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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 90/25

3:00 p.m., February 23, 1990

M. Camdessus, Chairman

Executive Directors	Alternate Executive Directors
G. K. Arora	L. E. N. Fernando
	C. Enoch
C. S. Clark	
	Zhang Z.
T. C. Dawson	
	J. Prader
E. T. El Kogali	
E. A. Evans	S.-W. Kwon
E. V. Feldman	
L. Filardo	M. A. Fernández Ordóñez
	G. Montiel, Temporary
R. Filosa	
M. Finaish	
M. Fogelholm	I. H. Thorláksson
	O. Kabbaj
G. Grosche	B. Goos
J. E. Ismael	T. Sirivedhin
A. Kafka	L. M. Piantini
	G. Bindley-Taylor, Temporary
	J.-F. Cirelli
Mawakani Samba	
Y. A. Nimatallah	M. Al-Jasser
G. A. Posthumus	G. P. J. Hogeweg
K. Yamazaki	N. Adachi, Temporary

L. Van Houtven, Secretary and Counsellor
S. L. Yeager, Assistant

Also Present

A. Salinas, Debt Negotiator for Peru; J. Candela, Director, Central Reserve Bank of Peru; L. Chueca. IBRD: M. de Nevers, Risk Management and Financial Policy Department; R. Lago-Gallego, Latin America and the Caribbean Regional Office. African Department: C. Enweze. Asian Department: M. W. Bell. Exchange and Trade Relations Department: L. A. Whittome, Counsellor and Director; T. Leddy, Deputy Director; E. Brau, J. J. Clark, G. R. Kincaid, M. V. Shadman, B. C. Stuart. External Relations Department: R. R. Brauning, G. Newman, H. P. Puentes, E. Ray. Legal Department: F. Gianviti, General Counsel; W. E. Holder, Deputy General Counsel; R. H. Munzberg, Deputy General Counsel; T. M. C. Asser, A. O. Liuksila. Research Department: P. Isard, S. Takagi. Secretary's Department: A. Tahari. Treasurer's Department: D. Williams, Deputy Treasurer; D. Berthet, M. P. Blackwell, J. E. Blalock, Z. Ferhadian-Lorie, D. Gupta, B. E. Keuppens, O. Roncesvalles, D. Ross, G. Wittich. Western Hemisphere Department: S. T. Beza, Counsellor and Director; J. Ferrán, Deputy Director; S. B. Brown, L. H. Duran-Downing, J. Fajgenbaum, M. E. Hardy, J. E. Leimone, C. M. Loser, E. Mendoza, S. C. de Sosa, L. Valdivieso. Office of the Managing Director: A. K. Sengupta, Special Advisor to the Managing Director; E. A. Milne. Personal Assistant to the Managing Director: H. G. O. Simpson. Advisors to Executive Directors: M. A. Ahmed, F. E. R. Alfiler, M. B. Chatah, Z. Iqbal, J. M. Jones, K.-H. Kleine, P. O. Montórfano, B. S. Newman, D. Powell, F. A. Quirós, A. Raza. Assistants to Executive Directors: C. Björklund, B. A. Christiansen, E. C. Demaestri, T. T. Do, S. K. Fayyad, B. R. Fuleihan, J. Gold, M. Hepp, J. Heywood, L. Hubloue, A. Iljas, C. J. Jarvis, K. Kpetigo, C. Y. Legg, J. A. K. Munthali, D. Saha, H.-J. Scheid, J.-P. Schoder, Shao Z., J. C. Westerweel, Yang J.

1. BULGARIA - APPLICATION FOR MEMBERSHIP

The Chairman informed Executive Directors that earlier in the day he had met with a delegation of Bulgarian officials, headed by the Deputy Minister of Foreign Economic Relations, which had presented to him Bulgaria's application for membership in the Fund (see EBD/90/66, 2/23/90).

2. OVERDUE FINANCIAL OBLIGATIONS - STRENGTHENED COOPERATIVE STRATEGY - FURTHER CONSIDERATIONS

The Executive Directors continued from the previous meeting (EBM/90/24, 2/23/90) their consideration of the Managing Director's statement on further considerations with respect to the strengthened cooperative strategy for dealing with overdue financial obligations to the Fund, taking up the matter of the financial impact on the Fund's financial position of a member's compulsory withdrawal.

Mrs. Filardo remarked that some staff comment on experience with withdrawal from membership in the Fund would be helpful.

The Deputy Treasurer recalled that in three of the four cases of withdrawal from membership in the Fund's history, to the extent that there was a need for a settlement of accounts, the agreed schedules had been met. In the case of Cuba, one of five annual installments was missed, and the Executive Board had rescheduled that payment, which was made within the new agreed period for the settlement of accounts. The Fund therefore had no experience with a member's failure to settle its liabilities to the Fund at the time of its withdrawal.

Mr. Fogelholm observed that Czechoslovakia was the only case of compulsory withdrawal. He requested some further elaboration on that experience.

The Director of the Exchange and Trade Relations Department explained that Czechoslovakia's compulsory withdrawal in 1954 had been due to the member's failure to fulfill its obligation to provide the information that was required under Article VIII. After a series of discussions, the Executive Board had decided that in view of the authorities' refusal to provide the requisite information, Czechoslovakia should be subject to compulsory withdrawal.

Mr. Dawson observed that previous withdrawals from membership had not been generated by a failure to repay obligations to the Fund, but rather by noncooperation on the part of the member, or a decision by the member that it did not want to fulfill the obligations of membership, for whatever reason. The possibility of compulsory withdrawal without a full settlement of the member's liabilities to the Fund was therefore without precedent in the Fund's history.

Mr. Evans said that he wondered what presumption underlay the Chairman's statement that in the event of a probable loss, the Fund would first provision against the precautionary balances in the Special Contingent Account.

The Deputy Treasurer explained that in practice, a loss would first be charged against the Special Contingent Account, and then against current income, which might require financing through, first, the special reserve, then the general reserve, and then against the Fund's assets.

Responding to a question by Mr. Enoch on the role of the new special contingent account, the Deputy Treasurer remarked that the staff envisaged that the Board would be asked, when establishing the account, to enable that account from the outset to provide protection not only against claims arising from the "rights" approach, but also against the overdue obligations of those members which did not enter into a Fund-monitored program. That approach was purely precautionary and recognized the fact that not all 11 arrears countries were likely to enter into a Fund-monitored program.

Mr. Enoch asked whether the new special contingent account would be separate from the existing Special Contingent Account even though both accounts presumably covered the obligations of overdue countries which were not participants in the rights approach. An alternative approach was to maintain the existing Account, with additional coverage to secure claims under the rights approach.

The Deputy Treasurer explained that at present, the Special Contingent Account was funded to the equivalent of 5 percent of the Fund's reserves as of the end of the previous financial year and represented a precautionary balance against all existing overdue obligations. A new special contingent account, as had been discussed so far by Executive Directors, added the extremely important element of providing backing to the rights approach. It was perhaps appropriate that the new, additional account should be funded quickly in light of the possibility of the use of the rights approach in connection with a Fund-monitored program, and that the rate of accumulation and the means of financing the new special contingent account could be different from the existing Special Contingent Account. It would be difficult to give the existing Special Contingent Account a dual purpose, particularly in view of the flexibility required for the rights approach and the desirability of a burden-sharing mechanism that would allow debtors to better discharge their obligations.

Mr. Dawson recalled that when he had first proposed the establishment of a new special contingent account, it was in the context of funding the rights approach. He wondered how the concept of "backing for the rights approach" differed from his original proposal.

