in addition to their commendable and continuing efforts to contain current expenditures and to reform state enterprises, the authorities should mobilize the support needed to advance the planned reform of the tax system. A more resolute course of fiscal consolidation than envisaged by the authorities would also be consistent with the large overall indebtedness of the federal government amounting to almost 100 percent of GDP and the substantial share of interest payments of almost one quarter of federal expenditures.

Finally, in view of the repeated slippages in budgetary targets, including the substantial shortfalls in development expenditures, there may be scope for strengthening the budgetary process to improve the predictability of fiscal policy. Furthermore, the reference on page 10 of the staff report to the recent provision of incentives for particular activities; to selective cuts in import duties and sales taxes to stimulate competition and restrain price pressures on certain products; and to the increase in subsidies for some industries left me with the impression that the authorities are engaged in quite interventionist industrial

policies. I therefore should like to caution against the obvious risks of such policies for efficiency and longer-term growth given the danger that such measures tend to create rigidities and perpetuate nonviable activities.

Mr. Westerweel said that he commended the authorities for implementing over a number of years, sound economic policies which had resulted in a resumption of sustainable economic growth.

He supported the basic thrust of Malaysia's fiscal policy, especially the reduction of the deficit from unsustainable levels to a more manageable amount, Mr. Westerweel remarked. The authorities' current efforts to address the problem of continued losses by some public enterprises, noted in Mr. Ismael's statement, were welcome. He asked for staff comments on the efficiency, from a macroeconomic perspective, of using tax reductions as incentives for specific industries, such as wood processing and tourism, and subsidies, notably for electricity supplied to some industries. Moreover, he wondered whether subsidizing one specific input had any adverse microeconomic consequences resulting from the use of an inefficient combination of production factors. He supported the introduction of broad-based consumption taxes, especially a value-added tax, as soon as it was politically feasible. He urged the authorities to continue programs for alleviating poverty and improving social equity, with stress on a selective targeting of recipients and using aid to stimulate participation in productive activities. As examples of the latter, he cited vocational training and assistance in operating agricultural and other small-scale enterprises.

He fully agreed with the staff recommendation for an early and moderate tightening of financial policies to return demand growth to a more sustainable path and thus avoid sharper and more disruptive adjustments later, Mr. Westerweel continued. The authorities should monitor closely both actual inflation and any signs indicating an imminent upward drift of inflation--for example, a surge in private consumption indicating demand-pull and labor shortage bottlenecks indicating cost-push.

Allowing the market to determine the broad trend of the exchange rate seemed appropriate for Malaysia, Mr. Westerweel observed. Fiscal and monetary policy and structural measures--such as labor training targeted at labor market shortages--were well aimed at containing inflation, leaving room for the exchange rate to reflect market developments such as the 20 percent terms-of-trade loss in 1986. However, exchange rate suppleness should not be a substitute for sound domestic policies. In that context, particular attention should be given to the structure of wage negotiations, especially collective bargaining agreements, most of which included a three-year advance specification of wage increases, which could be especially dangerous if adverse developments occurred.

The medium-term outlook for Malaysia was bright, Mr. Westerweel commented. Of the three alternative medium-term scenarios found in Annex I of the staff report, he suggested that the second alternative, which assumed that the external environment was less favorable, be further developed to take into consideration not only the effects of slower growth in commodity prices and foreign GDP, but also the effects of an increase in foreign protectionism. Malaysia would be particularly vulnerable to foreign protectionism at its current stage of development.

Mr. Ghasimi said that the Malaysian authorities should be commended for the successful implementation of wide-ranging macroeconomic policies and structural reforms aimed at further involvement of market forces; for enhancing the role of the private sector; and for diversification of the economy. Such effective economic management had resulted in a remarkable economic performance in recent years.

Indeed, the available economic data for 1989 and 1990 presented in Mr. Ismael's comprehensive statement showed that economic growth had maintained its buoyancy, inflation had remained at a low level, and unemployment had begun to decline from the high level of the preceding years, Mr. Ghasimi stated. Moreover, in light of greater confidence in the economy, private capital inflows had registered a high growth.

It could hardly be denied that with the ongoing rapid expansion of economic activity in Malaysia, further strengthening of infrastructures and promotion of private sector activities should continue to be granted the highest priority, Mr. Ghasimi remarked. In that regard, the implementation of a number of new tax measures in 1989 to stimulate further private sector activities and the allocation of substantial government outlays in education, transportation, and rural development were most encouraging. However, the prevailing high domestic demand and recent concerns about potential inflationary pressures necessitated the implementation of a prudent fiscal policy, mainly by avoiding excessive expansion of current government expenditures.

Although the full impact of the excessive growth in liquidity had not yet been reflected in higher price levels, the potential inflationary pressures inherent in excess liquidity could translate into actual price increases, particularly in the context of the current high utilization of productive capacity, Mr. Ghasimi noted. To that end, while he welcomed the authorities' intention to gradually tighten monetary policy, it was important that they maintain vigilance over economic developments and remain ready to respond quickly and adequately to any sharp adverse developments.

He also commended the authorities for their continuing efforts to rehabilitate the remaining ailing banks and strengthen domestic financial markets, Mr. Ghasimi said. In that regard, the return to normal operations by some of the previously restructured commercial banks was encouraging. Furthermore, the Banking and Financial Institution Act of 1989, aimed at

exercising uniform control over the operations of deposit-taker institutions, would facilitate proper management of the financial market.

Turning to the external sector, the exemplary case of Malaysia as a developing country that maintained a liberal exchange and trade regime was indeed impressive, Mr. Ghasimi observed. That policy had so far resulted in a considerable degree of international competitiveness and contributed significantly to the expansion of the country's exports. However, consolidation of those gains by pursuing appropriate macroeconomic policies to keep inflation under control would be crucial.

As far as medium-term prospects and policies were concerned, the high vulnerability of the economy to price fluctuations in international commodity markets necessitated attaching the highest priority to the effective diversification of the economy and exports, Mr. Ghasimi stressed. The excellent performance of manufacturing exports in recent years had been facilitated by giving proper attention to marketing factors--including quality improvements--and they deserved further investment and attention. However, since manufacturing exports were highly concentrated on two groups of goods which accounted for half of the total exports of that sector, efforts to diversify manufacturing exports in terms of both composition and direction of trade was essential to safeguard sustainable growth and a viable external position.

Mr. Noonan made the following statement:

> I welcome the opportunity to congratulate the Malaysian authorities on their successful adjustment in recent years. Their success is remarkable when it is recalled that Malaysia's budget and external current account deficits were as high as 17 percent and 14 percent of GNP, respectively, in 1982; that that adjustment was carried out in the face of a subsequent substantial drop in the terms of trade; and that Malaysia's total external debt had reached 84 percent of GNP by 1986. While exogenous factors played a favorable role, I agree with the staff and other speakers in their assessment. First, the major credit must go to the sound economic policies pursued by the authorities, and second, there are important lessons to be learned from Malaysia's experience. One lesson is the role of relative price stability and an open economy with outward-looking trade policies in underpinning Malaysia's successful adjustment.
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> Turning to the present and the immediate future, it would seem prudent to view the successes of the past several years in terms of a transition to a new phase of sustainable growth and to tailor policies accordingly. Therefore, like the staff, I would caution the Malaysian authorities with respect to the 1989 acceleration in the rate of growth in M3 to 24 percent and the concomitant possibility of mounting inflationary pressures. Hopefully,

this rate of growth has begun to slow down, as indicated in Mr. Ismael's helpful statement, and the authorities will be able to keep within their target range of 12 percent to 14 percent for 1990.

As for the sharp increase in consumption expenditure in recent years, the background paper notes that the marginal propensity to consume has risen, partly in response to easier credit conditions and to asset appreciation as a result of the buoyant stock market. Since wage rates do not seem to have increased unduly, I would appreciate having the staff's interpretation of consumption developments over recent years and whether there is concern regarding the prospects for the medium term. On another point, I note that despite the foreign direct investment of recent years, net factor payments abroad--shown in Table 4 of the background paper--appear to have fallen since 1985. I would like to ask the staff whether these payments are expected to pick up in the coming years and, if so, whether they are likely to have a significant impact on the balance of payments.

Regarding the authorities' fiscal policies, I commend their prudence and their desire to enhance public investment in infrastructure and human development. However, the decline in the ratio of revenue to GNP since 1986 is rather striking and I wonder what the explanation is for its apparent inelasticity with respect to GNP. To the extent that it reflects the authorities' strategy of lowering company taxation, including extensive provisions for tax holidays for new enterprises, I wonder--as did some previous speakers--if the staff has a view on how important that strategy has been in inducing a "supply-side" response. We would also note that roughly one third of total fiscal revenue is derived from petroleum, suggesting that receipts could be vulnerable to a price reduction. Given recent petroleum price developments, the dependence on petroleum revenues reinforces the need to bolster other sources of revenue. It would be a pity if support for a value-added tax had to await a sharp downturn in revenue and consequent budgetary problems.

Finally, I note that the staff recommends the removal of perceived structural rigidities in the labor market by moving away from collective pay settlements to an approach based on productivity and profitability in individual enterprises. In principle, the more responsive wages are to supply and demand, the better. However, the recommended approach might lead in practice to so-called headline settlements, which can be higher than what might be afforded by the economy as a whole. Sometimes profitability can be a reflection of limited effective competition, particularly in high-tech industries like electronics and pharmaceuticals, or it can reflect conditions of excess demand, as can occur in build-

ing and construction. High pay settlements in those industries or sectors can, in practice, establish headline settlements for workers in other enterprises--even if those enterprises are less profitable--or for workers in the public sector. Workers in such industries and sectors are likely to see their labor as being of equal value and to exert industrial pressure to achieve comparable pay increases, particularly where there has been a practice of collective pay settlements. By contrast with that approach to pay settlements, some successful economies achieve broad-based consensus on appropriate general pay increase norms, sweetened by provisions for discretionary bonus payments where warranted by profitability. That system might well allow a faster pace of economic growth than would be likely from any free-for-all system with its attendant risks of industrial conflict. Accordingly, I would like to hear from the staff what the experience of wage flexibility has been in other rapidly developing east Asian countries.

Mr. Himani made the following statement:

The performance of the Malaysian economy in 1989 and the favorable outlook for 1990 once again bear testimony to the fundamental soundness of the authorities' economic and financial policies. Economic growth continues to be rapid in an environment of stability. Of all the positive developments noted in the staff paper, what I regard as being the most striking is the fact that Malaysia is among the few developing countries that can point to having achieved rapid economic growth along with impressive progress in its social and demographic indicators.

Since I am in general agreement with much of the staff appraisal, I can be brief, focusing my remarks on a few areas. On the general stance of economic policies, I have one comment. It is clear that the Malaysian economy is now working under resource pressure, with strains evident in the edging up of inflation, a tightening labor market as reflected in some pickup in wage demands, and a sharp swing in the current account position. The challenge that faces the authorities is how to bring the momentum of domestic demand into better alignment with supply capacity while supporting business investment and external adjustment.

The staff takes the view that the transition to a more sustainable growth path should be achieved primarily by a tightening of monetary policy. Higher interest rates and a strong exchange rate are the main channels through which a tighter monetary policy would be expected to reduce the pace of nominal spending. One might agree, of course, that the recent and prospective fiscal position--which is favorable--would argue against a larger role for fiscal policy in containing domestic demand and that fiscal

policy may not be the ideal tool for short-term demand management, especially when demand pressures are emanating from the private sector. One can also argue that a tighter fiscal policy stance than is being planned would reduce the extent of monetary tightening that would be needed for any target rate of inflation. The important point is that by reducing the pressure on interest rates and the real exchange value of the ringgit, and by facilitating monetary policy's task of countering inflationary forces, fiscal action could--and indeed should--serve as an important complement to a restrained monetary policy stance. In this connection, the scenario that I would have liked to see is one which combined monetary tightening with a more active fiscal policy.

My second comment is on the employment issue, which also attracted Directors' attention last year. In the staff report for the 1990 Article IV consultation, it appears that the unemployment rate is finally beginning to show signs of falling in response to the continued expansion of the economy. The staff says that the slow response of employment to output growth is related to rigidities in the labor market, particularly in the manufacturing sector. However, the data on output and employment provided in Tables 5 and 8 in the background paper do not seem to lend much support to the view that labor market imperfections are seriously impeding the creation of adequate employment opportunities in manufacturing. The average elasticity of employment with respect to real output growth in the manufacturing sector during the three years to 1989 is about 0.54 and would appear to be in line with, or better than, the experience of many other developing countries.

Of course, one could always argue that a more "flexible" system of wage setting would have resulted in a higher elasticity and hence a more rapid rate of growth in employment for any given level of output. However, a closer inspection of the figures shows that the real problem might indeed reside in the employment performance of the tertiary sector which engaged some 45 percent of the labor force in 1989. Here the elasticity appears to have fallen quite dramatically--from a high of about 0.9 in 1987 to less than half that figure last year. Perhaps the staff could comment on this sharp decline in the labor absorptive capacity of the tertiary sector and, if possible, also explain the causes of the decline.

Finally, given the importance of the employment issue, I would have liked to see some assessment of the impact on unemployment associated with the medium-term scenario contained in Tables 1 and 2 of the staff report.

Mr. Thorlàksson said that the Malaysian economy performed remarkably well in 1989, as it had in the previous two years. The economy had grown for the third consecutive year at an impressive rate. Price stability had continued to prevail while the external sector had remained in a rather comfortable position owing mainly to the very high level of foreign direct investment. Sound economic policies--for which the authorities must be commended--had laid the basis for those very positive developments. Information provided by Mr. Ismael confirmed the expectation that the economy would continue to expand in 1990. As he broadly agreed with the staff appraisal, he would only make one general remark regarding the sustainability of the most ambitious medium-term growth objectives.

Given the present situation, which showed signs of emerging inflationary pressures, he agreed with other Directors that an early tightening of monetary policy might be warranted, Mr. Thorlàksson commented. In addition, a more ambitious target for the fiscal balance might be appropriate to dampen the demand pressure and raise public savings. While inflation had remained low, the current expanding aggregate demand, particularly the booming private consumption, must be contained to avoid an overheating of the economy. Otherwise, developments could get out of hand with a detrimental impact on price performance and the external balance. The envisaged current account deficit of 3 percent of GNP might prove to be too optimistic, but in any event it would only be sustainable as long as it could be financed by inflows of equity capital. Since foreign direct investment in turn would occur in the required volume only if the economic environment in Malaysia was perceived to be stable, the authorities would be well advised to closely monitor price developments and be prepared to make the necessary adjustments in financial policies sooner rather than later. Only then could adverse consequences for future economic performance be avoided and the rapid growth rate sustained.

