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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 89/127

10:00 a.m., September 15, 1989

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

Executive Directors	Alternate Executive Directors
	C. Enoch
	Zhang Z.
	C. S. Warner
	J. Prader
	L. B. Monyake
	S.-W. Kwon
	E. C. Demaestri, Temporary
L. Filardo	
	N. Kyriazidis
	N. Morshed, Temporary
M. Fogelholm	M. Pétursson
	S. Rouai, Temporary
G. Grosche	
J. E. Ismael	
	A. Raza, Temporary
A. Kafka	L. M. Piantini
	D. Powell, Temporary
Mawakani Samba	K. Kpetigo, Temporary
Y. A. Nimatallah	
	D. Marcel
G. A. Posthumus	
	N. Adachi, Temporary

L. Van Houtven, Secretary and Counsellor
L. Collier, Assistant

Also Present

IBRD: W. G. Tyler, Latin America and the Caribbean Regional Office. Exchange and Trade Relations Department: T. Leddy, Deputy Director; E. Brau, G. R. Kincaid, A. Leipold. Legal Department: H. Elizalde, A. O. Liuksila. Western Hemisphere Department: S. T. Beza, Counsellor and Director; L. A. Cardemil, M. A. Da Costa, J. C. Di Tata, P. C. Leme, C. M. Loser, L. L. Pérez, K. A. Swiderski. Office of the Managing Director: A. K. Sengupta, Special Advisor to the Managing Director; P. Shome. Advisors to Executive Directors: M. Al-Jasser, J. Basiuk, M. Eran, Z. Iqbal, C. Obame, R. Wenzel. Assistants to Executive Directors: J. R. N. Almeida, H. Brohs, B. A. Christiansen, J.-F. Cirelli, S. K. Fayyad, C. J. Jarvis, M. E. F. Jones, L. I. Jácome, K.-H. Kleine, A. Rieffel, J.-P. Schoder, M. J. Shaffrey.

1. ECUADOR - 1989 ARTICLE IV CONSULTATION, AND REQUEST FOR STAND-BY ARRANGEMENT

The Executive Directors considered the staff report for the 1989 Article IV consultation with Ecuador and Ecuador's request for a stand-by arrangement in an amount equivalent to SDR 109.9 million (EBS/89/164, 9/21/89; Cor. 1, 9/13/89; and Sup. 1, 9/14/89), together with the letter of intent from the Ecuadoran authorities (EBS/89/161, 8/15/89). They also had before them a background paper on recent economic developments in Ecuador (SM/89/178, 8/23/89).

Mr. Kafka made the following statement:

One year ago the Ecuadoran Government implemented an economic program aimed at improving economic performance, which had been affected by serious imbalances in the external and fiscal sectors--with deficits of 11.9 percent and 9.6 percent of GDP, respectively, in 1987--and by an acceleration of the rate of inflation to levels well above the historical trend. These disequilibria were the result of the fall in international oil prices--Ecuador's principal export commodity--in 1986, the earthquake of March 1987, which interrupted oil production and exports for almost six months, and slippages in the implementation of economic policies. At the same time, and for the same reasons, the country fell into arrears with commercial banks in early 1987. It should be noted that in 1986 and 1987 Ecuador lost revenues of $2 billion as a result of oil price developments and the earthquake.

In the first part of 1988, although oil output returned to more normal levels, international oil prices started to fall again. At the same time, expansionary financial policies continued, leading to a rise in prices of 50 percent from January to July of that year, and by August 1988 international reserves had fallen to a negative $330 million.

In these circumstances, the main objective of the economic program of the new Government, which took office in August 1988, was to deal with the problem of inflation and to correct distortions in relative prices. A crucial element of this program was the implementation of a restrictive demand policy, consistent with flexible exchange rate management designed to change expectations about inflation. Likewise, it was considered imperative to improve the relationship of the country with its external creditors in order to promote a better environment for saving and investment, and hence to enable the economy to achieve higher sustained growth, after a decade in which Ecuadoran society had to reduce in real terms its level of income and consumption per capita.

After the first year of the new Administration's program, the main economic indicators show a strong improvement in the performance of the economy. The monthly rate of inflation declined from an average of 6.5 percent a month in the period from September 1988 to March 1989 to 2.2 percent a month during the past five months. At the same time, the exchange market remained stable with a spread of about 5 percent between the free market rate and the intervention rate, i.e., dramatically less than the 100 percent spread observed in July 1988. Unfortunately, the adjustment measures were adopted in an environment in which economic activity was slowing down and unemployment was rising, and it is projected that real GDP growth will be less than 1 percent in 1989.

To achieve these results during the first year of the new Administration, the Central Bank has maintained severe monetary discipline. Money supply grew by less than 40 percent in the year through August 1989, which was substantially less than the rise in prices; the growth in net domestic assets of the Central Bank was directed to the private sector since net credit to the public sector was negative. This monetary contraction was possible because of the limitation of expenditures on the part of the Central Government and the public enterprises during the second part of 1988. Current expenditures, excluding interest payments, fell from 18.6 percent of GDP in 1987 to 13.9 percent of GDP in 1988, a trend that has continued in 1989. Civil servants received an increase in salaries below that of the private sector, resulting in a substantial decrease in real wages during the past 12 months. Public sector revenues are benefiting from the sixfold rise in telephone rates and the 45 percent increase in electricity rates, the latter followed by a 3 percent monthly adjustment to avoid distortions in relative prices. In addition, the tax reform approved at the end of last year has allowed the Central Government to improve tax collections.