The Deputy Treasurer stated that Mr. Dawson's original proposal, namely, to augment the resources of the General Resources Account outside

that account, could only be accomplished on a voluntary basis through an Arora-type scheme. The alternative approach to financing rights that had been proposed by the Chairman would necessitate a strengthening of the precautionary balances within the General Resources Account. The staff had therefore proposed to strengthen the totality of the Fund's precautionary balances--the general reserve, the special reserve, the Special Contingent Account, and a further special contingent account--all of which would be totally within the General Resources Account and would be financed through some burden-sharing mechanism.

The further special contingent account would serve importantly to buttress the measures of deterrence, the Deputy Treasurer commented. Among measures of deterrence, that of compulsory withdrawal involved charging any losses against the Special Contingent Account and the proposed new account, and then against income, followed by reserves. In that sense the two Special Contingent Accounts were envisaged to be the first line of reserves against the financial impact of a member's compulsory withdrawal.

Mr. Enoch observed that some compulsory withdrawals were likely in the coming year, or within two or three years for those countries participating in the rights approach. If the new special contingent account could be used to provision against withdrawals as well as against claims arising from the exercise of rights, it was possible that compulsory withdrawals would entirely exhaust the account. In that event, what would back the rights approach?

The Deputy Treasurer explained that the amounts available for backing the rights approach would depend on the amounts accumulated in the new special contingent account. It might well be that the conditions governing the use of the new special contingent account would provide for building up resources first as backing for the rights approach and only later as a precaution against compulsory withdrawals.

Mr. Posthumus observed that under the rights approach, arrears would remain over the three-year period of a Fund-monitored program. Consequently, the only difference between the existing Special Contingent Account and a new account was the burden-sharing mechanism.

The Deputy Treasurer said that during a three-year Fund-monitored program, the member would accumulate rights. If during the program period something went wrong, the Board might wish to exercise a measure of deterrence. In that event, the new special contingent account would provide an additional precautionary balance.

Mr. Evans remarked that countries which were not eligible for the rights approach were likely to be subject to compulsory withdrawal, and that the new special contingent account would not be relevant to those cases. Thus, there was a distinction in coverage of the new account. Moreover, the

existing Special Contingent Account would provide backing for any future arrears, while the new account would be limited to a subset of the 11 countries currently in arrears.

Mr. Filosa observed that there were not two amounts at risk, as Mr. Enoch had suggested. Rather, the new account would provide backing against the failure to repay rights, which was also the amount subject to provisioning in the event of a member's compulsory withdrawal. In any event, it could be argued that the amount of provisioning provided by the existing Special Contingent Account was not sufficient.

Mr. Enoch recalled that the staff had explained that two accounts were needed because two types of risk were involved. He agreed with Mr. Filosa that there seemed to be one amount at risk and two possible uses of the Special Contingent Account. In any event, the distinction between the two accounts was not clear. Moreover, the establishment of another account would restrict the size of the existing Special Contingent Account to only SDR 30 million, which was relatively small when compared with possible demands on that account and with the projected size of the new special contingent account. He would therefore suggest that if the two accounts served to provision against the same loss, it might be more helpful to merge the accounts.

Mr. Dawson said that he understood that there were two possible purposes for the new account, but only one eventuality. If the new special contingent account was available to cover losses owing to a compulsory withdrawal, he did not understand why those resources could not be used to finance rights rather than to back them, because the amounts involved were the same. There were two possible uses of the resources of the account in a sense, because the financing would be used either to finance rights or to provision against losses owing to withdrawal, but the overall arrears to be covered by either rights or as a consequence of withdrawal remained the same.

The Deputy Treasurer remarked that the overdue charges were automatically covered through the decision on deferred income, and the Special Contingent Account was an additional application of the burden-sharing decision to generate a fixed amount equivalent to 5 percent of reserves at the end of the previous financial year. While it was true that the existing and proposed accounts added usable resources to the General Resources Account, purchases by a country under the rights approach would not be charged against one of those accounts. That would only happen if the additional resources were outside the General Department, which he understood was Mr. Dawson's original proposal, namely, to finance rights with resources held in a special account that would be outside the General Resources Account.

Mr. Dawson commented that the word "backing" caused a problem for him, but he could accept it in the sense of "a method of financing," as the staff had explained.

The Chairman remarked that the staff would try to find a more precise formulation of that point in a revised presentation of the rights approach.

Mr. Enoch said that he wondered how a new special contingent account would relate to Guyana, which had followed a Fund-monitored program and would soon receive a large front-loaded disbursement, even though it was not under the rights approach. It had not been suggested that the arrangement for Guyana needed to be backed by financing such as a new special contingent account. He wondered whether the expectation that disbursements to countries under the rights approach would be larger and involve a greater degree of front-loading meant that there was need for additional contingent protection.

The Director of the Exchange and Trade Relations Department explained that the best argument for additional reserves was prudent accounting. It was for the Executive Directors to decide whether they could dispense with the proposed account, which had originated from Mr. Dawson's suggestion to establish an account to finance the rights approach. While it could be argued that a new special contingent account was not necessary, it could equally be argued that in view of the large disbursements expected to be made to countries which had not shown good economic performance over recent years, it would be prudent to strengthen the Fund's reserves.

Mr. Fogelholm said that he understood that the idea of "backing" had arisen so as to avoid the use of the word "provisioning" in the Fund. Backing, in effect, took place whenever a country failed to discharge an obligation, namely, when charges were being deferred.

Mr. Dawson observed that Mr. Fogelholm's description of backing might have applied to the existing burden-sharing mechanism, but his own proposal was intended to go beyond burden sharing to build up resources to finance the accumulated principal that was overdue.

Mr. Grosche said that he was satisfied with the staff's explanation of backing. The risk already existed and provision was being made to build up precautionary balances. That provisioning, however presented, was to reduce, to a certain extent, the risk that the Fund already carried on its books.

The Chairman said that he welcomed the fact that Directors had raised no questions or objections to his remarks on the financial consequences of compulsory withdrawal.

Mr. Dawson remarked that the Chairman's formulation with respect to compulsory withdrawals raised no objections in that it was mechanically

consistent and logical. He further noted that the sale of a part of the Fund's gold had been included as an option to help restore the Fund's financial position in the event of an impairment of its assets owing to a member's compulsory withdrawal. In some sense, the U.S. proposal to mobilize gold had similarly recognized such a possible need, and it would be especially prudent to consider mobilizing a portion of the Fund's gold at an earlier stage to strengthen the precautionary balances.

Mr. Kafka said that he supported Mr. Dawson's observations. On another matter, he continued to be troubled by the idea of additional burden sharing, even according to the 50/25 formula, and he would not like to forgo using a modest amount of gold to avoid or reduce such additional burden sharing.

The Chairman remarked that it would be difficult to achieve a consensus on the sale of gold to avoid, or reduce further, the cost of burden sharing, because most Directors remained unconvinced of the merits of that proposal.

Mr. Dawson said that he could agree with Mr. Kafka's point--although he disagreed on how to deal with burden sharing--to the extent that the mobilization of gold would lower the cost of whatever financing was provided to the arrears strategy.

Mr. Grosche remarked that both Mr. Kafka's and Mr. Dawson's suggestion would make the Fund poorer if the price of gold remained at its current level. Thus, the merits of the use of gold to help with refinancing always depended on the future price of gold.