Mr. Serre made the following statement:

> Like previous speakers, this chair commends the authorities of Malaysia for having successfully pursued the sound economic policies launched five years ago. Their renewed commitment to an equitable distribution of the fruits of growth is also highly commendable. As in 1988, the 1989 results are impressive, among others in the debt area, and we fully share the staff's analysis that Malaysia is "emerging as one of the most dynamic economies in the developing world."
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> I shall limit my comments to monetary and fiscal policies. First, a major accomplishment of the authorities is having kept inflation under control within the context of a strong demand expansion despite some remaining rigidities, in particular in the labor and wage system, and the emergence of shortages in skilled manpower. As regards monetary policy, the measures undertaken by the Central Bank to mop up excess liquidity are welcome. However,

a tighter monetary policy should be firmly pursued to avoid further inflationary pressures since an increase in consumption could place a strain on available resources. These conditions could be quickly improved by early action on the interest rate front, as well as through the recent increases in reserve requirements. Moreover, as underlined by the staff, increasing interest rates would follow developments in world financial markets and would serve to avoid short-term capital outflows. It is also true that in the present circumstances, the rise in interest rates will not likely exert further pressure on the exchange rate since external competitiveness still relies on industrial productivity as illustrated by the development of Malaysia's incremental capital output ratio.

Finally, I encourage the authorities to pursue financial system reform in line with the progress already achieved in 1989. The establishment of an independent credit rating agency as well as the introduction of a more flexible financial management policy by the Employees' Provident Fund are welcome initiatives.

Second, with regard to fiscal policy, since public finance consolidation has nearly been achieved, owing to both the recovery of oil prices and the buoyancy of the economy, it is now important to strengthen the federal budget structure further and to ensure its smooth functioning. To reinforce the role of the budget in the economy, I agree with the staff that more specific actions are still needed. Taking into account the present pressures on resources, a lower fiscal deficit seems more appropriate. In this regard, public enterprises should be kept under close review, insofar as several major enterprises continue to record losses. The initiative of an action plan aimed at streamlining the sector is a welcome first step.

Finally, the fiscal structure could be improved by easing the transition to lower direct taxation. Like the staff, I urge the authorities to reduce the country's dependence on petroleum taxes and to broaden the consumption tax base through the implementation of a value-added tax. This could also pave the way for facilitating a stabilized high level of national savings over the medium term.

To conclude, I concur with this well-balanced staff appraisal. The success story of Malaysia is very encouraging and price stability has played an important role in its success. However, several indicators show that the situation could lead to an overheating of the economy and a resumption of inflationary pressures. Some rigidities need to be urgently overcome, in particular in the labor and wage system. The earlier actions to address these difficulties are undertaken, the smoother the

transition to consolidate the progress will be. We wish the authorities every success.

Mr. Shaffrey said that--as other speakers had noted--Malaysia's excellent economic performance continued apace and there was much to commend in the authorities' management of the economy. It provided an example which many other countries at a similar stage of development could well emulate. He could endorse the staff's appraisal, particularly the underlying theme that the authorities needed to adopt a cautious approach to their handling of an economy running at almost full throttle. In that regard, he welcomed the recent tightening of monetary policy referred to in Mr. Ismael's statement, which was in line with the staff's recommendations. It was important that liquidity growth be reined in. The authorities' actions were appropriate but, like others, they should be prepared to constrain liquidity growth further if pressure on resources and prices did not show signs of abating. He also agreed with the staff that a tightening of fiscal policy was warranted in view of the continued very strong growth in domestic demand--which itself provided an ideal window of opportunity for the authorities to pursue their goal of containing the role of Government.

The authorities' ambitious privatization plans were consistent with that goal, but he would be interested in knowing whether the limits to the extent of foreign investment allowed in the privatized industries were entirely necessary, particularly for those enterprises engaged in activities that would normally be undertaken by the private sector, Mr. Shaffrey said. The restriction seemed a little difficult to justify for a country that had gained so much from foreign investment.

The Employees Provident Fund was expected to be a significant holder of stock in the privatized enterprises, Mr. Shaffrey noted; it would be swapping its holdings of government debt for shares in those enterprises. Since those shares might very well not be perfect substitutes for government paper, being presumably a riskier asset, he wondered to what extent the Employees Provident Fund would be directed to hold those shares rather than have the freedom to arrange its own portfolio, consistent with minimizing the risk to its contributors' funds.

Mr. Dai made the following statement:

Malaysia is to be commended for its remarkable economic performance, with--as I stated in last year's consultation--the authorities' skillful management of the economy a main factor in its continuing success and favorable external conditions also playing an important role. The staff again accorded much credit to Malaysia's achievements, indicating that "Malaysia appears to be emerging as one of the most dynamic economies of the developing world," and "Malaysia's experience with economic adjustment during the 1980s contains some important lessons." I shall briefly comment on the lessons that are of the most interest to me.

One important lesson is the strategy the authorities implemented in the Fifth Plan (1968-90) which both promoted private sector activity and strengthened the supporting role of the public sector in providing adequate infrastructure and public services. The Malaysian authorities have coordinated private sector and public sector roles remarkably well in accordance with Malaysia's circumstances and conditions. Both sectors are mutually complementary and reinforce each other in a harmonious manner. Significant progress has been made in the diversification of the economy. Moreover, the profitability of most nonfinancial public enterprises has improved. In light of their experience, the authorities--while stimulating private initiative through tax relief--continue to place their fiscal policy emphasis on the expansion of public investment and spending to strengthen infrastructure, develop human resources and further alleviate poverty, all of which are undoubtedly essential to the sustained development of the economy. For various reasons, many developing countries have a relatively large public sector component, not just for political or social causes but also for economic reasons. The key challenge today remains how to manage it rationally and effectively so that the public sector can fully play its appropriate role in the process of economic development.

Another lesson I found interesting is that the authorities have taken full advantage of favorable exogenous factors and domestic comparative advantages. They capably coordinated and integrated external and internal factors to promote rapid and stable growth. In 1987, when domestic demand was weak but the outside world demand rebounded, Malaysia's economy recovered vigorously through the strong expansion of manufactured exports. Booming exports led to strong growth in the following years, which in turn brought about buoyant domestic demand and strong private investment. The expansion of investment was then translated into a larger productive base and higher productivity, which led to a lower unit labor cost compared with its trading partners in the region. Increasing external competitiveness has boosted exports and made the rapid growth of imports possible, which in turn strengthened supply conditions so that constraints in the economy and inflationary pressures could be eased. In addition, Malaysia has benefited from large direct investment inflows resulting from a shift in investments by major capital exporters recently. The authorities have taken advantage of this opportunity by changing their emphasis from external borrowing to a policy of encouraging large inflows of foreign direct investment. The marked progress in this policy, particularly reflected in a doubling of direct investment in 1989, will certainly not only support the balance of payments position, but will also greatly strengthen the basis for a continued strong supply response.

In sum, although Malaysia's economic growth is to a large extent dependent upon exogenous factors, it appears settled into a virtuous cycle at present. While agreeing with the staff recommendation that early action to rein in inflationary pressures is needed as a precautionary measure, I share the staff's judgment that the Malaysian economy--following sound policies--remains strong and is now reasonably well positioned to weather external shocks.

Mr. Cassell made the following statement:

Like other speakers, I have no difficulty accepting the conclusion that the strong growth we have seen in the Malaysian economy reflects not only favorable international conditions, but also the generally sound economic policies pursued by the Malaysian authorities and the resolution with which they tackled the imbalances threatening to undermine the country's prospects in the early 1980s. The staff paper draws attention to the authorities' exchange rate policy, which by allying flexibility with sound macroeconomic policies has allowed Malaysia to restore and subsequently maintain its competitiveness. It also rightly praises the authorities' emphasis on the private sector as the engine of growth; the importance they have attached to cutting tax rates, reducing regulation, and fostering an attractive climate for investment; and their prudent approach to expenditure and borrowing in general.

As noted in the staff paper, however, the Malaysian economy is now entering a new phase and the balance of risks has changed since the last consultation. After two years in which domestic demand has risen by over 15 percent per annum, there are now clear signs of emerging inflationary pressures. The consumer price index, which may understate the underlying rate of inflation, is moving upward; there are signs of labor shortages and other capacity constraints; and the current account has swung sharply into deficit. In part these developments reflect the strong rise in investment seen over recent years, and indeed, so far the authorities have had no difficulty financing the deficit. However, it also reflects buoyant consumer demand--and an accompanying fall in private savings--and is a further indication that the economy may be in danger of overheating.

I therefore agree with the staff that the main challenge now facing the authorities is to return demand growth to a more sustainable path so as to avoid the need for sharper and more disruptive adjustment later on. The authorities appear to believe that the recent surge in activity is essentially a cyclical phenomenon which will be automatically followed by a slowdown. I think this

view has some force. Nevertheless, the most recent survey evidence suggests that the dynamism of the Malaysian economy is continuing unchecked and Mr. Ismael's statement tells us that first quarter GDP growth was over 10 percent. This level of expansion confirms that a deliberate effort on the authorities' part to temper the vigorous growth of demand will be required. Indeed, the projections for 1990 included in the staff paper assume a tighter policy stance this year than the authorities have actually pursued to date.

On monetary policy, I share the staff's concern about the excessive growth of broad money last year. That growth in the money supply was primarily owing to inflows of private capital and not to laxity on the part of the authorities does not in itself make the buildup of liquidity in the banking system any less threatening as far as inflation is concerned. The authorities are right to attach importance to smooth implementation of monetary policy; it is therefore surprising that a measured response--in the form of a cautious but significant early increase in short-term interest rates--was not taken earlier. Although--as Mr. Ismael records--interbank rates rose in April, broad money seems still to be growing well above its target range. Perhaps Mr. Ismael or the staff could confirm that higher interbank rates are in fact driving up lending rates, which have remained remarkably stable in recent years. Doubts about the efficiency of Malaysia's financial system and the need to make it more responsive to market forces were expressed in last year's report. In the present context they seem more pressing than before. I hope the authorities will not hesitate to tighten monetary policy further; the indications are that this move would not put great upward pressure on the exchange rate and, in any case, a rise in domestic inflation would be more damaging than a small appreciation of the currency.

As for fiscal policy, although the budget deficits last year and this year seem likely to be below planned levels, its essentially expansionary stance at this stage of the cycle is surely inappropriate. This should be a period of consolidation of public finances, particularly in view of the dependence of those finances on petroleum revenues. While a federal deficit of some 5 percent of GDP may still permit a sustained decline in the debt ratio, it is exacerbating the pressure on the country's resources and widening the savings-investment gap. A more rigorous examination of budgetary priorities, subsidies and transfers, and the acceleration of the privatization program might have produced significant savings while allowing the authorities to expand infrastructure and development programs.

I would like to turn now to Malaysia's unfinished structural reforms. I was glad to learn that the authorities agree on the desirability of introducing a broadly based consumption tax or value-added tax, although it is disappointing that they do not feel the political climate is yet ready for such a change. I also welcome the authorities' continued effort to improve incentives and the climate for investment by cutting direct and corporate taxes. There are, of course, dangers in allowing resource allocation to be overly determined by the tax system and I hope that the authorities have fully considered them. Other countries have found that too often tax incentives cause distortion, quickly outlive their usefulness, and are difficult to withdraw. I therefore hope that tax incentives in Malaysia will be carefully targeted and prudently reviewed.

The staff paper also draws attention to rigidities in the Malaysian system of collective wage bargaining which applies to a significant minority of employees and which may have contributed to the persistence of relatively high unemployment despite several years of strong growth. This system is insufficiently responsive to economic developments and, if inflationary expectations become entrenched, will make it all the more difficult to break them. I hope that the tripartite discussions being held with employers and trade unions will not inhibit the authorities from putting forward radical reforms to inject greater flexibility into this very important area.

The nonfinancial public enterprise sector accounts for about one fifth of Malaysia's GNP and the country's healthy economic condition provides the ideal background for pressing ahead fast with an ambitious program of privatization. While the sector taken as a whole is in modest surplus, it is largely owing to the oil and commodity enterprises. The heavy industries under state control, such as steel and cement, continue to lose money. Alongside privatization, I trust that the authorities will not flinch from taking remedial action to end the reliance of these industries on public subsidy.

I would like to express a word of thanks to the staff for including in the background paper an analysis of the Malaysian economy in a regional context. I hope other Directors found it as enlightening as I did and that those who have expressed concern about this sort of perspective have had their fears eased.

To conclude, I hope that the authorities will heed the warnings implicit in the staff report. The outlook for Malaysia's economy appears bright; with its natural resources and developed infrastructure, continued rapid growth is achievable. Indeed, the staff paper suggests that growth of 7 percent per annum is sus-

tainable in the medium term. However, the successful conduct of economic policy depends largely on judicious risk appraisal and the balance of risk does seem to have changed in the past year. Any accommodation of emerging inflationary pressures would not only be deeply damaging to the country's competitiveness, but it would also undermine the confidence on which a continuing inflow of foreign investment depends. To many of its neighbors, the recent history of the Malaysian economy has been an enviable success story. It would be a great pity if that story were now to be soured by an overambitious attempt at a pace of expansion that is not sustainable. I am sure that the authorities realize this situation and I wish them well in their endeavors.

The staff representative from the Asian Department, confirmed Mr. Schoder's understanding of the relationship between local purchasing power and the movements in GDP per capita measured in U.S. dollar terms. Even measured in terms of GDP per dollar, Malaysia's improvements in per capita incomes had been enormous. Taking into account the changes in the exchange rate, in terms of actual local purchasing power, the increase in incomes was even larger.

The manufacturing sector's dependence on foreign markets and its lack of integration with the domestic market was linked to the issue of Malaysia's vulnerability to protectionist pressures overseas, the staff representative observed. It was true that Malaysia's manufacturing sector was still relatively narrowly based, depending on exports of a limited range of products, mostly electronic and electrical equipment goods. There had been a significant deepening in the past couple of years; most notably, there had been a movement toward higher value-added products in the electronic and electrical industries. However, the manufacturing sector was still fairly undiversified. The Government's policy was not to prejudge the decisions of the market to determine the most appropriate investments. Nevertheless, it would, of course, like to see greater diversification.

As to the reason for the continued existence of incentives for foreign investment since they had played only a minor role in attracting foreign investment, and whether they could be phased out, the staff representative explained that while the authorities recognized that the incentive system per se had not been a major factor in attracting new investment, they felt constrained by competitive pressures from other countries in the region with similar incentives not to reduce them unduly rapidly. Broadly speaking, Malaysia's incentive system was about the same as those in other countries of the region.