The Chairman observed that at the moment, it was likely that the Fund would have to consider borrowing to meet its future financing needs. It was therefore not an opportune time to sell gold, particularly to reduce burden sharing. If the Fund was to borrow on favorable terms, it had to be strong and possess hidden reserves.

Mrs. Filardo remarked that gold sales would not make the Fund poorer. With gold selling at $420 an ounce, the Fund would realize a considerable profit on a sale of a small amount of its gold holdings, which were valued at $35 an ounce. The nominal value--$35 an ounce--could be deposited to the General Resources Account and the remainder to the Special Contingent Account.

Mr. Grosche commented that the U.S. suggestion assumed that the price of gold remained the same or did not decline. If, however, the price of gold increased over time, the Fund would suffer a loss. As no one could accurately foresee the future price of gold, the suggestion was based on questionable assumptions.

Mr. Enoch remarked that in his view, there was no unambiguous answer to whether gold sales would result in a profit or loss over time. Most central

banks were well aware, for instance, that they could always claim that their foreign exchange intervention was profitable, because the base date for a purchase could be set against some other date when currencies might have been sold at a lower level. It seemed, however, to be agreed that additional financing could be provided, in some way, from the expansion of burden sharing, and several Directors had endorsed the staff's view on the need to back the rights approach, including the possibility of the use of gold to assure participants that the amounts that were generated by increased burden sharing would be available to finance rights. That approach would help to reduce the residual financing gap, which was one of the Board's objectives.

The Chairman stated that his remarks on gold sales had been carefully crafted. Sales of gold had been included under the heading of last resort financing because he considered it of the highest importance to maintain for the membership, and in particular for central banks, the clear idea that the Fund did not use its gold for ordinary purposes. He had taken that approach because under the current prospects for the quota increase, the Fund would probably have to rely heavily on borrowing for the next five years at least. The sale of gold could not be considered lightly, because from the day that the Fund started to dispose of its gold, its ability to borrow, as well as the cost of its borrowing, would be affected.

Mr. Arora said that he understood that the new special contingent account was a form of provisioning against disbursements under the rights approach. But the question remained whether such provisioning was needed. Underlying the proposal for such an account was an assumption that the Fund-monitored program would not be able to bring a member in arrears back on track. That assumption was somewhat disturbing, and for that reason, the idea of building up precautionary balances had to be examined carefully. Of course, he agreed on the need for provisioning against overdue charges and, therefore, to further burden sharing.

The Director of the Exchange and Trade Relations Department remarked that Mr. Dawson's original proposal was based on an implicit assumption that provisioning in the Fund should be strengthened, in view of the extent of overdue obligations, and because, as Mr. Filosa had pointed out, although the nature of arrears would be changed under the rights approach, the risk remained. Whereas that transformation of arrears might not justify more provisioning, the concern about the adequacy of current provisioning in view of the nature of the risk was, in the staff's view, a justification for the establishment of a new account.

Mr. Posthumus observed that the rationale behind the proposal to provide backing for the rights approach reflected a view that the U.S. chair had held for some time and that his chair had supported. The two Special Contingent Accounts would serve the same purpose, but the distribution of burden sharing would be different.

Mr. Dawson commented that the need for further provisioning certainly was an element in his authorities' thinking on the matter. But he would also be concerned about the Fund's ability to borrow if it appeared that the Fund had been overtly engaging in rescheduling. Thus, from his viewpoint, anything that strengthened the Fund's ability to tell not only auditors but member governments that it had strengthened the Fund's financial position through whatever mechanism--including enhanced burden sharing or gold sales--would place the Fund in a better position to borrow. He continued to hold the view that the sale of a modest amount of gold to help settle the arrears of 11 countries would not weaken the Fund.

The Chairman said that the effect of gold sales depended on their timing and how they were carried out. If the sale of gold appeared to be an ordinary means of financing, even for a reduced number of countries, then there was a risk of an adverse impact on general market perceptions. But if those sales were clearly consonant with the role of the Fund--namely, a last-resort line of defense after all other means had been exhausted--that risk would be minimized. He therefore urged Directors to consider carefully the difference between utilizing gold at an early stage--for instance, as a means of financing the Fund-monitored program--or as a last line of defense.

Mr. Dawson remarked that he agreed with the Chairman's view. He did not, however, consider the mobilization of 2 or 3 million ounces of gold to help clear the arrears of 11 countries as an ordinary means of financing. That would be an extraordinary use of the Fund's resources, justified only by a serious financial threat to the Fund.

Mr. Kafka commented that he agreed with the Chairman's remarks on the potential dangers of gold sales. But he would also note that the Fund had never borrowed more, and more successfully, than after the sale of one sixth of its gold holdings.

The Chairman remarked that Mr. Kafka's observation about past gold sales was correct, but that those sales had taken place in the context of an international agreement rather than as an open-ended operation, which made a certain difference to the market.

Mr. Finaish said that he remained unconvinced about the need for backing. If the rationale was to back new disbursements, he doubted that such backing was necessary because the quality of those purchases would be much improved. If it was a matter of further backing for overdue claims, he wondered when the participants in the current burden-sharing mechanism could expect to be repaid under the new scheme.

The Director of the Exchange and Trade Relations Department remarked that it was for the Board to decide when the contributions would be repaid. One option would be to effect repayment when the Board considered that the risk was suitably diminished. Of course, it could be argued that the risk had diminished with the exercise of the accumulated rights, but it was

equally rational and prudent to argue that the backing should extend to the time when the amounts purchased under the rights approach were repaid.

As Mr. Enoch had correctly noted, the basic purpose of the revised Arora proposal was to assist a country and its support group in keeping current on charges, which had financial consequences on burden sharing, the Director commented. And as Mr. Enoch had further noted, the proposal had tipped the burden-sharing mechanism in favor of the debtors. But the provision could also be formulated in such a way that that benefit did not accrue to the debtors, or accrue equally to creditors and debtors. Thus, Mr. Enoch's point was a fair one, but it was also a manageable point and could be taken into account in the course of redrafting the proposal.

The projection of voluntary contributions under the Arora scheme was not an easy matter, the Director of the Exchange and Trade Relations Department observed. Although the figures on burden sharing fluctuated from quarter to quarter, in the staff's view, a sensible projection could provide a reasonable basis for requests for voluntary contributions.

The Chairman remarked that he would prepare a further statement incorporating the broad sense of the discussion on the arrears strategy for the Board's consideration in the near future.

3. PERU - OVERDUE FINANCIAL OBLIGATIONS - REVIEW FOLLOWING DECLARATION OF INELIGIBILITY

The Executive Directors considered a staff paper on the further review of Peru's overdue financial obligations following the declaration of its ineligibility to use the Fund's general resources effective August 15, 1986 (EBS/90/30, 2/21/90).

Mr. Abel Salinas, Debt Negotiator for Peru, Mr. Juan Candela, Director of the Central Reserve Bank of Peru, and Mr. Luis Chueca, Advisor to Mr. Salinas, were also present.

The staff representative from the Western Hemisphere Department remarked that since the staff paper was issued, the staff had had further discussions with the Peruvian authorities. In the light of those discussions, the staff had concluded that the proposed decision should be revised to better reflect Peru's distinct change of policy with regard to its relations with the Fund, including payments that had taken place since the end of August 1989 and the adoption of certain policy measures that had been foreshadowed in the agreed working document, which had been distributed to Executive Directors for their information in December 1989 (EBD/89/382, 12/11/89). The staff therefore would propose some changes to the draft decision to reflect more accurately the current circumstances of Peru's relations with the Fund when the Board considered that matter.

Mr. Abel Salinas made the following statement:

When the situation of Peru's relations with the Fund was last reviewed (EBM/89/108, 8/23/89), my Government, through its Alternate Governor, Mr. Juan Candela, announced its intention to normalize relations with its creditors. Since that time, Peru has established a fluid dialogue with the management of the Fund.

On December 8, 1989, we agreed with the Managing Director on a working paper which set forth commitments by both parties and contains the guidelines within which the Peruvian authorities are to prepare their economic program, which is aimed at improving social welfare through growth in GDP per capita, increased employment, and the real value of remuneration. As it is necessary to apply measures that will lead to the stabilization of the economy, the working paper indicates that the program should envisage and contain economic policies that will obviate the adverse effects of certain measures on the rural and urban low-income segments of society, and recognizes that current conditions in Peru require us to take into account the existence of subversive armed groups, drug trafficking, unemployment, and the low level of income of the people, all of which undermines and erodes democracy. The working document establishes the commitment of the Fund to seek to mobilize the necessary resources to resolve Peru's arrears vis-à-vis the multilateral institutions and to support its medium-term economic program.

Since the document was signed, my Government has honored the commitments it has undertaken. A Fund mission recently visited Peru to undertake Article IV consultations, and the staff's report on those discussions is tentatively scheduled for Board consideration in March.

The program should be based on a new economic approach, reoriented to undertake thorough-going structural changes so that we can attain the fundamental objective, namely, to improve the quality of life of our people. This means facing up to the critical deterioration in the Peruvian economy owing to erroneous protectionist and relative price policies that have been followed for several decades; transforming the structure of the state to respond effectively to the requirements of society in terms of well-being and justice; defeating the fanatical and perverse terrorist aggression that is taking us to an ever-increasing scale of violence; and, eliminating the drug traffic, which corrupts people and institutions and whose influence goes beyond our frontiers, undermining democracy.

We believe that to deal with these major, delicate problems it is necessary, inevitable, and possible to reach a national

consensus. Furthermore, in Peru there is agreement among the political and professional segments of society on certain points. For example, there is agreement on restoring the level of revenues through modernizing the tax system, reducing the number of taxes, eliminating exemptions, broadening the tax base, and reducing the number and level of customs tariffs; and on legislation to ensure that the labor stability law is not an obstacle to, or a limitation on, the creation of new sources of employment, and that it does not discourage new productive investment that Peru needs. We know that without investment there is neither work nor growth. There is agreement on the need to promote exports, to stimulate foreign investment, to maintain positive interest rates, to increase domestic savings to finance national investment, and to use subsidies only as a temporary instrument. There is also agreement on normalizing and improving relations with the international financial community, giving priority to agricultural development, and spurring on the process of regionalization. The skillful management of these points may ensure the viability of a program to modernize and integrate the country's productive structure. Differences with other political groups exist with respect to the instruments of political economy, including the size of variations, timeliness, and the speed of implementation. Some hold the view--which is certainly worthy of respect--that the implementation of a shock program is inevitable, but in our view, a shock program would only lead to further recession and unemployment, and it would render the stabilization program unworkable. Moreover, it would increase violence and promote the transfer of the unemployed to subversive groups and to coca leaf production.

We must be able to find an effective solution to this problem. Failure to do so would mean that our ideas are unsuited to the social and economic realities of our country. An economic stabilization program should not treat persons as mere statistics. Such an approach would imply acceptance of a deterioration in the standard of living and health of an individual as a means of payment for our debts or for a promise of a future that would be better but uncertain for the more unfortunate.

Bearing in mind the delicate situation of our economy, Peru needs the assistance of the international financial community, particularly of the governments of the industrial countries, to make the implementation of a stabilization program socially viable and feasible. While the guidelines of the economic program are being worked out together with its means of financing, Peru will continue to implement exchange rate, fiscal, and monetary policies with the objective of avoiding economic deterioration, despite the restrictions that are inherent in an electoral period. In this regard, we require the Fund's technical assistance to advance more rapidly in the area of tax reform. The most recently adopted

exchange rate measures are directed at continuing to reach a positive trade balance and to avoid a loss of reserves. I should point out that over the past year, the balance of payments has shown a significantly positive balance. A large part of supply and demand for foreign exchange has been transferred to the free exchange market, and we are trying to ensure that exporters can obtain free market exchange rates.

To avoid a deterioration in the cash flow of the central bank and in foreign exchange, we have reduced prefinancing in foreign exchange to exporters. The daily adjustment of the official exchange rate is increasing at a pace in line with the average increase in inflation over the last four weeks. Similarly, we have started shifting imports to the free exchange market, and we have established a prior deposit in domestic currency equivalent to 50 percent of the value of imports. These measures are aimed at greater stability in the exchange market.

In the area of fiscal policy, the Government has implemented new measures to improve public sector revenues, including an increase of 20 percentage points in the selective tax on the consumption of certain products and an increase of 2 percentage points in the general sales tax. An additional progressive tax has been created, which is to be collected through electric power tariffs. Public prices and tariffs are being increased regularly at a rate exceeding the monthly inflation rate. Subsidies have been reduced and only a few products remain under the controlled price regime. In general, the new measures are leading to a reduction in the fiscal deficit.

In the monetary area, the Government has maintained a more restrictive credit and monetary policy by establishing increasingly lower limits for various forms of central bank financing, in line with the objective of containing the expansion of the monetary base at a rate that is lower than the rate of inflation so as to avoid a loss of international reserves. To avoid a loss of purchasing power, the monthly adjustment of minimum pay levels has been adopted. In recent months the Government has emphasized productive recovery. A significantly positive rate of GDP growth has been achieved despite a continuing high--but relatively stable--rate of inflation.

The Government's objective is the transfer to the new Administration of a growing economy that is in the process of rapidly normalizing its relations with the international financial institutions. Peru is discharging its financial obligations vis-à-vis the Fund punctually, particularly the obligations that fell due as of August 31, 1989. Over the last six months, Peru has made greater payments to the Fund than to its other creditors, which

shows that it has given priority to meeting its obligations vis-à-vis the Fund within the framework of Peru's external debt policy.

I wish to reiterate Peru's willingness to maintain a dialogue and to normalize its relations, as well as its concern for international cooperation, which complements our efforts. It is encouraging to see from the discussions that have been taking place within the Fund's Executive Board that progress is being made in the search for new mechanisms to overcome the problem of members' overdue financial obligations and to support more firmly and in a more timely fashion their stabilization and development programs. Provisions of this nature will doubtless make it easier for Peru to comply with the intentions set forth in the working paper of December 8, 1989. In conclusion, I wish to express our appreciation to the management of the Fund, and particularly to the Managing Director, as well as to the staff of the Western Hemisphere Department, for their commitment and serious efforts to establish this dialogue and facilitate these positive developments in Peru's relations with the Fund.

Mr. Feldman remarked that he wished to stress the authorities' request for the resumption of technical assistance. Such assistance would be extremely helpful to Peru in its preparation and elaboration of a new economic program.

Mr. Dawson stated that his authorities warmly welcomed the recent understandings between Peru and the Fund with respect to the resumption of constructive economic relations, particularly the recent payments by Peru and its stated intention to remain current on its obligations to the Fund. The economic problems confronting Peru and the sheer magnitude of its arrears represented a daunting challenge to the authorities, the Fund, and the international community. The continued rapid deterioration of the economy into hyperinflation and negative growth underlined the urgency of the situation and the need for a comprehensive program of stabilization, adjustment, and reform.