Discretionary versus rules-based removal of those incentives depended on the circumstances, the staff representative continued. Particular incentives to a particular manufacturer were based on specific rules and expired at the end of the period for which they were granted. The incentives for

an entire sector of industry were based on a discretionary approach; the authorities continually reviewed whether certain industrial sectors merited such incentives and sometimes removed industries from the incentive system. Most recently, various packing and plastics industries were removed. Therefore, the important message for the private sector was that incentives would not be permanent. They were not to be looked upon as a substitute for competitiveness and the ability to make profits on the world market.

A related issue was the regulation of investment and how it compared with other countries--especially foreign ownership regulations--the staff representative noted. As a general rule, it was very difficult to compare across countries because the regulations were complex. However, Malaysia's regulations were less restrictive than those of other countries in the region, with the exception of Singapore.

On the issue of tax reform, the authorities would favor a tax reform in the medium term that was revenue neutral, the staff representative reported. The revenue measures that had been taken in 1989 and 1990 did cause a short-term loss of revenues, it was true, but the broader thrust of tax reform policies was to be revenue neutral. In terms of how that fit in with the current need for some demand restraint, the authorities would recognize the need, but would not want to interrupt the medium-term thrust of tax reform--to raise taxes, for instance, in areas where reductions had been made--just for the purposes of demand restraint.

The fall in revenue-to-GNP ratios that had taken place since 1986 was mostly a reflection of the decline in commodity prices on revenues, and did not signal any longer-term aim of the Government, the staff representative observed.

As for electricity and other incentives, he frankly did not think that there were good economic reasons for them, the staff representative said. He shared Directors' assessment that they were likely to lead to distortions in resource allocation. However, he did not think it would be fair to say that they reflected a growing interventionist trend in industry, particularly considering the reductions in import tariffs that had taken place recently; on the contrary, there was a commitment gradually to increase the open orientation of the economy. The tariffs that had been reduced had had some protectionist component, and the authorities' position was to remove them over time; industries should be prepared to compete at world market prices.

Recent developments in consumption expenditures, the staff representative noted, were to some extent cyclical phenomena, a view shared by the authorities. However, in the staff's view, the surge in expenditures was not just cyclical; it was also a reflection of the fairly easy credit conditions, the booming economy in general, and the booming stock market. Therefore, it would perhaps be dangerous to assume that consumption expenditures would decline in and of themselves, without policy actions.

Looking at the trend of net factor payments in the balance of payments and the questions of why they had not declined and what were the prospects for the medium term, he did not think that net factor payments as a whole would decline; however, there had been a significant structural shift within them away from interest payments toward dividend and other profit repatriation payments, the staff representative noted. Foreign investors were beginning to share more of the risks that Malaysia would face in the future; it was a very positive development that would cushion the economy. Gradually the economy would become much less vulnerable to various exogenous shocks because profit payments overseas would bear part of the burden of those shocks.

Despite the recent monetary restraint, there had been no observed increase in the average bank lending rates through April or May, the latest information he had available, the staff representative reported.

He could not give a precise answer to the request to compare wage flexibility with what was happening in other rapidly industrializing developing countries, but he could clarify one point, the staff representative said. The Malaysian system of wage determination and wage bargaining was a very rigid one at present. It had some features he thought did not exist in most other countries. The generally predetermined increases in real wages built into the wage settlements for the three upcoming years were not a problem during a period of steady economic expansion. However, if a downturn or a terms-of-trade impact caused profitability to decline, then the three-year advance agreements could be a problem. The dangers of such a rigid system had been demonstrated during the 1985-86 recession. Fears that a similar difficulty might occur again had been a significant factor in the relatively slow pickup in employment in the recent period of rapid economic expansion.

Turning to comments made by Mr. Himani that shortfalls in the services sector might have been the real cause of the slow growth in employment, the staff representative said that employment growth in the service sector, which had lagged behind output, reflected mainly two developments. First, employment in Government was growing very slowly. Second, the various problems faced by many large banks and other financial institutions had led to layoffs and change in the financial sector.

The Government had not announced any policies directing the Employees Provident Fund (EPF) to hold shares in privatized companies in place of government securities, the staff representative noted. The portfolio regulations applying to the EPF were to be liberalized and the institution would become much less of a captive market for government securities. Nonetheless, he shared the concern that the EPF might be instructed to hold shares in certain companies. Such a policy would not be helpful.

Mr. Ismael made the following concluding remarks:

I wish to extend my appreciation to the Board for its commendations on the policies pursued by my authorities and on the recent economic performance of Malaysia, as well as for its comments and recommendations. I shall convey these views to my authorities. The staff representative has addressed practically all the questions raised. My comments, therefore, should only be seen as a supplement to make the picture whole. First, I would like to reiterate that my authorities are committed to continuing their prudent policies in the pursuit of sustaining the growth momentum within the context of internal and external stability.

Second, with the threat of inflationary pressures, the Central Bank has undertaken several measures in an effort to mop up excess liquidity through increases in reserve requirements and open market operations. The growth in the money supply will continue to be monitored closely, and additional steps will be taken, if necessary, to ensure that it does not become a source of inflationary pressure.

Third, the 1990 budget was designed primarily to sustain rapid economic growth with price stability. The policy of expenditure restraint was continued, and budgetary measures and tax incentives to encourage greater private sector initiative and higher productivity were introduced. Significantly larger allocations were again provided for development programs, in particular for the expansion of investment in physical infrastructure to support private sector activities.

Fourth, on the size of the fiscal deficit, it should be recognized that an overall budget deficit of 6 percent of GNP is not considered large by Malaysian historical standards. In the 1970s, it averaged 6.7 percent of GNP. Moreover, the Malaysian fiscal system of not consolidating the social security institutions tends to give the wrong impression--that the fiscal deficit is too high to be sustainable. If the social security institutions were consolidated as part of the fiscal system--as is the practice in many countries--instead of treating them as a below-the-line financing item, the overall budget deficit in 1990 would be significantly lower at about 3.3 percent of GNP.

Fifth, to enhance the role of the private sector as the engine of growth, my authorities have embarked on a massive privatization exercise with the adoption of the Privatization Master Plan. The Master Plan identified 246 enterprises for privatization in the next several years. The corporatization of the National Electricity Board, scheduled for September 1990 constitutes the first step in this exercise. A total of 69 enterprises are scheduled to be privatized in one to two years and 107 in two to five years.

Sixth, last year, Mr. Enoch made the remark that reserve buildup at the cost of growth should be avoided. Today, Mr. Goos seems to be rather apprehensive about the recent lower levels of reserves. This divergency again shows that the determination of an appropriate level of reserves is indeed a judgmental problem. My authorities' stance is that any reserve level below the current 4.6 months of imports level may have adverse effects on international confidence in the economy and the ringgit, as well as the country's high credit standing in international capital markets.

Seventh, as to the labor market situation, my authorities have made a start in removing some of the rigidities in the labor market by amending the relevant labor legislation. Nevertheless, they recognize that much more needs to be done; in particular, the system of wage determination has to be made flexible. In this regard, a tripartite commission consisting of employers, unions, and the Government has been formed to consider recommendations on wage reform. Meanwhile, in 1989 a number of schemes were established to equip unemployed university graduates with the necessary training in agriculture, business, and specific professions. Through the Ministry of Human Resources, the authorities continued to emphasize the upgrading of skills. During the year, a large number participated in the Ministry's National Apprenticeship Scheme and various courses in trade skills. Recognizing the growing demand for professional, technical, and skilled workers in a rapidly expanding industrial sector, the authorities have put into place a long-term plan for human resource development.

Eighth, the emphasis on industrial promotion is indeed on production for export. I am not aware of any stress being placed on backward linkages or on domestic resource-based industries. During the Article IV consultations, the authorities did express a desire to reduce promotional privileges, but felt constrained from doing so because competitive policies in neighboring countries might divert foreign direct investment away.

In concluding, I would like to convey my authorities' appreciation to the Fund for making technical assistance available to Malaysia over the past years, including more recently, assistance for the preparation of a manual for bank supervision and a study on the feasibility of a futures market.

The Acting Chairman made the following summing up:

Directors commended the authorities for the success of their economic strategy. Sound macroeconomic policies and wide-ranging structural reforms initiated by the authorities had enabled the economy to embark on a vigorous recovery. Strong output growth

continued in 1989-90, with inflation remaining relatively low and the balance of payments recording an overall surplus owing to large inflows of equity capital. Directors noted the vigorous response of the private sector to the favorable environment created by fiscal consolidation and lower direct taxes, deregulation, strengthening of the financial system, and the competitive exchange rate. At the same time, the public sector had played a supportive role through an adequate supply of infrastructure and public services.

Directors were of the view that the authorities' successful stabilization policies and the ongoing investment boom laid a good foundation for continued strong growth in the medium term. However, in the near term, the smooth management of the transition from the current rapid expansion of demand to a more sustainable pace presented an important challenge for economic policies. Directors recognized that the increased inflow of private capital ensured the financing of the external current account deficit, but they expressed concern about the continued surge in domestic demand. Whereas supply-demand imbalances had, so far, been relieved by higher imports, other signs of inflationary pressures were becoming more manifest; the economy, for example, remained highly liquid, capacity utilization rates had increased, segments of the labor market were tight, and demands for higher wages were growing. Therefore, Directors recommended early action to tighten budget and monetary policies, in order to avoid the need for sharper adjustments later that might unduly interfere with the medium-term growth prospects of the economy.

Directors concluded that monetary policy would need to play a key role in moderating the pace of demand growth. They encouraged the authorities to adopt a more restrictive stance and accept some increase in interest rates. It was particularly important to avoid a repetition of the rapid monetary expansion experienced in 1989. Several Directors shared the view that under the present circumstances, a moderate increase in interest rates would not entail substantial offsetting capital movements or a significant upward pressure on the exchange rate. Directors generally agreed, however, that even if pressures did develop for a further appreciation of the exchange rate, monetary tightening to contain inflationary pressures should remain paramount as the best way to preserve Malaysia's favorable external competitiveness and to promote sustained growth over time.

Directors welcomed the significant fiscal consolidation achieved in recent years; however, given pressures in the economy, some saw further progress as being desirable. They supported the key elements of the authorities' fiscal policy aimed at providing an adequate underpinning to sustained private sector growth

through priority spending on infrastructure and human development and reduced direct tax rates. They encouraged the authorities to allow a reduction of the overall deficit by taking advantage of any additional revenue gains from a more buoyant economy and by resisting pressures for additional current expenditures. In this context, there was a note of caution against heavy reliance on the surpluses of the Employees Provident Fund (EPF) as a source of financing for the budget deficit. Some further fiscal consolidation might be needed in both the short run and over the medium term, in line with the Government's goal of giving a greater role to the private sector as the engine of growth. The continued commitment of the authorities to their medium-term tax reform plans, aimed at reducing direct and commodity-based taxation in favor of broader-based consumption taxes, was also welcomed by Directors; some reiterated their view that the adoption of a VAT remained an efficient solution, the early introduction of which could facilitate near-term reductions in the fiscal deficit.

Directors commended the authorities' prudent foreign debt management policy. The emphasis placed on the prepayment of debt and the encouragement of equity capital inflows rather than new borrowing had significantly reduced Malaysia's debt and debt service ratios. Most Directors shared the view that the openness of the economy and the susceptibility of export earnings to external shocks justified a cautious approach to domestic policies and the desirability of continuing to diversify the economy and maintain a strong reserve position.

Directors commented favorably on the gains in investment efficiency brought about in large part by the authorities' structural policy initiatives. An important aspect of the ongoing reform agenda would be to further human resources development. This required a greater responsiveness of the training and education system to the skill requirements of the market, and a lessening of rigidities in the wage system so that wages could respond more flexibly to changes in productivity and profitability. Directors strongly commended the authorities' major initiatives to rehabilitate and privatize nonfinancial public enterprises and to advance financial market reform. Although the nonfinancial public sector was in surplus, some public enterprises in the industrial sector still suffered relatively large losses. It was also suggested that a more limited use of tax incentives would have both efficiency and macroeconomic benefits over time.

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

2. REPORT BY MANAGING DIRECTOR

The Chairman remarked that, in view of recent inaccurate press reports, he wished to comment on his meeting in New York with President-elect Fujimori of Peru. The meeting had been arranged by the Secretary General of the United Nations, a Peruvian citizen, who had wished to facilitate the first contact of his country's new President-elect with the heads of the Inter-American Development Bank, the World Bank, and the Fund. Together with Mr. Iglesias and Mr. Conable, he had attended a luncheon with Peruvian delegation, UNDP representatives, officials of the UN Secretariat, and several economic advisors from the Latin American region--including Mr. Silva Herzog--all of whom would advise the President-elect on the broad design of economic policy. The luncheon had provided an opportunity to inform the President-elect of the expectations of the international financial institutions in regard to cooperation with Peru. Referring to the summing up of the recent Executive Board discussion on Peru (EBM/90/100, 6/22/90), he had discussed the broad outlines of the appropriate approach to relations with the Fund, the key preconditions for the rights approach to become operative, and, in particular, for a strong Fund-monitored program to be put in place.

The similar points conveyed by the other heads of the international financial institutions had come as no surprise to President-elect Fujimori, the Chairman continued. One advisor to the President-elect had pointed out, however, that the economic program needed was different from the one that had been announced. Another advisor, Mr. de Soto--the author of a recent interesting book on the Peruvian informal sector, The Other Path--had made a presentation on Peru's informal economy. In his response, he himself had agreed on the importance of progressively reintegrating such sectors into the formal economy, and had indicated that it was important for the authorities to deregulate their economy, thereby allowing the private sector to make a greater contribution to general development. In responding to the presentations made, the President-elect had strongly emphasized his desire to reintegrate Peru into the international community as soon as possible. As he had explained to the President-elect, that would require work on a program for the period after the inauguration.

In the afternoon, he, along with the Director of the Western Hemisphere Department and another staff representative, had had an opportunity to hold further discussions with the President-elect and to explain further the procedures for collaboration, the Chairman stated. The President-elect had indicated his desire to explore the possibility of starting immediate work on a program, and had been informed that the Fund would need to know as soon as possible the designated Minister of Finance and Central Bank Governor, without whom progress would be slow. While those appointments would be made soon, the President-elect had asked if a small and highly qualified team could begin discussions on July 2, 1990, in Washington, D.C., with a view

to enabling him to know the kinds of measures regarded as necessary for announcement at his inauguration. He was well aware of the magnitude of the economic problems.

At a subsequent press conference, journalists had apparently interpreted the meetings with President-elect Fujimori to have resulted in a broad agreement with the Fund, which was, of course, at variance with the simple agreement reached to hold discussions, the Chairman observed. In any event, if a Fund mission was to visit Peru, he had told the President-elect that it would be important to associate the World Bank and the Inter-American Development Bank with that mission.

After the meeting, the President-elect had traveled to Japan, the Chairman concluded. In that regard, Peru obviously expected to have the backing of the international community for the program that would be adopted, but the President-elect knew well that agreement with the Fund would be an essential precondition for international support; and the country was entirely committed to making every effort to staying current with the Fund and to finding an early solution to the arrears problem.