His authorities recognized that the development of such an economic program would, of necessity, have to await the results of the April elections, Mr. Dawson continued. However, it was essential that the authorities avoid actions during the election campaign that could intensify an already bad situation. Furthermore, his authorities were concerned that a vacuum not be created during the interregnum between the election and the installation of a new Government in July. That would require close cooperation between the outgoing and new Administrations and, especially in the short run, emphasis on financial policies to regain some semblance of control over inflationary pressures.

In that context, the approach that the Fund should take during the transitional period and the possible implications for a strengthened arrears strategy needed to be considered carefully, Mr. Dawson remarked. At present, a cautious response seemed to be most appropriate.

He supported the staff's recommendation to delay, temporarily, a declaration of noncooperation until the intentions of the new Government became clear, Mr. Dawson commented. In particular, his authorities would want to see whether the promised payments to the Fund were made and what steps were taken to avoid further economic deterioration.

He wondered, however, whether concluding the forthcoming Article IV consultation prior to the April elections served a useful purpose, Mr. Dawson stated. While it would provide an analysis of current problems and the outlook, it might not reflect the views and intentions of any new Government. As such, it would not provide the basis for reaching a decision on arrears at the time of the next review. A temporary postponement of the Article IV consultation to late April or early May, combined with a further arrears review, would enable the Board to reach a decision based on a comprehensive assessment of the situation, outlook, policy intentions, and payments experience.

He agreed to, and supported, a resumption of technical assistance on a selected basis, Mr. Dawson concluded.

Mr. Cirelli remarked that his authorities welcomed the recent rapprochement between the Fund and Peru. They commended both parties and, in particular, management's efforts to convince the Peruvian authorities of the dangers associated with their previous line of conduct.

The payments made by Peru in December 1989 and the mechanisms put in place to ensure the payment of the obligations falling due at the beginning of 1990 were significant and encouraging, Mr. Cirelli considered. The regularity of payments and the ability of the authorities to prevent overdue obligations to the Fund from rising above their end-August 1989 level would constitute a crucial test of Peru's willingness to find again a place in the international financial community. He wondered whether a similar mechanism could be put in place for the payments falling due in March or April.

The staff was right in recalling that one of the criteria for judging the extent to which a member in arrears was cooperating with the Fund, namely, the adoption of appropriate economic policies, had not been met, Mr. Cirelli commented. Indeed, the improved payments performance had not been accompanied by substantial action toward implementing the needed adjustment policies. He was very concerned by the magnitude of the economic problems facing Peru. The overall picture outlined in the staff report was less than encouraging: hyperinflation, the flight from currency, increasing

fiscal imbalances, and the reduction in GNP all testified to the scope of the challenges lying ahead, while little progress could be expected in the coming months.

In view of the upcoming elections, he could understand the difficulties in implementing the adjustment program, which was absolutely necessary to solve the balance of payments problems and re-establish normal relations with Peru's creditors, Mr. Cirelli stated. He welcomed Mr. Salinas's statement, particularly with regard to the need to avoid a vacuum during the transitional period and the authorities' willingness to transfer a better situation to the new Government. He agreed that the situation should be looked at more closely, and he urged the Peruvian authorities to formulate as soon as possible the required adjustment policies. He could go along with the resumption of the Fund's technical assistance to Peru and the proposed decision.

Mr. Evans remarked that he welcomed the steps taken by Peru to normalize its relations with the Fund, including the various measures mentioned by Mr. Salinas--steps which represented a marked change with earlier practice. It was clear, however, that partial repayments alone still fell well short of the two-pronged test of active cooperation with the Fund, because of the failure to elaborate and implement a comprehensive economic program. That issue should be taken most seriously, particularly in the light of the Board's recent discussions on an enhanced arrears strategy. Those discussions should have left no doubt that for a country with overdue obligations of the magnitude of Peru's, access to the proposed rights approach and to voluntary support of the international community would be entirely dependent upon Peru's embarking on a comprehensive--and politically acceptable--economic program.

The staff had noted the authorities' view that the forthcoming April elections precluded the development of such a program at present, Mr. Evans observed. While that may well be the case, at the same time--and noting again Mr. Kafka's dictum that programs must be politically acceptable--he wondered whether a prospective administration which had not fully declared its intentions prior to an election would be able to implement such a program after the event. He therefore believed that it was imperative that in the decision to be taken at the present meeting, the Board should leave no uncertainty as to the importance of the early implementation of a comprehensive economic program.

The decision taken on the occasion of the previous review on August 23, 1989 had noted that at the present review, the Board might consider a declaration of noncooperation, Mr. Evans recalled. That intention had subsequently been conveyed by letter to all Fund Governors and to certain financial institutions. Any of them would be entitled to ask whether the Board, at its meeting on February 23, 1990, had considered a declaration of noncooperation and if so, what it had decided. The draft decision did not answer those questions. He believed that it should do so. He was, however,

prepared to accept the staff's implicit recommendation that a declaration of noncooperation should not be proposed at the present meeting, and he supported the provision of technical assistance. But the decision should make clear, as would the minutes of the meeting, that the matter of a declaration of noncooperation had been considered and that it had been decided not to adopt such a measure. It should also make clear that further consideration of the matter had not been precluded.

In that regard, the staff had stated on page 11 of its report that "Such a proposal, however, would be submitted for the consideration of the Executive Board at a future time if, in the interim, Peru does not make the promised payments to the Fund and progress is not made in the formulation of necessary adjustment policies," Mr. Evans observed. In fairness to the Peruvian authorities, that message should be conveyed in the decision--it should not be left buried in the text of the report. He therefore proposed that a new paragraph 4 should be added to the draft decision, to read: "The Fund has considered the adoption of a declaration of noncooperation and has decided, in the light of the factors noted above, not to pursue such a measure at this time. Such a proposal, however, could be considered again by the Executive Board at a future review." The original paragraph 4 would then become paragraph 5.

Mr. Goos remarked that he could fully subscribe to Mr. Evans's view. He welcomed Mr. Salinas's presentation and the recent adjustment measures that had been adopted. But, he agreed with Mr. Evans that those measures fell short in redressing the situation, which urgently needed a comprehensive adjustment program.

He also welcomed the authorities' renewed willingness to maintain the dialogue and restore normal relations with the Fund, Mr. Goos continued. But it was not the first time that such intentions had been expressed by representatives of Peru in the Board. He recalled that in the recent Article IV consultation discussion with Peru it had been envisaged that the authorities, together with the staff, would build upon the framework for an economic program that had been agreed in the working documents toward the end of 1989 and that it was the authorities' intention to develop specific economic guidelines for a program, as they had promised when they invited the staff for the Article IV consultation mission. He understood from Mr. Salinas that the authorities still had not reached the stage where those guidelines had been formulated, and the fulfillment of their intentions remained to be seen.

He also shared the concerns expressed by previous speakers that the policy measures adopted so far did not meet the criterion for cooperation, namely, the adoption of the comprehensive adjustment program, Mr. Goos stated. He recognized that in view of the political situation, it was difficult to adopt a comprehensive program at present, but he did not understand why the forthcoming elections should prevent the authorities from undertaking resolute measures to improve the prospects of the economy in

view of extraordinarily difficult circumstances--with GDP growth substantially negative in real terms for the second consecutive year. In his view, an improved economic outlook lay at the heart of the aspirations of the population.