3. STRUCTURAL ADJUSTMENT FACILITY, ENHANCED STRUCTURAL ADJUSTMENT FACILITY, AND ESAF TRUST - REVIEW AND AMENDMENT; AND POLICY ORIENTATION AND BALANCE OF PAYMENTS ASSISTANCE OF AID AGENCIES

The Executive Directors considered a staff paper reviewing the operations of the structural adjustment facility (SAF) and enhanced structural adjustment facility (ESAF) (EBS/90/106, 6/12/90; and Cor. 1, 6/29/90), together with a staff paper on the attribution of payments for SAF and ESAF Trust loans under an enhanced structural adjustment arrangement (EBS/90/122, 6/29/90), a paper on the policy orientation and balance of payments assistance of bilateral and multilateral aid agencies (SM/89/252, 11/30/89), and an update of the latter paper (SM/90/120, 6/20/90; and Cor. 1, 7/17/90). They also had before them a background paper on the structural adjustment and enhanced structural adjustment facilities (EBS/90/107, 6/14/90).

Mr. Mawakani made the following statement:

> We welcome this review of the operations of the SAF and ESAF, as it gives Directors the opportunity to exchange views on means of improving the effectiveness of those facilities. While, on the whole, we can agree with most of the staff's analysis and recommendations, we have some reservations about some of its proposals.
>
> I note the progress made by most countries using SAF or ESAF resources in regard to growth, especially when compared with some countries without programs under the facilities. It is encouraging to note that the primary goal of programs supported by the SAF and ESAF--the realization of positive per capita growth--is being

achieved. This performance indicates the soundness of the strategy being followed with these programs.

The staff indicates that performance regarding inflation and external positions has been less satisfactory. I would note, in this connection, that higher levels of domestic expenditure and imports are not incompatible with the objective of the programs. The increase in external deficits in the short run should not be a cause for concern. What is important is that progress toward an improved economic and financial environment has been made. Therefore, the mixed results pointed to by the staff should not be given undue weight.

I note also that the staff has made repeated comparisons between performance under the SAF and the ESAF. Such comparisons are not warranted, since these two facilities complement each other. As mentioned by the staff, nearly all countries that have undertaken programs under enhanced structural adjustment arrangements have had previous experience under stand-by and/or structural adjustment arrangements. In fact, for many of these countries, the arrangements under the SAF were the preparation for those under the ESAF. Under these circumstances, performance under the latter is bound to involve a better record of policy implementation. For example, many of the studies needed prior to the introduction of far-reaching structural measures were carried out under programs supported by the SAF, and experience was built from the implementation of such programs. I therefore do not agree with many of the implied criticisms that the staff has made about programs supported by the SAF.

With regard to structural measures, and while noting the staff's conclusion that progress in structural policy areas has been slower than expected, I welcome the understanding shown that, in many cases, coverage may have been too broad and the efforts and time needed to undertake these measures may have been underestimated by the staffs of the Fund and the World Bank. This recognition indicates that the level of technical expertise required to deal with some structural adjustment issues may be inadequate in the Fund, and that more time for preparation might be needed. It is also an indication of the need for a more realistic timeframe and sequencing of reform measures.

Another issue that appears to have hampered structural reforms is the shortfall in external financing. The introduction of many important reforms depends on the timely availability of financing; otherwise, the introduction of these measures can have an adverse social impact--in contradiction to an important program objective, of mitigating the adverse impact of adjustment on the poorer segments of populations as much as possible. External

financing gives authorities the needed public support to introduce unpopular measures. It is therefore most worrisome that, in two thirds of the programs under review, official external financing has fallen short of the amount assumed and has resulted, in many cases, in program implementation being adversely affected and program objectives not being achieved. Therefore, I agree with the staff on the need to improve the information base and to develop a closer relationship with the staff of the World Bank--since the main reason, in half of the cases of financing shortfalls, was delay in disbursements from the Bank. On the whole, while welcoming the section on external financing in the staff paper, I do not think that it has stressed enough the impact of shortfalls in external financing as well as that of adverse terms of trade on the adjustment efforts of countries making use of SAF and ESAF resources and the means by which these effects could be attenuated so as to better protect the programs. Experience indicates that more efforts need to be made to coordinate the official foreign assistance of the Fund, Bank, and donors to ensure timely disbursement of committed resources.

In regard to program design, I have no major disagreements with the staff on the role that fiscal adjustment and appropriate macroeconomic policies can play in promoting savings. I can agree with the suggestions to improve the formulation of fiscal policy, and to strengthen technical assistance in the fiscal area. I would, however, stress the need for a better understanding by the staff of the sensitivity of certain measures, and of their political and social consequences. In general, caution and judgment must be exercised in deciding on the pace of fiscal adjustment so as not to cause a contraction of the economy, which would lead to lower growth and savings, thereby leading to the opposite of what was envisaged.

Concerning exchange rate policy, where devaluation has been one of the instruments of adjustment, the results seem to have been mixed. The dependence of almost all of the countries involved on the export of a few primary commodities and on the import of almost all of their basic needs--in addition to their limited resource base and their external debt burdens--accentuates the negative impact of a devaluation on their output, inflation, and balance of payments performances in the short to medium terms. Only when the exchange rate is considerably out of line has exchange rate adjustment exerted a positive impact on output. Generally, a stable exchange rate, accompanied by the proper supporting financial and pricing policies, will probably contribute more to output growth and help to attain the other objectives of the program than devaluation will. It is difficult to achieve export growth and diversification through price competitiveness only. As my chair has pointed out on several occasions, the

problem is not only a matter of pricing but also of barriers to exports from developing countries, finding market outlets, and developing export marketing capability. More attention needs to be paid to these factors in addressing exchange rate issues in the policy framework papers.

On program implementation and monitoring, I fully share the staff's views on the need to obtain domestic consensus for the implementation of the more difficult structural measures. In many cases, the difficulties in attaining some of the benchmarks set were related to the fact that consensus had not been achieved, encouraging opposition to the measures and slowing down the adjustment process. To avoid such delays, closer cooperation between the staff and the authorities on developing policy measures in a more realistic manner seems essential. The preparation of a detailed plan of action and greater quantification in the analysis of structural areas, as mentioned by the staff, should be considered before the measures are included as benchmarks. The sequencing of the measures should also be looked at carefully.

I agree that the policy framework papers should remain a document of the authorities. It should be up to the authorities, with the technical assistance of the Fund and the World Bank, to set realistic objectives and to design the measures to achieve them. Once this is done, and the additional technical assistance and the financial requirements needed are clearly spelled out, a wider distribution of the policy framework papers to the donor community may be envisaged. However, greater donor involvement in the preparation of the policy framework papers is not practicable.

On operational issues, while the adjustment process may not have been as fast under the SAF as the staff would have preferred, important progress in economic performance has been achieved by those countries that have chosen to make use of this facility. It has especially allowed authorities to lay the necessary foundation on which to build. Rigidities and bottlenecks have been identified, and the measures to tackle these problems have been formulated. In many cases, progress has also been made toward removing the rigidities, and the basis is being laid for stronger measures under the ESAF. Delays in adopting corrective measures were often due to an underestimation of the efforts needed, inadequate financial resources, and delays in foreign disbursements, as mentioned above. These are important factors that should not be underestimated. I doubt very much that a strengthening of monitoring techniques along the lines suggested by the staff would be appropriate; the staff has not made a good case for introducing formal reviews to monitor progress under the SAF. Formal reviews do not guarantee that delays encountered in the implementation of a program supported by the SAF will not occur. Moreover, the paper is

not clear about the consequences that these reviews will have on the phasing of SAF resources. Consultation clauses, along with the various improvements described in the paper, should be sufficient to improve monitoring of programs supported by the SAF. As presently designed, the SAF is achieving the goals set, and it should be maintained in its current form. I do not see the necessity for formal midterm reviews. In cases where key structural measures have been missed, the reasons must be analyzed carefully, and appropriate modifications made, before the measures are reintroduced as prior actions in advance of the next annual arrangement.

With regard to access under the ESAF, I view with concern the staff's suggestion to reduce access to some categories of countries, even those with strong policy programs. The staff seems to be becoming overly cautious and to be making repayments to the Fund its primary objective. Ensuring repayment is important, but this objective can be better achieved by designing programs that fit the specific conditions of the countries, and ensuring that they receive timely and adequate resources to develop their economies. Reduced access or back-loading, as the staff is suggesting, can only reduce the incentives to these countries to take the additional and painful measures necessary--especially when the gains will be apparent only in the medium to long terms. As was mentioned during the past review of the two facilities (EBM/89/40, 3/29/89), many countries hesitate to undertake programs supported by the ESAF mainly because the level of access is not commensurate with the efforts required, and the catalytic effect of a Fund program has generally been below expectations. Moreover, many eligible countries feel that the level of conditionality, with its emphasis on a strong track record and prior actions, is excessive. A much greater level of access is the best incentive to get countries into programs and to take the strong measures necessary. This, in itself, will ensure that the objectives will be met and that the countries will repay their loans, particularly as initial success has a tendency to feed on itself and lead a country to higher rates of growth and an improved balance of payments position. In this context, the staff's suggestions to extend ESAF arrangements by one year, to a fourth year, is in the right direction, and I can support it. However, I would add that this extension should be accompanied by an augmentation of access.

On eligibility, I believe that all IDA-eligible members should have access to SAF/ESAF resources, and that the list should be kept under review, taking into consideration the availability of resources.

Regarding the possibility of introducing contingency provisions under the ESAF, I can support the proposal along the lines suggested by the staff.

I support the proposal for two-year extension of the cutoff date for use of ESAF resources, as well as the current policy with regard to phasing of disbursements and the rate of interest of such arrangements. I support the proposed decisions.

Extending his remarks, Mr. Mawakani said that he wished to comment as well on the staff paper on the policy orientation and balance of payments assistance of aid agencies. Regarding, first, the role of the Fund in aid decisions, the staff had indicated that most of the agencies that usually concentrated on lending for sectoral and social objectives did not wish to be involved directly in macroeconomic conditionality. His chair considered that position to be consistent with the concept of aid in general, in both the aid agencies and the recipient countries. Nonetheless, he agreed that a macroeconomic and structural framework, put in place with Fund and World Bank support, could better attract aid flows. Concerning the question of transmittal of the Fund's assessment of macroeconomic policies to multilateral agencies--such as the African and Asian Development Banks, and the European Communities (EC), his authorities did not see any major difficulty in providing those institutions formally with all of the relevant Fund papers, if appropriate safeguards were in place.

With respect to the linkage between policy performance and aid availability, while his chair shared the view that an appropriate economic environment in recipient countries could facilitate the disbursement of aid flows, it could not favor any linkage between policy performance and the availability of aid, because it did not agree that continued aid availability would prolong inappropriate policies in the recipient countries, Mr. Mawakani continued. Moreover, such linkage raised the issue of cross conditionality. Most countries recognized the importance of aid provided by the international community; they were well aware that international aid could not substitute for their own adjustment efforts; and they had demonstrated over the past years their commitment to the adjustment process.

Protecting adjustment programs against shortfalls in aid disbursement was an important matter that merited full consideration, Mr. Mawakani stated. But, the problem seemed to be complex; and as far as financing assurances were concerned, the staff was certainly correct in noting that "it would not be fruitful to try to formalize the current ad hoc practices for seeking financing assurances about aid availability as is the case for financing assurances from commercial banks." The question remained, nonetheless, of how to protect Fund-supported programs from aid shortfalls. The staff had suggested two approaches, namely, providing a "cushion" in the form of more ambitious programmed increases in international reserves, and reaching understanding at the outset on ways in which certain categories of

expenditure would be adjusted in the event aid flows differed from those programmed. Those two approaches, in his chair's view, did not constitute a satisfactory solution to the problem. In particular, the second alternative was far from realistic given that, in many cases, further reductions in expenditure--where it had already reached very low levels--could not be made without discouraging or disrupting adjustment efforts. The real solution would be to secure in a timely manner the financing committed by donors in support of members' adjustment efforts.

He had no difficulties with the staff's suggestions for strengthening its relationship with aid agencies, Mr. Mawakani said. In particular, there was merit to the suggestion that Fund resident representatives, where they existed, should assist the authorities and the Bank staff by developing informal working relationships with local donor representatives. There was also merit to the suggestion of strengthening the effectiveness of the two staffs through better coordination.

He had already touched on the question of strengthening the policy framework paper process in his statement, Mr. Mawakani remarked, although he would note that it had always been the position of his chair that coordination in policy advice between the Fund and the Bank was the best means of facilitating sound implementation of programs by member countries. The policy framework paper could be strengthened by giving clear priority to structural policy measures, as well as a realistic timetable for implementation.

Mr. Finaish made the following statement:

> I will address the issues relating to the review of the two facilities, and the balance of payments assistance of bilateral and multilateral aid agencies in that order.
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> The strong emphasis that the staff attaches to the need to achieve a meaningful improvement in national savings performance is, of course, well placed and justified. Although the extent to which various policy instruments may be utilized for that purpose will vary, depending on the circumstances of the cases involved, fiscal adjustment can be expected to continue to be the centerpiece of the effort to strengthen domestic resource mobilization in the vast majority of cases. And in this regard, I agree that it would be helpful to pay greater attention at an early stage to a clearer definition of fiscal measures, but would stress that a thorough assessment also be undertaken at an early stage on the technical and political difficulties that may be encountered in implementation. Indeed, with the opening up of the political processes in many countries eligible to use the resources of the SAF, one would also expect the "legislative lag" issue to increasingly become a more integral element of such an assessment.

It is generally agreed that appropriate exchange rate and interest rate policies can be instrumental in mobilizing national savings. However, with regard to the former, the staff's conclusion that a sharper focus needs to be placed at an early stage on moving rapidly toward a realistic exchange rate should be tempered by the caveats mentioned on pages 13-14 of the main paper. Quite apart from the difficulties inherent to coming to a judgment on what a realistic exchange rate is--and, partly in consequence, the protracted delays in negotiations often experienced in coming to an agreement on the initial rate--the weakness in the financial environment in the period leading to a program increases the risk of a depreciation/inflation spiral, resulting from excessive exchange rate depreciation. Of course, where available as an instrument, exchange rate policy should also be conducted in a manner that is consistent with the need to strengthen and diversify the export base. But, there would not--to say the least--seem to be much point in insisting on substantial exchange rate policy action to achieve that objective before ensuring that the more serious structural impediments to export diversification are being, or will be, removed. At least to some extent, the same caveats I referred to apply with regard to the role of interest rate policy in mobilizing national savings. Here again, while there is no disagreement that attainment of positive and competitive real rates should be an important objective of policy, the primary focus should, in many cases, be on the development and institutional reform of the financial sector.