He could also endorse Mr. Evans's observations on the proposed decision, Mr. Goos remarked. There should be a reference in the decision to the fact that the Board had considered the matter of a declaration of noncooperation. The change in the situation of Peru since the previous review was not sufficient to justify the adoption of a much more lenient decision than that taken at that review. He would propose a further amendment to Mr. Evans's proposal when the Board considered the draft decision. It should be clear that during the review period, the Fund would keep the performance of Peru, both in terms of payments to the Fund and the adoption of economic policies, under review, and if there was a deterioration in that performance, the adoption of a declaration of noncooperation would then be considered.

Miss Montiel stated that she was grateful for Mr. Salinas's informative remarks concerning the Peruvian economy and Peru's attitude and plans with respect to its obligations to the Fund. His presence was another significant step toward normalizing relations between Peru and the Fund.

Since the last review of Peru's overdue financial obligations, and as a result of the intensive dialogue between the Peruvian authorities and the staff, significant progress had been achieved in the process of normalizing relations between Peru and the Fund, Miss Montiel observed. Indeed, the framework for developing an economic program for Peru had been agreed, which gave broadly the main objectives and constraints for the elaboration of a medium-term economic program. Peru had remained current in the SDR Department and had met its obligations falling due in both the General Resources and SDR Departments during the period September 1, 1989 to February 15, 1990. A staff mission had visited Lima to conduct the 1989 Article IV consultation discussions.

The staff paper indicated that the economic situation had worsened at an increasing pace recently, the Central Bank had been losing foreign reserves during the last four months, inflation had been accelerating, and government revenue had continued to decline in real terms, Miss Montiel continued. She was aware that the upcoming elections imposed serious constraints on the immediate implementation of a comprehensive program to redress the deep-rooted problems faced by Peru. However, she concurred with the staff's view on the necessity for fiscal and credit restraint during the coming period, with the dual aim of reducing distortions and paving the way for future stabilization efforts.

In that connection, the prevention of further deterioration in the area of public finance and in the external position would be fundamental to ensure the degree of freedom that the new authorities would need to launch

a program that would help to restore sustainable growth and to reverse the ongoing economic and social deterioration, Miss Montiel commented. Her chair considered that the opportune availability of technical assistance would be instrumental in the preparation of the economic program and could help in its prompt implementation following the elections.

Regarding the evaluation of Peru's willingness to cooperate with the Fund, her authorities considered that to better assess Peru's payments performance and its observance of the Fund's preferred creditor status, payments made by the public sector since the previous review should be taken into account, rather than those made during the whole of 1989, Miss Montiel stated. She would appreciate receiving information from the staff on public sector payments during the period September 1989-February 1990.

She urged the authorities to intensify their efforts to normalize relations with the financial international community and, as a cornerstone of that process, to continue fulfilling Peru's obligations falling due to the Fund, Miss Montiel concluded. She supported the proposed decision, as amended by the staff.

Mr. Thorláksson stated that it was encouraging that the Peruvian authorities had started the process of breaking their unproductive and ineffective isolation by resuming payments falling due to the Fund. Although he understood that the account in the Federal Reserve Bank of New York, into which the authorities had deposited amounts to cover obligations falling due to the Fund, would run out of resources by the end of February, he welcomed the fact that the authorities were prepared to continue cooperating in that respect. Thus, he concurred with the staff's conclusion that the authorities, in the context of payments to the Fund, were--for the time being--demonstrating a desire to cooperate with the Fund.

He also shared the staff's assessment regarding the prolonged lack of substantive economic reforms in Peru, Mr. Thorláksson continued. It was indeed regrettable that the present political situation of the country--according to the authorities--precluded the adoption of a medium-term, comprehensive economic program. Moreover, it was disquieting to learn that, in the months to come, the economy would be managed only under the principles of prevention and avoidance of major economic disruption rather than under the formulation and implementation of more immediate and urgently needed positive actions.

Even though it had been stated many times before in the case of Peru, it deserved to be restated that a postponement of necessary stabilization and structural policy measures would only lead the country into a situation where a more painful set of actions would have to be undertaken, Mr. Thorláksson commented. Given that the political situation impeded any substantial economic adjustment efforts by the present Administration, he urged the authorities, as a minimum, to prepare promptly and carefully the

necessary measures for the formulation of a medium-term economic program and to implement them as soon as the political situation allowed.

Mr. Clark said that he welcomed the progress made with respect to Peru's overdue financial obligations since the previous review in August. The recent payment was the most substantial payment that the Fund had received from a country with protracted arrears. Peru's recent record of cooperation provided some evidence that peer pressure could in fact be useful in getting countries to improve their relations with the Fund, and that the possibility of a declaration of noncooperation could serve as an effective deterrent.

Nonetheless, it was disappointing that Peru had not been able to fulfill the second criterion used to judge a member's willingness to cooperate, Mr. Clark considered. Over the past few months, little progress had been made by the authorities in adopting appropriate adjustment policies. Although he was pleased to learn from Mr. Salinas about the most recent measures, he was concerned that in light of the upcoming elections and the long interim period before a new Administration assumed office, there might be little positive development on that front. He was also concerned that during the transition period, payments from Peru on amounts coming due to the Fund may not be as readily forthcoming as in recent months.

If events were to unfold in such a disappointing manner, the authorities should have no doubt about the Board's willingness to pursue a declaration of noncooperation, Mr. Clark commented. To avoid that outcome, he wondered whether there were ways to ensure cooperation over the coming months. He would be interested to hear Mr. Salinas's views on steps that could be taken to ensure payments coming due to the Fund during the transition period; also, he wondered whether it would be possible for the outgoing and incoming Administrations to begin working together on an economic strategy during the transition period. His concern about prospects in the coming months went beyond the wish to ensure continued payments to the Fund; rather, he wished to see the implementation of adjustment measures that would arrest the accelerating deterioration of the economy. If the latter was not accomplished, payments to the Fund would not be forthcoming for much longer.

He could support the resumption of technical assistance to Peru and, in light of the uncertainty surrounding developments in the next few months, he could agree that the next review should be held within three months, Mr. Clark concluded.

Mr. Bindley-Taylor recalled that at the last review of Peru's arrears in August 1989, the Board had generally concluded that despite Peru's avowed interest in restoring normal relations with its creditors and the appointment of a foreign debt negotiator, the critical elements necessary for Peru to be considered as cooperating with the Fund were still absent. Recently, however, there had been positive developments in the Fund's relations with

Peru. He was pleased to note the agreement on a working document, which would provide a framework for an economic program in the near future.

He welcomed Peru's payment of SDR 32.8 million to the Fund in December 1989, Mr. Bindley-Taylor continued. That represented full payment of Peru's financial obligations for the period September 1989 to December 1989. He also welcomed the commitment to remain current on all remaining obligations falling due for the period ended August 1989 onward. He also noted Peru's improved payment record to most of its creditors.

In his chair's view, the Peruvian authorities, within the limits of their prevailing constraints, were cooperating actively with the Fund, Mr. Bindley-Taylor commented. His authorities were assured that after the elections in April, the current level of cooperation would strengthen and increase. Therefore, a declaration of noncooperation was not appropriate at the present time, and with some reservations, he fully endorsed the proposed draft decision, particularly with respect to the need for technical assistance. However, he shared Mr. Evans's reservations and could go along with the amendment that he had proposed.

The task before Peru was an enormous one, Mr. Bindley-Taylor observed. A change in the country's arrears strategy would only be successful if it was comprehensive. He urged the Peruvian authorities to restore relations not only with the Fund but with other multilateral institutions and commercial creditors, as the financial flows necessary to sustain growth and eliminate arrears, which were estimated at SDR 15 billion, would be substantial. Obviously, sound macroeconomic policies together with financial support from a sympathetic international community were essential. He hoped that the Fund's efforts would be successful in mobilizing the needed support once Peru had presented an appropriate adjustment program to the Fund for its consideration.

Mr. Enoch remarked that he welcomed the policy changes outlined by Mr. Salinas. Clearly, the very different policies that had been pursued over a number of years and the long delay before implementing the policies that Mr. Salinas had outlined, had made the situation in Peru extremely difficult. It was indeed regrettable that only a limited set of measures had been introduced to date and that, realistically, several months were likely to elapse before the needed comprehensive program was introduced. He joined Mr. Dawson in stressing that it was essential that over the coming months the authorities should do nothing to worsen the situation in the economy for the incoming administration and that there was no vacuum in policymaking through the transition.

He welcomed payments made by Peru to the Fund over the past months, Mr. Enoch continued. It was essential that Peru continued to make payments at least sufficient to stabilize arrears at their August 1989 level.

Technical assistance could clearly be helpful in maintaining the dialogue between the Fund and the Peruvian authorities over the coming months, Mr. Enoch considered. He could therefore support reinstating Fund technical assistance to Peru at the present stage as proposed by the staff.

Regarding the proposed decision, he shared the views of Mr. Evans and Mr. Goos, Mr. Enoch commented. He agreed that there should be an explicit reference to the consideration of a declaration of noncooperation in the decision, as well as to the need for Peru to continue in particular to remain current on its obligations to the Fund in order to avoid consideration of such a declaration in the coming months.

Mr. Adachi remarked that he was grateful to Mr. Salinas for his detailed statement. He found the thrust of the staff paper to be appropriate. He welcomed the recent substantial increase in payments that Peru had made to the Fund. Nonetheless, he believed that Peru had the capacity to do more than simply stabilize its overdue obligations to the Fund at their end-August 1989 level, particularly in light of the significant improvement in the current account in 1989. He therefore doubted that the Fund should be content with the authorities' intention to settle forthcoming obligations to the Fund. Furthermore, he wondered whether Peru had treated the Fund as a preferred creditor, since Table 3 of the staff paper showed that debt service payments to nonmember countries had far exceeded payments to the Fund. He would like the staff or Mr. Salinas to provide a breakdown of Peru's repayments to nonmember countries as well as to member countries.

He agreed with the staff that a declaration of noncooperation would not be appropriate at the present stage because Peru's increased payments to the Fund appeared to provide evidence of the authorities' willingness to cooperate with the Fund, Mr. Adachi commented. However, at the next review, Directors should consider the possible application of the strengthened remedial measures on which the Board would soon agree, if the prospects for a clearance of Peru's arrears were judged not to have improved by that time. In that light, he could support Mr. Goos's suggestion on the decision.

While he understood the difficulties that the authorities were facing in developing substantial policy measures prior to the general election, he believed that there was a compelling need to initiate appropriate adjustment measures without delay, Mr. Adachi stated. Meanwhile, the staff's recommendation on price adjustments should be carried out as soon as possible. Although he would like to reserve his assessment of Peru's economic policy until the forthcoming Article IV consultation with Peru, he welcomed the measures taken by the authorities which Mr. Salinas had outlined, since some of those measures seemed to aim in the right direction. However, the deteriorating economic situation clearly called for bolder action. The authorities should recognize that the demonstration of convincing adjustment efforts would be the only means to mobilize the external resources necessary for the resumption of economic growth. Any delay in adopting comprehensive adjustment measures would only worsen the situation. Thus, he believed that

the next review should take place within three months. He also supported Mr. Dawson's suggestion with respect to the timing of the Article IV consultation. In a similar vein, he could support the provision of technical assistance. Finally, he would like the staff to elaborate on the proposed changes to the decision. He also supported Mr. Evans's proposed amendment to the decision as well as the suggestion made by Mr. Goos.

Mr. Prader stated that he welcomed the payments by Peru and the recent economic measures, as well as the policy changes announced by Mr. Salinas. He recognized the difficult circumstances surrounding economic policymaking and implementation in Peru in the face of the upcoming general elections. He therefore considered that a cautious policy approach was needed and that a declaration of noncooperation by the Fund at the present time would not be appropriate.

At the same time, it was important to maintain the momentum of the Fund's arrears strategy and to ensure that the process of settling Peru's arrears to the Fund was not interrupted, Mr. Prader considered. It would therefore be useful to amend the decision as proposed by Mr. Evans and by Mr. Goos. Finally, he favored the resumption of the Fund's technical assistance to Peru, particularly in view of the need to help the authorities in the difficult transition to a new administration.

Mr. Posthumus remarked that he had taken note of Mr. Salinas's statement as well as Mr. Dawson's. He supported the staff's proposals, including the resumption of technical assistance. The proposed decision, however, gave rise to two questions. First, the Board had accepted that a country in arrears could limit itself to remaining current with the Fund if it had a program that was agreed with, or even monitored by, the Fund. That was, however, not the case for Peru. Instead, Peru was availing itself of a concession--namely, technical assistance--without undertaking a program. Such a program was mainly in the interest of Peru, and he was not sure that the proposed approach was the correct one in view of the objectives of the Fund's arrears strategy. Second, he wondered why Peru had not made some additional payments. In view of the increase in reserves in recent months, further payments not only would have been possible but would have been an even better indication of Peru's cooperation with the Fund.

The staff representative from the Western Hemisphere Department recalled that a few Directors were not fully convinced that the Fund had been accorded preferred creditor status by Peru. In that regard, the payments that had been received by the Fund in the period from September 1989 through February 1990, as a proportion of Peru's total debt service payments, indicated a distinct change in the authorities' debt policy. Peru's total debt service payments in that period were estimated to be about SDR 120-140 million, of which SDR 60 million had been paid to the Fund. That clearly represented a change in Peru's treatment of obligations to the Fund, at least since September 1989.

Mr. Salinas stated that he appreciated the understanding that Directors had shown for Peru's economic and political situation. The fact that the country was scarcely 150 days from a new government and less than 50 days from the beginning of the electoral process changed the characteristics of the political, social, and economic scenario. The reality was that in the current circumstances, it would not be possible for the Government to implement a comprehensive stabilization program with firmness, clarity, and consistency, because the Government and the economic agents were not yet agreed on the appropriate course of action.

Nonetheless, there were clear signs that Peru was making its best efforts to comply with the undertakings that it had given in the working paper agreed in December 1989, Mr. Salinas continued. In that regard, he recalled that the working paper contemplated payments from September 1989 onward; and Peru had been punctually meeting its obligations as from September, and had made payments totaling about SDR 65 million, or $84 million. The present Government intended to comply with those undertakings to the last minute of its existence.

Comparing Peru's payments to the Fund with its payments to other creditors, it was clear that since September the Fund had been treated as a preferred creditor, Mr. Salinas commented. Of the total payments made, 80 percent had been applied to Peru's obligations to the Fund. To ensure that that line of conduct was maintained during the transition to a new Government, he had been consulting with the main leaders of all the major political groups on issues relating to the Fund and would keep them informed of developments so that Peru's relationship with the Fund would continue to be maintained during the transition period.

In concluding, he wished to thank Executive Directors for supporting a resumption of technical assistance for Peru, Mr. Salinas remarked.