I agree that a good deal of selectivity should be exercised in identifying priority areas for structural reform, with the primary focus being placed on those areas with direct bearing on the effectiveness of macroeconomic policies. Of course, a comprehensive approach to reform recommends itself on the grounds of the interlinkages involved, but adopting such an approach risks excessively straining the technical and administrative capacity to implement and monitor reforms, which is limited in many cases. I would, of course, agree on the need to strengthen the Fund's technical assistance in the implementation and monitoring of structural reforms, as well as on the need to strengthen, and achieve a better coordination in, the provision of technical assistance in the context of the policy framework paper process.

The limited technical and administrative capacity to implement structural reforms and the broad coverage of policies were not the only factors underlying the slower than expected progress in structural policy areas, and the staff has been candid in pointing to design flaws as also having been a culprit. This obviously is not unrelated to the relatively limited experience that the Fund has had to date in the area of structural reform policies, the not-so-clear or precise theoretical underpinnings of

structural reforms, and the difficulties involved in conducting with reasonable accuracy quantitative assessments of the effects of policies, or of the interlinkages and feedbacks involved. It is hoped that difficulties relating to this factor will be alleviated as more experience is gained with structural reform policies, a more focused approach to reform is adopted, and a more thorough preparation is undertaken. But the staff also points to a rigidity in the way that work is done in Fund departments. I would appreciate some elaboration on the rigidities involved and on what is being done to deal with them.

With respect to operational issues, I agree that the continued operation of the SAF in parallel with the ESAF has served, and continues to serve, the useful purpose of making possible the provision of Fund financial support across a wide range of circumstances. Thus, I support the continued operation of the SAF. With the pace of approval of structural adjustment arrangements continuing to decline--down to 3 arrangements in 1989, from 7 in 1988, and 13 in 1987--it would seem increasingly less relevant to argue that the availability of Fund support under the SAF may have discouraged timely adoption of ambitious programs under the ESAF. I, of course, take comfort in noting the apparent lack of difference between the SAF and ESAF in mobilizing other sources of financing. There probably will continue to be cases where--owing either to a lack of adequate experience in implementing adjustment and reform programs, or to a relatively limited capacity to observe the higher standards of implementation and monitoring expected under the ESAF--countries would prefer to make a meaningful start in tackling their economic difficulties in the context of a program under the SAF than under the ESAF. It is of paramount importance that the efforts of those countries continue to be supported by the international community. Having said this, it is to be recognized that experience would seem to suggest that there is some scope for strengthening the monitoring process under structural adjustment arrangements. In this regard, one finds merit in the proposal to hold midterm consultations in the context of structural adjustment arrangements along the lines suggested by the staff.

The proposed tightening of the guidelines on access to provide for "pitching" access on the low side for those cases with weak prospects of achieving balance of payments viability--even with a strong program--would result in scaling down assistance to members who need it the most. The likelihood of achieving external viability cannot and should not be viewed independently of what the Fund does, or of the scope of its financial involvement. As to the proposed tightening of the guidelines in cases of weak administrative capacity and policy records, it is to be emphasized that a weak policy record should not be taken as establishing in

itself the case for back-loading, as such a record can sometimes be the outcome of adverse exogenous factors, including financing shortfalls, which in turn complicate policy implementation. Thus, I would not support taking a weak policy record as necessarily evidencing a prima facia case for back-loading--much less for reducing--access.

For the reasons mentioned by the staff, I support extending the ESAF cutoff date to end-November 1992. It is, of course, likely that a further extension will be needed in order to accommodate potential drawings by members currently in arrears in the context of the rights approach. I stand ready to support such an extension.

I note that the utilization of ESAF resources has continued to be disappointingly slow. It is hoped that the pace of utilization will quicken in the period ahead, and, in this regard, I agree with the staff that efforts should be made to facilitate speedy conclusions of arrangements. This should be achievable without compromising program standards through, as noted by the staff, a more intensive policy dialogue and more timely provision of technical assistance.

Even though the pace of utilization of ESAF resources has continued to be slow to date, I continue to feel that the target of SDR 6 billion for the ESAF Trust remains appropriate. I also support continued lending of ESAF resources at an interest rate of 0.5 percent, as well as the proposal to modify SAF regulations to allow disbursements of Special Disbursement Account (SDA) resources under enhanced structural adjustment arrangements beyond the initial three-year commitment period of structural adjustment arrangements.

In principle, I agree that there is need for extending, in some cases, enhanced structural adjustment arrangements by one year. However, there would not seem to be a compelling reason for Directors to come to a conclusion on this matter at this stage. I would thus rather take another look at it, perhaps some time in early 1991--when a better view emerges of, among other things, how much of the resources will be called upon in connection with the rights approach--in the broader context of resource availability, developments in the pace of utilization, and a possible expansion of the eligibility list. In this latter regard, I agree that expanding the eligibility list to include all members that are IDA-eligible at this stage could strain the resources, given the prevailing average access and the size of the combined quota of those IDA-eligible members that are not currently on the eligibility list. However, the slower than expected pace of utilization to date and the considerable uncertainty that attaches to current

projections on utilization argue for an early consideration of the eligibility issue. That consideration could benefit from an examination by the staff of the methodology used for measuring per capita income. It may be recalled that I have made a suggestion to that effect during the Board's most recent discussion on the work program (EBM/90/84, 5/30/90).

I support the provision of contingency financing in association with programs supported by the ESAF, by augmenting access both through the annual review of access and in the context of midterm reviews, as outlined by the staff. However, one should caution that adopting too mechanical or formalistic an approach to the provision of such financing, of the kind followed under the compensatory and contingency financing facility (CCFF), could lead to either undue delays in concluding arrangements, a weak interest in incorporating contingency financing in arrangements, or both. One final thought on this subject. I would hope that the omission of a reference--which in fact appears in the body of the main paper--from the section containing the conclusions, to the possible use of favorable developments for an appropriate increase in imports, is unintentional.

Regarding the balance of payments assistance of aid agencies, particularly the proposal put forward in the updated staff paper--containing staff proposals for expanding access to country specific staff reports by certain multilateral agencies--I can go along with the proposal, provided that appropriate safeguards are in place, and subject to the concurrence of the Executive Director concerned. It should facilitate the coordination process and help ensure consistency in policy advice to the benefit of the countries concerned.

On the linkage between policy performance and aid availability, it would seem to me that the best way to help recipient countries adopt and sustain appropriate economic policies is to gear assistance more directly and immediately to an improvement in the policy environment, including, for example, a closer synchronization of disbursements to policy developments in recipient countries. The best signal that donors could send to countries contemplating major economic reforms is that their efforts will be supported promptly and with the right form and amount of assistance. I recognize that the capacity of donors to respond with quick-disbursing assistance in association with adjustment programs is circumscribed by the inherent complexities of aid operations. Yet, the greater the flexibility for increasing aid commitments in the face of improved policy performance through more flexible forms of assistance and streamlined procedures, the greater would be the encouragement to recipient countries to adopt and sustain good programs.

I have noted the cautionary note sounded on page 19 of the staff paper, which discusses possible donor response to a weakening of policy performance. I agree that disrupting aid disbursements when policy performance is less than satisfactory could be counterproductive, and therefore would need to be approached with appropriate deliberateness. Experience shows that the reasons for shortfalls in policy performance are much too varied and complex--ranging from design flaws to complex administrative requirements on the part of donors--to lend themselves to straightforward, causal analysis. Moreover, one should be careful not to create a situation where the curtailment of aid would make it difficult for the country to meet its priority obligations, including to the Fund.

On improving the predictability of balance of payments assistance, the high incidence of aid shortfalls in the cases reviewed clearly indicates that protecting adjustment programs against recurrent shortfalls in aid disbursements remains a major challenge confronting all parties. Clearly, this is an issue that is still very much with the Fund and one that commands Directors' most careful consideration, given the significant negative impact that aid shortfalls have had on program implementation and, more importantly, on the political commitment to, and public support for, the adjustment effort.

There are several things that can be done in this regard, and the staff paper puts forward a number of useful suggestions. Evidently, there is scope for better and more effective channels of communication and information on the amounts, forms, and expected timing of disbursements, as well as a better understanding of donors' administrative procedures and restrictions. Technical assistance can play a very useful role here in helping countries cope with and understand aid procedures. Furthermore, good communication with the donors during program formulation needs to be followed up by close and effective monitoring of flows deriving from donor commitments, so as to be alert to incipient deviations from program assumptions. Donor agencies could also do a great deal more to improve the predictability of disbursements by streamlining their procedures and offering more flexible forms of assistance, which are less subject to complex administrative requirements. In this regard, the fact that some donor agencies expect to be in a position to provide more flexible forms of noncountry-specific assistance with more transparent procedures is a welcome development.

On the related issue of means of protecting Fund-supported programs from aid shortfalls, I agree that there should be clear understandings at the beginning of programs on the manner in which certain expenditure categories would be adjusted in the event aid

flows were below program expectations. I would also suggest that there should be clear understandings on, and better specification of, how and which policy actions may need to be modified, giving due consideration to the administrative capacity of the country to adapt policies to evolving circumstances. Due consideration also needs to be given to the need to avoid protracted delays in program negotiations. Moreover, given the preponderance of cases experiencing aid shortfalls, and the latter's effects, perhaps all, instead of most, programs should incorporate automatic adjustment clauses in benchmarks allowing for policies and/or targets to be adjusted in the light of actual availability of external assistance. Finally, where the vulnerability to aid shortfalls is particularly high, it might be useful to discuss this more explicitly in quantitative terms by presenting alternative financing scenarios.

Regarding the question of staff contacts with aid agencies, I agree that efforts should be made to develop effective local donor coordination mechanisms; strengthen existing practices of informal contacts in the capitals of bilateral donors and in Washington, D.C., as well as in the field; and improve communication with the staffs of the regional development banks and the EC--subject always to the approval of the authorities involved and subject to their being fully informed of the discussions that have taken place. We must never lose sight of the fact that, ultimately, the recipient country has principal responsibility for managing and coordinating all aid flows.

Finally, on the strengthening of the policy framework paper process, I believe that the policy framework paper should be enhanced by, first and most importantly, strengthening the authorities' involvement in the process. While some progress has been made in this regard, I believe more needs to be done. More extensive use of the policy framework paper in domestic policy discussions, and wider circulation to donors, would also be beneficial and help secure the fullest commitment of the authorities to the reform process. The content of the policy framework paper can be strengthened by clearer indications of priority structural measures and specific information on the types of financial assistance needed and the envisaged uses, including the need for technical assistance to enhance administrative capacities. There would also appear to be scope for a stronger emphasis on, and a more careful targeting of, social measures. This would call for closer informal involvement of bilateral and multilateral donors at an early stage of the policy framework paper process, so that their expertise in sectoral and social issues, and available financial and technical assistance, can be maximized in the design of specific measures to help address the adverse social impact of adjustment.

Mr. Kyriazidis made the following statement:

I commend the staff for its informative and realistic papers on the SAF and ESAF. My chair is in general agreement with the staff's conclusions and recommendations.

As indicated in the main staff paper, the results have been mixed, particularly with regard to programs supported by the SAF, while with regard to programs supported by the ESAF, no clear conclusions and judgments can be arrived at in view of the limited experience so far. Although I agree that use of the SAF is still appropriate in some cases in which the adjustment process has only just begun, or is just about to begin, I am disturbed by the apparent Gresham's Law effect the facility seems to be having on progress under the ESAF. I therefore wish to endorse strongly the staff's recommendations that, in the few cases in which programs supported by the SAF as a preparation for an ESAF arrangement are still to be considered appropriate, monitoring should be improved and strengthened. In this connection, midterm consultations, as suggested by the staff, would be particularly useful. Furthermore, to bring programs back on track, it is also appropriate that prior actions be required before the continuance of the second or third year annual arrangements under the SAF. I also agree with the staff's recommendations regarding access to the ESAF, where the record of policy implementation has been weak under the SAF. Moreover, in this connection, it is particularly important that, as we agreed in the past review, programs should include as prior actions those measures that were not implemented as expected under the previous structural adjustment arrangement before an enhanced structural adjustment arrangement can be entered into.

As far as program implementation is concerned, it is important to note that the experience accumulated so far demonstrates the importance of adequate technical preparation for successful pursuit of internal adjustment. Therefore, a particular effort should be made with appropriate assistance from the Fund, so that the technical and administrative prerequisites for implementation are in place when the program starts. On the other hand, greater attention should be paid to the timeframe for implementation of internal measures and to monitoring in a timely fashion the development of the economic situation. In this respect, I believe that it would be particularly useful to design the financial benchmarks with the purpose of detecting policy slippages as soon as they occur.

One other point that is of some concern to my chair is the precise meaning of the term "progress toward external viability," particularly as regards those cases in which exceptional financial assistance will continue to be needed after the three-year period of enhanced structural adjustment arrangements. In these cases, of course, the catalytic role of the Fund is crucial. I therefore believe that the program should include an explicit discussion of the progress expected toward balance of payments viability, given the growth targets set in each case, as well as of the time horizon within which these targets are to be achieved.

With regard to program design, I agree with the staff's recommendation as to the priority that should be given to measures aiming at enhancing domestic resource mobilization, with particular attention to the fiscal sector and to exchange rate and trade policies. The design of programs should, of course, always be subject to the proviso that the number of structural policies that are targeted should be kept to the number essential for the clear focusing of the program, and take account of the administrative capacity of the country concerned and the need to allocate the limited Fund technical assistance resources in the most productive manner.

Concerning the more specific points proposed by the staff, I agree to the extension of the cutoff period for two years, namely, until November 30, 1992. I also agree that the interest rate on ESAF financing should remain at 0.5 percent, subject to continuing review. With regard to ESAF arrangements containing contingency provisions and possible fourth annual arrangements, current policies concerning access limits and phasing of disbursements should continue unchanged, with the two exceptions proposed by the staff as far as phasing is concerned.

I do not believe at this stage that the list of eligible countries for ESAF assistance should be changed. The question, however, should be kept under continuing review in the light of resource availability and rate of utilization of the facility.

The policy framework paper process should continue to be enhanced, as suggested by the staff, and strengthened to minimize financing shortfalls. Very close working relations between the Fund and the Bank staff and the major donors should be actively pursued in this connection. Close and informal involvement of bilateral donors at an early stage of the policy framework paper process is highly desirable. In this context, the arrangements proposed by the staff in SM/90/120 can be very helpful. It is highly desirable, even so, that the supply of information be organized on a reciprocal basis.

Finally, I could agree with the proposed draft decision in EBS/90/122 concerning the attribution of payments under SAF and ESAF Trust loans, although I would have preferred a solution--if it were legally possible--that would also cover the attribution of payments in cases where a member had obligations both under the SAF and ESAF, but contracted independently and outside the rights approach.