Mr. Feldman stated that in the light of Mr. Salinas's strong assurances that the present Administration would fulfill its obligations to the Fund, he would urge Directors to reconsider Mr. Evans's amendment to the proposed decision. In the circumstance, the proposed paragraph would not be helpful to his Peruvian authorities. Moreover, the exclusion of that paragraph would not weaken the deterrent measures of the collaborative arrears strategy because the staff report indicated that a declaration of noncooperation could be made if Peru suspended its payments to the Fund.

Mr. Salinas commented that as Directors had suggested that Peru's situation should be reviewed again in three months' time, the proposed paragraph could be withdrawn in the knowledge that the Board could adopt a declaration of noncooperation at any time.

Mr. Evans observed that although it was true that the Board could adopt a declaration of noncooperation at any time if, for instance, Peru interrupted its payments to the Fund, the Fund had always given a member fair

warning of that possibility. It was therefore only fair to all concerned that the proposed statement should be included in the decision. Failure to retain a reference to the possibility of a declaration of noncooperation would weaken the deterrent measures of the arrears strategy.

The Chairman suggested that if the first sentence of Mr. Evans's proposed amendment was incorporated at the beginning of the original paragraph 4, the second sentence could be dropped. There was already a reference at the end of paragraph 4 to a further review within three months from the date of the decision.

Mr. Evans stated that he would be pleased to drop the sentence, if it was understood and recorded in the minutes of the meeting that henceforth there was no longer a need to give members fair warning that the Board could adopt a declaration of noncooperation.

The Chairman observed that guidelines on the content of Board decisions on arrears could be discussed in the context of the Board's ongoing consideration of a strengthened cooperative approach. He recalled that on an earlier occasion he had suggested that the Board was not bound to apply the seven steps of the deterrence strategy in a particular order but could proceed directly, say, to the fourth or fifth step as warranted, on a case-by-case basis. Thus, whether there was a need for an early warning was but one point still open to consideration by the Board.

Mr. Dawson remarked that both Mr. Evans and Mr. Salinas had made valid points. It was certainly true that at its last review of Peru's overdue obligations, the Board had made a specific reference to the possible consideration of a declaration of noncooperation at the present review. The amended draft decision made no reference to that point. At the same time, Mr. Evans was correct to suggest that some reference should be made to the previous decision, and that an omission could send the wrong signal. He also acknowledged Mr. Salinas's concern that the inclusion of such language could send too negative a signal to the Peruvian authorities in view of their recent positive actions.

On balance, he would prefer to include the proposed reference, but to indicate that in view of the positive developments in Peru and the authorities' intentions, the Board had decided not to pursue a declaration of noncooperation at the present time, Mr. Dawson commented. A concluding sentence could state that the Board would return to the matter on the occasion of its next review.

Mr. Goos said that he wondered whether the formulation suggested by the Chairman would capture Mr. Evans's concern--which he shared--that the Board should indicate to the authorities what the next step in the collaborative approach would be. As Mr. Evans had stressed, omission of a reference to the fact that a declaration of noncooperation was still a possibility would be a break with existing practice. While some Directors had suggested

flexibility with respect to the application of a strengthened arrears strategy, others had suggested a need to tighten the sequencing for application of the various steps--a view for which he had great sympathy.

To avoid the impression that the declaration of noncooperation might be considered only at a specific future review, the new paragraph proposed by Mr. Evans could be combined with the original paragraph 4, Mr. Goos suggested. The second sentence of paragraph 4 would then read: "Such a proposal, however, could be considered by the Executive Board at a future review of the matter of Peru's overdue financial obligations to the Fund, in light of actions taken by Peru in the meantime toward settlement of its arrears to the Fund and formulation and implementation of a comprehensive adjustment program period." The final sentence would remain unchanged.

Mr. Salinas observed that the final sentence of the proposed paragraph specified that a review would be held within three months. It should be noted that in Peru, the President had to be elected by a voting majority of more than 50 percent. In current circumstances, it was highly unlikely that a new President would be elected in the first round, and in the event, there would be a period of at least 60 days between the first and the second elections. In 1985 the period had been 90 days, and the official counting of votes was concluded only when a contender formally declined to take part in the second election. It was therefore likely that a review within three months would coincide with, or precede, the second round of elections. In view of the ongoing electoral process and to ensure that the Government could fulfill its obligations as set out in the working paper and continue to make progress in its search for economic policy guidelines that would sustain a medium-term economic program, he suggested a review within four months.

Mr. Goos remarked that he could accept Mr. Salinas's proposal to extend the review period to within four months.

Mr. Dawson said that he understood that the reason for extending the period to four months was to allow for the possibility of a second round in the electoral process, and that if there was no second round, the Board could decide to accelerate the review.

Mr. Salinas said that he could accept that understanding, but wished to point out that that deadline for the next review would be tight in view of the need for the new President or Government to comprehend immediately the intricacies of the problem of Peru's arrears to the Fund.

The Chairman observed that Directors had agreed on the timing "within four months," on the understanding that it was linked to a possible second round of elections, and that the staff would be in continuous contact with the authorities during that period, not only through its technical assistance but also in the context of the preparation of a comprehensive adjustment program. Management would report to the Executive Board on

developments within that period, particularly if there was only one election round, including the prospects for the maintenance of Peru's current international reserves. A decision would also have to be taken on the proper timing for the next Article IV consultation; in that regard, he had noted Mr. Dawson's suggestion to postpone somewhat the Board's discussion of the staff report for the consultation discussions, which would soon be circulated, together with supplementary information on policies considered by the new Government and the latest developments.

The Executive Board took the following decision:

1. The Fund has reviewed further the matter of Peru's overdue financial obligations to the Fund in the light of the facts and developments described in EBS/90/30 (2/21/90).

2. The Fund acknowledges the recent payments made to the Fund by Peru that have settled obligations falling due since August 31, 1989, and notes the authorities' intention to settle forthcoming obligations to the Fund as scheduled. However, the Fund deeply regrets the continued existence of Peru's overdue financial obligations to the Fund, which place a financial burden upon other members and reduce Fund resources needed to help others. The Fund urges Peru to settle the overdue financial obligations to the Fund promptly, and stresses that settlement of these arrears should be given the highest priority.

3. The Fund welcomes the indication by the authorities of their intention to cooperate with the Fund in addressing the problem of Peru's overdue financial obligations to the Fund, and urges Peru to adopt as a matter of urgency a comprehensive set of measures that would bring about necessary economic adjustment. The Fund continues to stand ready to assist Peru in the formulation and implementation of a comprehensive adjustment program and, in the present circumstances, considers the provision of technical assistance to Peru for this purpose to be appropriate.

4. The Fund has considered the adoption of a declaration of noncooperation and has decided, in the light of the factors noted above, not to pursue such a measure at this time. Such a proposal, however, could be considered by the Executive Board at a future review of the matter of Peru's overdue financial obligations to the Fund, in light of actions taken by Peru in the meantime toward settlement of its arrears to the Fund and formulation and implementation of a comprehensive adjustment program. Such a review will be held within four months from the date of this decision.

Decision No. 9371-(90/25), adopted
February 23, 1990

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/90/24 (2/23/90) and EBM/90/25 (2/23/90).

4. EXECUTIVE BOARD TRAVEL

Travel by an Assistant to Executive Director as set forth in EBAP/90/48 (2/21/90) is approved.

APPROVED: November 29, 1990

LEO VAN HOUTVEN
Secretary