Mr. Iqbal made the following statement:

There has been some progress in achieving the broad objectives of the SAF and ESAF. However, the overall results remain mixed. While the growth objective appears to have been better met than was the case at the previous review of the facilities in March 1989, uncertainties remain with respect to other macroeconomic indicators. For example, of the ten countries reviewed in the staff's background paper, only three showed a positive correlation between an improvement in the fiscal balance and private sector savings. In other words, the better fiscal performance was probably revenue generated, and might have substituted for the private sector savings effort. This may imply that progress toward correcting structural rigidities in the public sector was not associated with a strengthening of the autonomous growth potential in the private sector. Moreover, the savings/investment gap for almost half of the countries with structural adjustment or enhanced structural adjustment arrangements has increased during the program period. Progress in external adjustment has been slow, and inflation has exceeded targets in most of the recipient countries. Moreover, it is not clear whether decisive progress has been made toward alleviating poverty.

Even though the results so far appear to be modest, they in no way lessen the important role that the SAF and ESAF have played, and continue to play, in the process of facilitating structural adjustment in developing countries. However, the Fund needs to take stock of the developments so far, and build upon the few lessons that have been learned. These lessons include the following points.

The same countries performed somewhat better under enhanced structural adjustment arrangements than under structural adjustment ones, largely because of Fund monitoring and probably also because more financing was available. However, despite the greater appropriateness of the ESAF to eligible countries, this facility was used much less than the SAF. The slower pace of commitments under the former had as much to do with its stricter

conditionality relative to the SAF as with the limited institutional capacity of eligible countries to implement simultaneously a wide array of structural changes.

A second lesson is that domestic resource mobilization was more effective where financial sectors were more efficient, and where the improvements in fiscal balances were associated with expenditure rationalization rather than simply with greater revenue efforts.

Furthermore, there was little evidence that countries that did not have recourse to exchange rate action, but followed strict financial policies, fared worse than those that used exchange rate policy actively to improve competitiveness and diversify exports. However, it was necessary to have an appropriate level of the exchange rate for financial policies to be effective. At the same time, failure to pursue effective financial policies led to a self-reinforcing cycle of depreciations and domestic inflation.

There have been difficulties in designing precise structural reforms. In part, these can be attributed to an inadequate availability of the required skills in the Fund. Attempts at being all-encompassing--which reflect the Fund's lack of experience in these matters--along with the time constraints, also contributed to these difficulties. In addition, administrative constraints in the member countries militated against the implementation of even properly designed reforms. Structural distortions were found to be much more deep-rooted than believed at first, and the pace of adjustment could not be forced.

A further and important lesson was that the catalytic effect of SAF and ESAF financing could not be depended on to generate a substantial amount of other external financing, which might be necessary to sustain investment and liberalize import regimes.

In view of these lessons, we need to strengthen the role and content of the process with the two facilities. I broadly agree with a number of proposals set forth by the staff for improving program design and policy content. In particular, it is essential that the programs supported by the SAF and ESAF should focus on strengthening the macroeconomic environment, instead of attempting to address a large number of disparate structural distortions, for which the Fund has neither the expertise nor the capacity. Hence, there is the need for prioritization aimed at strengthening the macroeconomic framework. This will, of course, call for additional Fund technical assistance; staffing constraints should be eased to handle additional work, perhaps through a restructuring of the available human resources in the Fund.

Regarding the policy content of programs, I endorse the need for an early correction of the exchange rate, if necessary, to restore competitiveness, but I would be against using exchange rate policy as a substitute for weak financial policies or to compensate for domestic inflation through frequent rate adjustments. Greater attention should be paid to financial sector reforms and strengthening budget and public sector controls. Stronger political commitment on the part of recipients is obviously essential.

I agree with the staff that, irrespective of whether SAF or ESAF resources are used, Fund monitoring will need to be strengthened. I have sympathy for the staff's position that reliance on the SAF should be reduced and that the ESAF should be viewed as the primary mechanism for structural adjustment. Since the purposes of the two facilities are identical, I wonder whether it would not be preferable to move progressively toward an eventual merging of the facilities on terms similar to those of the ESAF, without reducing aggregate access limits. However, this may not be feasible under current circumstances. In the meantime, I can go along with the proposal to extend the period for new enhanced structural adjustment arrangements within the existing ESAF Trust resources. I am also in favor of determining individual country access on the basis of the strength of the program; but this should be determined in light of the existing guidelines.

I can endorse the staff proposal for protecting programs supported by the ESAF against external exogenous shocks, through a contingency arrangement similar to that under the CCFF. It is to be understood that this approach would be applied symmetrically. Therefore, would it not seem advisable to amend paragraph II(d) of the draft decision on page 38 of EBS/90/106 (6/12/90) to reflect back-loading of phasing, in case exogenous factors turned out to be better than anticipated? I am also somewhat intrigued by the coverage on page 33 of the paper of the key components of the current account for this purpose. I expect that the coverage will extend beyond simply some key merchandise exports.

As for the catalytic effect of the SAF and ESAF, it is difficult to see a dramatic change in the attitudes of aid agencies and bilateral donors, even with a wider provision of information. While a wider circulation of the policy framework paper may help somewhat, programs under the two facilities should be looked at in their own stead, rather than in the context of their catalytic effects. The risk of having underfinanced programs can perhaps be handled through a greater degree of flexibility, better forecasting, conservative aid estimates in determining resource gaps, and a stronger commitment on the part of recipients to undertake additional measures, if assistance falls short of expectations.

With respect to the role of other multilateral lending agencies, there is merit in fostering closer collaboration with these agencies, which would facilitate effective adjustment and financing. I am broadly in favor of the staff proposals to encourage a better linkage between policy performance and aid availability, so that complementarity between Fund financing and aid can be enhanced without affecting the independence of donors.

I have only a few comments concerning other matters raised by the staff. First, it would be unrealistic to achieve the full matching of financing assurances from donors and the requirements of Fund programs. Nevertheless, as suggested by Mr. Finaish, efforts should continue to be made to improve such matching.

Fund-Bank collaboration through the policy framework paper process has been sufficiently flexible, and can be improved to meet more complex challenges. Greater participation of authorities in this process would be highly beneficial. However, I am not sure if the policy framework paper process can be usefully expanded to incorporate other multilateral agencies; the existing mechanism of contacts in the field with other donor agencies has been successful and should be continued.

I am in favor of expanding the exchange of information, with adequate safeguards, to protect the confidentiality of Fund documents and member countries' sensitivities. The proposed changes in the criteria for the access of other international agencies to Fund documents, as contained in SM/90/120, are generally appropriate, and I can support the modification of procedures to implement these criteria.

Regarding the attribution of payments under SAF and ESAF Trust loans, I can go along with the proposed decision contained in EBS/90/122.

Mr. Yoshikuni made the following statement:

After four years of operations with the SAF, and two years with the ESAF, the current review comes at a critical and most opportune time. The Board has identified and discussed various issues associated with the operations of these two facilities through actual country cases in the past year, and it is a good time to consolidate the Fund's experience in order to enhance the effectiveness and efficiency of the two facilities.

Indeed, there is widespread recognition that the two facilities are the most relevant vehicles for providing the Fund's financial assistance to low-income countries undertaking necessary

structural adjustment for sustainable growth and external viability. While programs supported by the SAF often buttress initial adjustment steps, a country should, ideally, consolidate its adjustment efforts by proceeding to programs supported by the ESAF, to restore their viability after the three-year program.

Japan has strongly supported the objectives of the two facilities. In particular, its active cooperation with the Fund in financing the ESAF, through both grants and loans, is based on its conviction that the high access under that facility encourages low-income countries to initiate and sustain far-reaching structural adjustment.

This being said, we are concerned about the mixed experience in the past year of programs supported by the SAF and ESAF. As the staff report elaborates, policy implementation is generally weak under the SAF; also, it is disappointing that no new country programs have been approved under the ESAF in the past 12 months, except for one country, whose request was approved on June 1, 1990 (EBM/90/86). I hasten to add, however, that the latter case does not appear qualified for support under the ESAF, as I clearly indicated at the time. We are also concerned that some of the other programs supported by that facility are, or have become, critically weak in their financing and repayment capacities, raising questions about the Fund's further support. Thus, at the current discussion, I wish to raise a fundamental question about how to facilitate low-income countries' adoption of programs supported by the ESAF, which can effectively address their deep-seated or structural balance of payments difficulties, within the limits of available resources.

In regard to program design in particular, concern was expressed at the previous year's review about the low growth targets of programs supported by the ESAF, notwithstanding the general objectives of the facility. In my view, however, there is a definite time lag between the implementation of key structural adjustments under that facility, and the time their effects can actually be felt. I attach great importance to creating firm momentum for sustainable and adequate growth over the medium term as a program objective, and I am concerned that the pursuit of immediate growth targets--possibly by adopting overly ambitious investment programs--may cause delays in financial adjustment and the achievement of external viability. Indeed, a program under the ESAF is a one-time opportunity for low-income countries to address their protracted balance of payments problems; and every effort, including sufficient prior actions and adequate technical assistance, should be made to this end.

Fiscal policy, as the staff stresses, remains at the heart of financial adjustment. Under programs supported by the SAF and ESAF, major structural reforms are needed in many cases to enhance public savings, including via tax reform aimed at broadening the tax base, budget consolidation aimed at curtailing expenditures, and civil service reforms. In view of the limited program periods, major reforms should be introduced at the early stage of the programs, and technical assistance should also be emphasized at this stage. As Mr. Finaish rightly notes, early assessment of possible difficulties should be made to protect the reform from critical delays later on.

External adjustment is often an essential element of Fund-supported programs. High access under the ESAF will provide the best opportunity for implementing actions such as trade and exchange liberalization, and, in some cases, exchange rate adjustment. That being said, it is vital that exchange rate adjustment be underpinned by strong and tight financial, and pricing, policies. Yet, in cases where institutional arrangements prevent exchange rate action, increasing pressure falls on export promotion; however, the outcome in that area has been relatively mixed, as elaborated in the background paper, thus raising a question about the comprehensiveness of adjustment in the limited program period. This matter should be fully discussed in the upcoming staff paper on the CFA franc zone.

Regarding program implementation and monitoring, I agree with the staff that Fund arrangements under the SAF and ESAF should continue to concentrate on relevant structural adjustments that are primarily aimed at enhancing macroeconomic adjustments. In reality, however, the mixed performance of financial adjustment under the two facilities often reflects the slowness of structural adjustment, as well as unforeseen exogenous shocks. I can endorse the staff's recommendation to quantify structural adjustment targets to secure progress in structural adjustment. At the same time, however, the staff should establish performance criteria and structural benchmarks in a coordinated manner, in order to prevent the achievement of structural targets--such as the financial target of a key public enterprise--from being a mere transfer of deficits within the public sector as a whole. I would also stress the importance of setting relevant prior actions to each annual arrangement, which should include unattained key measures in the previous arrangement, to secure smooth program implementation.

As to midterm reviews of enhanced structural adjustment arrangements, I would stress the need for appropriate timing when undertaking such reviews. An annual program is often reviewed in its early stages, permitting unjustifiable front-loading of the

semiannual disbursement. Moreover, such front-loading reduces the importance of the medium-term review as a meaningful monitoring of structural adjustments.

In the monitoring of structural adjustment arrangements, weak conditionality--including up-front disbursements and the lack of medium-term reviews and performance criteria--has resulted in discouraging program performance in many cases. Continuous review by the staff would certainly be welcome, and it may be useful to circulate a staff report on medium-term reviews to the Board--albeit they should not affect the Fund's annual disbursements--to draw the attention of donor countries to policy developments in countries implementing structural adjustment arrangements.

My chair has been supportive of greater selectivity and prioritization in the policy framework paper process, and at the past review it suggested simplifying the coverage of those papers, widening their circulation, and that it would be useful for non-eligible countries to prepare such papers. Thus, we broadly agree with the staff's proposal to strengthen the policy framework paper process and the proposed arrangements described in EBS/90/120. The relevant adjustment programs will be substantially strengthened if the financial and technical assistance of the various donors is coordinated effectively. I believe that the policy framework paper will be instrumental in coordinating donors, and thereby in enhancing the momentum of adjustment and protecting the programs from unforeseen financing shortages. It may be recalled that, in 1990, Japan established an administered account in the Fund with the purpose of extending its financial support for the Fund's technical assistance program, particularly in view of the Fund's central role in providing technical assistance for members' adjustment efforts. In the case of independent, bilateral, and multilateral technical assistance, the policy framework paper will be instrumental to securing better and more effective coordination.

This being said, I would stress a few important points. First, the involvement of other agencies and donors must not result in a weakening of the Fund's adjustment policies through the possible intervention of those other parties. Second, the staff's contacts with bilateral aid agencies should continue to be made in accordance with the institutional arrangements of the donor countries. These considerations should be further emphasized by the staff, if the policy framework paper is to play a more active role. In addition, due attention should be paid to ensuring the confidentiality of information in the transmittal of not only policy framework papers but also other Fund documents.

Before addressing operational issues, I should like to stress that the ESAF Trust is not an open-ended resource. Table 5 of the staff paper illustrates the sensitivity of the subsidy requirement for Trust loan commitments. In addition, it is essential that ESAF resources remain secure in order for ESAF creditors to continue to make loan disbursements to the ESAF Trust. Needless to say, good program implementation is the best security. However, the Fund should be very careful about operational arrangements, in order to ensure better use and efficient allocation of the facility's valuable resources.

My chair is concerned about the negative effects of the continuation of the structural adjustment facility, specifically, the reduced incentives for countries to proceed courageously with programs under the ESAF, and the relative decrease in the security of the ESAF Trust, as a result of the delay in transferring uncommitted SAF resources. However, in view of the slowness of countries in starting on an enhanced structural adjustment arrangement, I will go along with the continuation of the SAF, but with reservations. While the conditionality attached to the enhanced version of the facility must be stronger than that attached to the SAF--as my chair has always stressed--it is evident now that weakness in the latter's conditionality is causing delays in the adoption of programs supported by the ESAF. There is much room for strengthening the conditionality of the SAF. At least, not only should program design be stepped up in second and third-year programs, but also monitoring, so that the country is encouraged and prepared to undertake a program supported by the ESAF. In this regard, I agree with Mr. Kyriazidis on the requirement for prior actions to put programs back on track. Furthermore, I am interested in the possibility of incorporating performance criteria between the annual arrangements under the programs supported by the SAF.

With reference to access under the ESAF, my chair agrees verymuch with the staff that a member's track record and administrative capacity must enter into the judgment on access. In circumstances where these constraints may jeopardize the attainability of the program targets, Fund technical assistance would be instrumental in enhancing the country's ability to implement the program. Back-loading and reduction in access are also necessary in cases where the prospects for achieving external viability are weak. As I mentioned in regard to the policy framework paper process, every effort should be made to mobilize external resources in order to ensure the security of ESAF resources. This being said, since the restoration of external viability by the end of the arrangement period of a program supported by the ESAF should be regarded as a standard target, the staff should not propose an enhanced structural adjustment arrangement when the prospects for

external viability are extremely weak, or when repayment capacity is questionable. As the trustee of ESAF Trust resources--and in order to maintain the monetary character of the institution--the Fund should not give a country the benefit of the doubt when analyzing its capacity to repay. In this connection, I am much concerned that recent staff reports do not fully discuss repayment capacity. While I understand the difficulties associated with medium-term projections and the assessment of a country's willingness to repay, it is extremely risky to assume a country's capacity to repay if substantial financing gaps are expected during the repayment period. In addition, at every review, a country's repayment capacity should be closely reviewed, taking into account developments in the external adjustment scenario.

At the Board discussions on the rights approach, my chair expressed support for a two-year extension of the ESAF. However, the staff's proposal to allow a fourth-year program under the facility seriously undermines efforts by ESAF creditors to cooperate with the Fund. Although the staff intends to approve fourth-year arrangements in a restricted manner, the proposed extension--no matter how exceptional--would weaken a country's incentive to achieve the program targets within the three-year program. It is evident from recent experience that it is extremely difficult to keep "exceptional" treatment exceptional. In addition, as Mr. Finaish suggests, this proposal would necessitate consideration of other aspects of the ESAF's operations, and the availability of resources. The staff report does not fully address these issues. My chair is therefore strongly opposed to the staff's proposal.

As regards eligibility, I agree with the staff that an extension of the eligibility list is not appropriate at this time.

With respect to contingency provisions, the Board may recall the concerns raised by this chair at the review of the CCFF in November 1989 (IS/89/20, 11/29/89). We are still concerned about the possible underfinancing of subsequent annual programs, and the possible delay in attaining external viability, which would result from the proposed rephasing. A more appropriate provision for external exogenous shocks would be a more cautious and substantial buildup in the reserves target at the beginning of a program, which would avoid such ad hoc front-loading. In any event, we will not support rephasing proposals that would weaken the program targets of the subsequent annual programs. Furthermore, the suggestion in the staff report that the CCFF is inadequate for most eligible countries, notwithstanding the fact that the facility can be attached to the structural adjustment or enhanced structural adjustment arrangements, raises questions about the appropriateness of the modalities of the CCFF.

Concerning access to the ESAF, the lending target of SDR 6 billion for that facility, and its interest rate, I basically agree with the staff's proposals. That being said, I have some reservations about the staff's proposal to extend the disbursement of SDA resources under enhanced structural adjustment arrangements beyond the initial three-year commitment period, since this proposal--together with the continuation of the SAF--might contribute to undermining the security of the ESAF Trust as the unused SDA resources are to be transferred to the reserves of the ESAF. The staff may be worried about the increase in the exposure of ESAF Trust resources, and the increasing pressure on the interest rate. I basically support the maintenance of the interest rate at 0.5 percent for the time being. However, to avoid pressure on that rate, would it not be possible--in the case of delays in moving to enhanced structural adjustment arrangements--to lower access to the ESAF by the same amount of the unused SAF resources?

Finally, on the attribution of payments, I support the proposed decision.

Mr. Cirelli made the following statement:

The staff has provided a useful set of papers that allow Directors to come to some general views on the Fund's practices in regard to structural adjustment and enhanced structural adjustment arrangements. These analyses will certainly prove beneficial to better assessments of future programs, and they could serve as a guiding tool for Board consideration.

In examining its policies and implementation on a regular basis, the Board also acts to a certain extent as an evaluation unit, and I admit that I prefer that such evaluation take place in this manner, inside the Board, than outside.

Even though use of the SAF, and particularly of the ESAF, has been slower than was expected during the past months, many countries have used the facilities since their establishment--albeit the slow pace of utilization of resources under the enhanced version of the facility remains regrettable. Improvements are certainly needed in this area.

It is true that, to a certain extent, performance under structural adjustment arrangements has been mixed, particularly in regard to financial policy results. As for enhanced structural adjustment arrangements, even if no definite conclusions can be drawn--given the limited experience that has been accumulated so far--it is worth noting that the current achievements and

prospects are encouraging, even if exceptional financing during a three-year arrangement will not allow the full return to macroeconomic equilibrium in all cases.

In any event, this points to the need for the Fund to play an important role, rather than the contrary. Nothing would be more detrimental than for the Fund not to be involved with low-income countries. Indeed, only the Fund, through its catalytic role and macroeconomic policy aptitude, can provide the needed coherent macroeconomic framework that lays the ground for sustainable real growth. Low-income countries are certainly confronted with development problems; but, perhaps even more than others, they cannot afford to bypass macroeconomic adjustment. This implies, nonetheless, that conditionality is essential and that the Fund must maintain its quality.

In this regard, the staff papers rightly underline the role of technical assistance and the importance of preparatory work. The need for sufficient administrative capacity, for countries to implement whatever a program requires, cannot be underestimated. Such capacity is purely and simply the condition for success. Any effort in this area will be welcome, and the strengthening of local financial departments and administrations should be examined, in order to reinforce the capacity of governments to implement programs. I agree that programs supported by the SAF could play a useful role, if seen within the context of a dynamic approach. Such programs could play the role of a learning process, and prepare the ground for more ambitious efforts. But programs supported by the SAF should not become a sort of automatic drawing right, and be reduced to an experimental process. Although I recognize that the question of maintaining the SAF could arise, the facility should be retained in view of the flexibility that it affords--albeit I agree that its conditionality should be enhanced in order to allow faster progression of countries toward enhanced structural adjustment arrangements. Programs supported by the SAF should be better able to prepare the way for ESAF arrangements. To this end, the high standards of the enhanced version of the facility should be retained, and the standards of the SAF should be strengthened, particularly in terms of monitoring.

Indeed, the good results of the ESAF clearly indicate that close monitoring is undoubtedly one condition behind that positive outcome, especially as slippages could be detected and corrected as soon as they occurred. The reduction of what can be called the "conditionality gap" between the two facilities should be examined. However, increasing the attractiveness of the ESAF should also be possible.

The main staff paper indicates that, in terms of access, the ESAF is not always of significant advantage, particularly during second annual arrangements. Although this view could prove to be right, my chair believes that it does not take account of the reduced access to that facility. To the contrary, I believe that perhaps access to the ESAF could be reviewed with the intent of raising its average access. In any event, I strongly believe that a member's track record should not be taken as a criterion in considering individual access; tailoring of access could be an adequate response--in addition, when strong policy programs are in place. I am afraid that consideration of track records would bring the risk of a downward slippage, and that it could lead ultimately to a lowering in the standards of conditionality. In sum, while maintaining the institution's strong demands in terms of policy, we must regard access policy more in a dynamic than a regressive context--if we want the countries involved to agree to implement the far-reaching reforms that Directors expect.

In the same vein, the main staff paper clearly shows that one of the conditions for success is to focus on key sectors, with appropriate benchmarks. To concentrate on specific quantified objectives requires simplicity, streamlining, and good monitoring. I therefore believe that, notwithstanding its advantages, the introduction of a contingency mechanism in the ESAF should be avoided. Contingency mechanisms have not proved their success thus far, and--to avoid aggravating their complexity and introducing too great a degree of esoterism in programs supported by the ESAF--I would be highly reluctant to introduce such provisions at present.

The staff has drawn Directors' attention to the negative consequences, in terms of monitoring, of the mismatching between the program period and the annual arrangement period. I understand this point, but have the impression that the mismatching is also a result of the prior actions undertaken by countries, which should be seen as a positive element; it therefore does not seem abnormal that the latter has tended to cause disbursements to be bunched in the early months of programs. The staff could usefully comment on how it could be possible to ensure sustained policy momentum without reducing incentives for prior action.

I found the survey on program design in the background paper interesting, and cannot but agree with the staff's emphasis on three special areas. The staff is entirely correct in directing the aim of programs toward enhancing resource mobilization; indeed, strong savings performance will allow for sustainable growth, and I agree that the best means of achieving this goal is to couple it with price stability. Short-term growth with inflation--as is sometimes seen--is not an adequate answer. This fact

rightly underscores the emphasis that was placed during the past review on keeping inflation low.

I welcome the staff's analysis of exchange rate policy, particularly the decreasing emphasis on flexible exchange rate policy. This is not to say that exchange rates must be set forever; indeed, I agree that exchange rate movements should not be prevented if they are needed to ensure a more realistic rate. Even so, the staff paper makes a strong case for exchange rate stability, a direction that I certainly welcome, including the intent that the exchange rate play a greater role as an anchor to economic policy as well as in dampening inflationary expectations. Indeed, two supplementary points could buttress this view. Obviously, given the structural bottlenecks in the majority of developing countries, the advantages of a flexible exchange rate policy in terms of economic diversification and import substitution have been relatively mixed so far, at a time when the drawbacks of such policy have been clearer. Moreover, one cannot underestimate the beneficial role of monetary stability in attracting foreign investment, for which these countries have an urgent need.

On the key role of structural reforms, I fully share the staff's analysis, and believe that structural benchmarks need to be more precise and more quantified. This certainly calls for intensified collaboration with the World Bank. I support the idea of a greater focus on key structural issues, while reinforcing the monitoring of timely implementation.

Much has been accomplished with the policy framework paper, and it works successfully. Progress could be made, however, in making that paper more concise, especially for second and third annual arrangements under the SAF--when it could be focused on key points such as structural reforms, thereby allowing a more focused monitoring at the time of midterm reviews. Policy framework papers have proven to be highly useful in identifying financing from external donors; but attention must be paid to avoiding the "bureaucratization" process that could result if external donors are excessively involved in those papers' elaboration. The fact that the main reason for shortfalls in half of such cases was delays in disbursements in the World Bank's program lending reinforces the point that collaboration between the Bretton Woods institutions over precise objectives and timetables regarding structural reforms are a needed prerequisite as early as the start of programs.

The aim of the ESAF is to ensure sustainable growth while making progress toward external viability. Indeed, external viability is undoubtedly a main objective of programs supported by the facility, a notion that warrants better definition. While it

is not easy to draw firm conclusions from projections made up to the year 2000, extensive discussions of programs should be held when it is likely that balance of payments viability cannot be achieved during the three-year program period. Therefore, without formulating a policy, I can agree to the extension, if needed, of an existing arrangement for a further year.

These considerations do not weaken the case for maintaining the target of SDR 6 billion for ESAF Trust resources, but, indeed, to the contrary. My chair supports the Chairman's efforts to raise additional lending resources as well as further subsidies--which are becoming even more necessary as interest rate increases having widened the shortfall in resources--to allow actual loans to be subsidized and thereby to keep the existing concessional rates. In this regard, my chair still regrets that the contributions of certain industrial countries to the Trust have not always been in keeping with their relative economic positions.

I agree to an extension of the cut-off date for enhanced structural and adjustment arrangements by two years, and can also go along with the proposal to consider a fourth annual arrangement, if needed, along the lines proposed. However, I would disagree with introducing contingency provisions under the ESAF, and I do not believe that the list of eligible countries for the facilities should currently be changed. Indeed, before adding to the list, we must be sure that similar countries are not treated differently-- whatever their exact situation regarding IDA eligibility--and must assess the financial consequences that might result.

I can go along with the arrangements proposed by the staff in SM/90/120 regarding the transmission of Fund documents.

Mr. Enoch made the following statement:

The staff has produced a particularly thorough and interesting set of papers for this review. The staff is candid both about the methodological problems in carrying out the review and about the difficulties in drawing firm conclusions. But although many of the conclusions are necessarily tentative, this study will doubtless contribute substantially to the design and monitoring of programs supported by the SAF and ESAF.

The first point that becomes apparent in studying the papers is the low rate of use of the facilities, particularly of the enhanced version. Indeed, of the ten largest members eligible for the ESAF, leaving aside China and India, only two currently have programs under that facility. While the low rate of use of the

facility may be regrettable, it is clearly not the case that the conditionality of the ESAF should be compromised in order to attract further borrowers. The best inducement for members to adopt programs supported by the facility is a demonstration that such programs work. In that regard, the heavy emphasis in enhanced structural adjustment arrangements on achieving particular growth targets, and the general success of such programs in meeting those targets, is striking.

The staff has made a thorough attempt to evaluate the success of programs supported by both facilities in attempting to identify some counterfactuals. It is rightly wary of drawing too many general conclusions, given the diversity of experience. However, three broad results are discernible. First, overall performance by members following programs supported by the ESAF has been consistently more positive than performance by members with programs under the SAF. Second, those members that gained the most benefit from their programs were those that had been most meticulous in carrying out the agreed policies. Third, initial projections of the impact of adjustment policies have, in some cases, been overoptimistic. Each of these results brings its own lessons to members, to the staff, and to the Board.

Regarding the relatively better performance of members under the ESAF, the staff states that this is bound to be partly in consequence of those members being the best performers to begin with. But, given the relatively ambitious scope of most programs under the ESAF, the difference in performance also shows that seeking greater efforts from members does not, in itself, indicate that a program is less likely to achieve its aims. This, of course, is reassuring. The demonstrated success of the ESAF in continuing to achieve program objectives is the strongest safeguard of continued interest by donors and creditors in the facility.

Regarding the linkage between policy implementation and results, the implications again are largely self-evident. The linkage demonstrates also that policy slippages should generally not be accommodated by subsequent softening of benchmarks or targets. The staff's acknowledgment of its overoptimism in earlier projections should serve to avoid exaggerated expectations in the future, and should therefore help to avoid disappointment when such expectations are not fulfilled. Conversely, of course, recognition of this overoptimism means that to achieve the initially expected objectives on, for instance, growth, programs will require firmer policy actions than earlier envisaged. Overall, the acknowledgment that results projected under earlier programs supported by the SAF were overoptimistic in a number of cases does go a considerable way to meeting the concerns I

expressed in the 1989 review, that programs supported by the ESAF seemed, in some ways, no more ambitious than the earlier programs they were supplanting.

Past overoptimism had a number of causes, and analysis of these provides some of the main themes of the staff paper. These include weak implementation capacity by borrowers, policy slippages, the lags between actions and responses, and coordination between the Fund and other donors and creditors.

Implementation capacity is clearly a serious constraint for many members. The nature of programs supported by either facility is such as to require not just more or less of a particular action or policy, but, in many cases, some fundamental change. In fiscal policy, for example, the whole approach to budget formulation and control often needs reworking. Of course, limited administrative capacity does not necessarily imply the need for a less radical restructuring program. For example, the administrative constraints may often mean that the closure or privatization of inefficient public enterprises is a more realistic option than a complicated rehabilitation program. But as the staff rightly states, such administrative constraints enhance the need for careful prioritization, and, hence, sequencing of policy actions. This leads to the conclusion that programs should concentrate on reforms in a number of key areas.

Programs supported by the SAF and ESAF have already moved in this direction since their inception, and concentrate increasingly on key structural areas, particularly those that have a direct impact on macroeconomic performance. In a number of cases, this trend could be taken further, but it requires careful identification of the basic institutional adjustments, without which little can be achieved.

The staff has made considerable progress in identifying the needed institutional adjustments. Trade liberalization is an essential element of any structural reform program. Among the elements of a program, I would also emphasize cutting current and nonproductive public expenditure, unifying the budget process, and ensuring uniformity in the tax system. In addition, in the context of domestic resource mobilization, the staff rightly stresses the need for efficient financial intermediaries. (This is also a good example of an area for coordination, with the World Bank taking the lead, as it does in this sphere.) An efficient financial sector requires, in turn, an unencumbered central bank and positive real interest rates. Moreover, experience shows that little progress can be expected while price signals remain distorted. At a very early stage, the authorities need to tackle the

most important prices in the economy, especially, in most cases, energy and agricultural prices and major parastatals' prices.

The staff also rightly highlights the importance of technical assistance. The renewed interest in such assistance in recent years is dramatic, and doubtless reflects, in many cases, borrowing members' keenness to maximize the benefit they derive from a Fund-supported program. But technical assistance resources are finite. And, as the staff paper notes, in a number of cases where such assistance was provided, the recommendations were not implemented. Thus a member's technical assistance needs must also be prioritized; and where recommendations of past technical assistance have not been implemented, the Fund should be careful about quickly extending such assistance again.

Policy slippages have also been an important factor when initial projections proved overoptimistic. Again, this highlights the need for borrowing members' authorities to demonstrate fully their commitment to a program at the outset, perhaps by prior actions or by establishing a track record. And the authorities must not seek to circumvent program targets, for instance, by establishing extrabudgetary accounts, or by resorting to prefinancing. The staff is rightly becoming increasingly reluctant to acquiesce to such practices, and is thereby assisting finance ministries and central banks to obtain a better grip over activities of the authorities as a whole.

Overoptimism may in part also have resulted from underestimates of the lags between policy actions, especially structural policies, and performance. Especially where programs supported by the ESAF are concerned, the period under observation is short, and the effects of policy actions may only become strongly evident later. Clearly, the speed of response depends on the credibility of the authorities' adjustment efforts, particularly the credibility that they will persevere in their efforts--which may itself depend on the initial imbalances and distortions, as well as the authorities' past record of adjustment. But such credibility can be established most rapidly by vigorous action, particularly action that cannot easily be reversed, such as the sale of an inefficient public enterprise or the dismantling of a redundant element of the bureaucracy.

Finally, overoptimism in projections may have arisen through inadequate coordination of assistance. Such coordination extends to policy formulation, financing, and aid flows. For example, it is important to ensure that domestic counterpart resources are being mobilized to allow aid disbursements to be made on time. The policy framework paper process has been extremely helpful in coordinating the work of the Fund and the Bank, and it is welcome

that the benefits of such coordination are being increasingly recognized, both by the institutions themselves as well as by the borrowers. Coordination is usefully extending now to other agencies, and attempts are being made to have such coordination extend in some form beyond a one-year time period.

I will comment now on the specific policy actions recommended by the staff. The first action relates to closer monitoring. The staff rightly notes that slippages become much more difficult to correct if they are allowed to persist for a significant period of time; and it relates such occurrences to the relatively long period without monitoring that occurs under a structural adjustment arrangement, or under an enhanced structural adjustment arrangement, where the midterm review is near the start of the program. I would certainly go along with the staff's proposal to introduce midterm consultations for programs supported by the SAF, as well as ensuring correct timing for midterm reviews of enhanced structural adjustment arrangements. Taking note of performance under the SAF when determining access to the ESAF might also have some effect. But if indeed the problem with structural arrangements is as the staff describes, the logical consequence would seem to be to introduce more formal monitoring, and to phase disbursements accordingly. I would welcome staff comment on why this is not recommended.

Regarding the staff's proposal to downplay the SAF in favor of the ESAF, I am not fully convinced that there should be a wholesale change of approach, although there may well be individual cases where the staff will wish to follow such a course. It is clear from the staff paper that experience with the SAF has been disappointing in many cases, with considerable divergences from programs, postponements of external viability, and periodic emergence of arrears. But closer monitoring, on its own, is not sufficient to ensure compliance with a program. As the staff notes, monitoring under the SAF is complemented by that provided by accompanying stand-by arrangements for three members; and for two of these three members, the results have not been impressive. The higher access under the ESAF is associated with stronger programs, and there is no advantage to be gained either from weakening the programs, or from seeing members enter into programs that cannot be sustained. In some cases, the SAF has proved to provide a useful means of laying the groundwork for a follow-on ESAF arrangement; the policy framework paper process, for example, helps to identify administrative weaknesses. Moreover, such groundwork should include any necessary preparatory studies, so that the ESAF will give effect to the results of the studies.

The staff recommends that a stronger emphasis should be placed in program design on macroeconomic policy measures to

promote domestic savings, particularly a strengthening of the fiscal position and fiscal reforms. I generally endorse this, although encouragement of private savings is often equally important, and I am surprised that the staff seems--at least in the conclusions to the paper--to put slightly less emphasis on it. I also agree that greater emphasis should be given to making rapid progress to a realistic exchange rate, trade liberalization, and maintenance of positive real interest rates. But while much of the staff's recommendation is couched in terms of moving away from a gradualistic approach, I would note that in fact it accompanies a recognition of gradualism in objectives. While, originally, the ESAF was designed to enable members to achieve medium-term viability, the objectives presented in the current staff papers seem much more limited. Now, some borrowers should achieve progress toward medium-term viability, and others not even that. The staff says, candidly, that for some borrowers from the ESAF no decline in exceptional assistance is envisaged in the future. This is a major disappointment, and one whose implications require careful consideration.

The section in the background paper on the role of the exchange rate is interesting and illuminating, particularly in its finding that an active exchange rate policy--when accompanied by appropriately tight fiscal and monetary stance--has formed an integral part of adjustment in a number of countries. The Board will have the opportunity to discuss exchange rates in developing countries, as well as the CFA franc zone in particular, in the near future. I will make one point, however, in noting the reference in the background paper to the failure of the CFA franc countries undertaking programs supported by the SAF and ESAF to achieve significant export diversification. If this failure persists, it will have important implications for the design of such programs for the CFA franc countries.

The staff develops a number of ideas about how contingencies can be incorporated within programs supported by the ESAF. As with the CCFF, a balance between adjustment and financing is required. Regarding adjustment, in the event of favorable exogenous shocks--windfall gains in export prices, for instance--there should be prior specification of how the authorities ought to respond. As for adverse shocks, the high degree of reserve accumulation in most programs should absorb these to a considerable degree; but, again, some advance specification of possible adjustment might be appropriate. Regarding financing, the proposed rephasing of disbursements may help in some circumstances. However, as I said during the Board discussions on the CCFF, I see a possible role for concessional resources as contingency protection for countries under the ESAF. If there is a concern about the adequacy of total resources, or the associated

repayment risk, perhaps such disbursements could be made at a concessional charge but with a faster repayment period.

Continuing with operational matters, I have no difficulty with extending by two years the cutoff date for access to the ESAF, and I urge potential donors to the Trust to take advantage of this extension to help bring the available resources up to target, and to allow as many members as possible to use the extra time to enter into programs. And it seems sensible to amend regulations to make as much use as possible of SDA resources in programs supported by the ESAF.

I am disappointed by the staff's attitude to the extension of the list of eligible members. It seems inequitable to exclude a member that, by all criteria, is eligible, simply on the grounds of its size and the potential demand from other members. The staff's concern about extending the list seems to center primarily on potentially having to permit those members that might satisfy conditions for eligibility in the future, instead of the effect of extending eligibility to the one additional member that currently does satisfy the conditions. Perhaps there is scope for some restriction on the level of access for newly qualifying members, if resources are genuinely strained. This is a subject that should certainly be kept open for review.

I am not fully convinced at this stage of the merits of extending access for four years, especially if resources are tight. The problem is that an extension may be seen as a concession to gradualism. Fourth-year access could be an unfortunate signal to members about the urgency of adjustment and the requirement that programs supported by the ESAF aim for early external viability. For members that have followed their three-year programs with early viability in mind, it is not clear how the extra year would fit in with this medium-term objective. For those that have encountered slippages in implementing their programs, it would seem that a fourth-year program would serve to validate those slippages. The staff could usefully elaborate further on what specifically it has in mind.

I have a number of comments on the policy orientation and balance of payments assistance of bilateral and multilateral aid agencies. The staff's paper is useful and interesting. It represents the Fund's less short-term view in its programs supported by the SAF and ESAF, and comes at a time when multilateral and bilateral aid agencies are also recognizing that an appropriate medium-term macroeconomic framework is a sine qua non for sustainable long-term economic development.

As the paper notes, this coming together of viewpoints has led to closer association between Fund-Bank structural adjustment programs and balance of payments support by donors, especially bilateral aid agencies. Not surprisingly, I fully endorse the need for such strong linkages. Indeed, the United Kingdom usually goes one step further, as its grant agreements with recipient governments almost always contain explicit linkage to Fund-Bank adjustment programs.

The question arises whether to extend this link to the multilateral agencies as well. The staff paper reports that only the Asian Development Bank has a formal procedure for taking account of the Fund's views on the macroeconomic framework when considering balance of payments support for a member country. It is also clear, however, that the Fund is less than generous in sharing information with multilateral agencies and that contacts remain ad hoc, rather than routine. So, while it would seem helpful for all multilateral aid agencies offering balance of payments support to adopt the formal procedure of the Asian Bank to take account of Fund views, this institution could probably also do more. For instance, the Fund could provide collaborating multilateral agencies with copies of papers on Article IV consultations, recent economic developments, and use of Fund resources. Strengthened relationships with the EC might be particularly productive following the addition of a specific adjustment dimension to the Fourth Lomé Convention.

Cooperation with bilateral agencies is perhaps more satisfactory. In recent months, the Fund appears to have made efforts to keep bilateral donors better informed on progress with stabilization programs and to take advice from institutions with particular knowledge of sectoral and social issues. However, collaborative efforts need to go further. In this regard, I support the recommendation for greater Fund involvement in local donor coordination groups, which will, I am sure, lead to improvements in the quality of policy framework papers.

That being said, the Fund should not move into areas where it does not have a comparative advantage. So, while I welcome any steps that can be taken to improve Fund estimates of financing, I would suggest that this is best done by closer liaison with the World Bank instead of by developing an independent capacity within the Fund. The Bank has the best information on other donors' aid flows and expertise in understanding disbursement modalities, a capacity that has been considerably enhanced for the countries covered by the Special Program of Assistance for sub-Saharan Africa.

Finally, I agree with the stress in the staff paper on the need for balance of payments assistance by donors to be in as flexible a form as possible. It is not only appropriate that aid agencies should liberalize their procedures in return for liberalization of foreign exchange allocation systems in borrowing countries, but flexibility at the donor end should also result in more rapid disbursement and lessen the risk of financing shortfalls. I can support the proposed decision in the main staff paper, and also that on attribution of payments.

In response to a query by the Chairman on the point that the Fund should not move into areas where it did not have a comparative advantage, Mr. Enoch noted that the Fund had rightly been trying to improve its estimates of overall financing gaps in future years. That had been the case in regard to Mozambique and in the effort to develop support groups, although much work remained to be done. Much of the detailed knowledge required in the area existed already within the World Bank, however, particularly for African countries. The Bank had close links with donors and understanding of when disbursements might be delayed; it could thus contribute usefully to the assessment of whether it would be realistic to project a certain disbursement profile. The most effective means for improving the Fund's estimates of financing gaps would therefore be for the institution to collaborate closely with the Bank.

The Executive Directors agreed to resume their discussion in the afternoon.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/90/104 (6/29/90) and EBM/90/105 (7/2/90).

4. NINTH GENERAL REVIEW OF QUOTAS - INCREASES IN QUOTAS - GOVERNORS' VOTE

The Executive Board approves the report of the Secretary (EBD/90/91, Rev. 5, Sup. 1, 6/29/90) on the canvass of votes of the Governors on Resolution No. 45-2, effective June 28, 1990, with respect to Increases in Quotas of Members - Ninth General

Review, approved by the Executive Board (EBM/90/79, 5/21/90) for submission to the Board of Governors. The Governors' vote on the Resolution is recorded as follows:

Total affirmative votes	923,683
Total negative votes	4,056
Total votes cast	927,739
Abstentions recorded	0
Other replies	0
Total replies	927,739
Votes of members that did not reply	11,336
Total votes of members	939,075

Decision No. 9484-(90/105), adopted
June 29, 1990

5. PROPOSED THIRD AMENDMENT OF ARTICLES OF AGREEMENT - GOVERNORS' VOTE

The Executive Board approves the report of the Acting Secretary (SM/90/101, Rev. 3, Sup. 1, 6/29/90) on the canvass of votes of the Governors on Resolution No. 45-3, effective June 28, 1990, with respect to the proposed Third Amendment of the Articles of Agreement, approved by the Executive Board (EBM/90/83, 5/30/90), for submission to the Board of Governors. The Governors' vote on the Resolution is recorded as follows:

Total affirmative votes	745,428
Total negative votes	34,561
Total votes cast	779,989
Abstentions recorded	59,802
Other replies	5,407
Total replies	845,198
Votes of members that did not reply	93,877
Total votes of members	939,075

Decision No. 9485-(90/105), adopted
June 29, 1990

6. STRUCTURAL ADJUSTMENT FACILITY, ENHANCED STRUCTURAL ADJUSTMENT FACILITY, AND ESAF TRUST - EXTENSION OF PERIOD FOR REVIEWS

a. The Fund decides that in Decision No. 9114-(89/40) SAF/ESAF, adopted March 29, 1989, "June 30, 1990" shall be replaced by "July 31, 1990."

b. The Fund, as Trustee, decides that in Decision No. 9119-(89/40) ESAF, adopted March 29, 1989, "June 30, 1990" shall be replaced by "July 31, 1990."

Decision No. 9486-(90/105) SAF/ESAF, adopted June 29, 1990

7. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 89/140 through 89/142 are approved.

8. EXECUTIVE BOARD TRAVEL

Travel by an Executive Director as set forth in EBAP/90/169 (6/28/90) is approved.

APPROVED: June 20, 1991

LEO VAN HOUTVEN
Secretary