The monetary authorities have followed a flexible interest rate policy that allows deposit and loan rates to be determined on the market, although the spread between the rates for each bank cannot exceed a certain limit--15 percentage points--to avoid an excessive widening of the margin against savers, as had occurred in previous months. This policy received the support of the World Bank, within the conditions of a sectoral financial loan. While real interest rates were negative over the past year, the decline in inflation during the past five months has moved both lending and deposit rates to levels that are significantly positive in real terms.

Consistent with interest rate policy, a forward-looking exchange rate policy, based on an announced and flexible weekly depreciation of the sucre, commensurate with the inflation target, has been successful in bringing greater stability to the external sector. Measures that initially were adopted on a temporary basis in order to restrain the level of imports--such as financing restrictions on capital goods imports and the mandatory spread of 10 percent between buying and selling rates--have been partially relaxed. The country's net international reserves have improved by some $280 million in the past 12 months, and in recent months there has been a real effective depreciation as domestic inflation has declined. Also, during the first year of their Administration, the Ecuadoran authorities have cleared arrears with multilateral institutions, and, starting in July, partial interest payments to commercial creditors have been made.

The Ecuadoran authorities are committed to consolidating the stabilization of the economy. In this respect, inflation is expected to come down further and the balance of payments is projected to show continued improvement. Consistent with these targets, money supply is to grow no more than 37 percent during 1989, which is substantially less than the 54 percent growth rate in the preceding year. For this purpose, net credit to the nonfinancial public sector will continue the trend started in the second half of 1988 and will be negative in 1989. This is consistent with the objective of reducing the nonfinancial public sector deficit from 5.1 percent of GDP in 1988 to 3.4 percent of GDP in 1989.

The public sector will continue a policy of flexible prices for telephone and electricity rates and for domestic oil derivatives; prices for the latter are being raised monthly to achieve a cumulative increase of 50 percent during 1989. A cautious policy toward wage adjustment and employment will be followed by the public sector. On this basis, it is expected to be possible to reduce current expenditures, excluding interest payments, to 11.2 percent of GDP in 1989, the lowest figure since 1984. This is expected to raise nonfinancial public sector savings from 0.9 percent of GDP in 1988 to 5.5 percent of GDP in 1989.

In the external sector, the current account deficit is expected to come down from 7 percent of GDP in 1988 to 5.7 percent of GDP in 1989. To achieve this target the Ecuadoran authorities intend to maintain, at the very least, the real effective exchange rate at the level of May 1989. Indeed, according to preliminary data, the real effective exchange rate had depreciated by about 2 percent by end-August and this trend is expected to continue, given the deceleration of the rate of inflation. In addition, the gradual elimination of temporary import restrictions will continue. Notwithstanding these gains, the balance of payments is expected to show a financing gap of $315 million, or about 3.1 percent of GDP in 1989. On this basis, Ecuador will be able to make interest payments or set aside a maximum of one third of total interest owed to commercial banks. In this context, as already mentioned, partial interest payments to commercial banks were renewed last July and will continue on a monthly basis in line with foreign exchange availability. Also, a request for debt rescheduling was presented to the Paris Club and will be considered in the third week of October.

In spite of the success in stabilizing the economy in 1989, the rate of growth of GDP will be less than 1 percent, which points to a further decrease in per capita income. This development is of special concern to the Ecuadoran authorities because of the social and political implications in a country that up to now has been able to maintain an environment of social peace. Therefore, an important target for 1990 is a growth rate of 3.5 percent of GDP, which implies the resumption of per capita growth. This is expected to be consistent with a further deceleration of the rate of inflation to less than 25 percent during 1990. Other targets for 1990 are an additional reduction of the nonfinancial public sector deficit to about 2.25 percent of GDP and of the current account payments deficit to 5 percent of GDP.

To achieve these objectives, in the fiscal area a new tax reform is expected to be approved before the end of the year aimed at simplifying and broadening the scope of income taxes and transforming the present sales tax system into one based on a value-added tax. The pattern of prudent expenditure policies will continue. In the external sector, the main objective is to favor export competitiveness through a flexible exchange rate policy. Other measures to be adopted are the elimination of prior import deposits and the reduction of the spread between buying and selling rates to 2 percent before the end of 1990. In addition, the Ecuadoran authorities are preparing a set of structural reforms, directed at promoting better resource allocation, to be implemented as the stabilization of the economy is consolidated.

The behavior of the Ecuadoran economy during the next five years will depend greatly on the evolution of the external debt situation. In recent years the debt burden has worsened. The ratio of debt to GDP and the debt-service ratio have risen to 110.6 percent and 50 percent, respectively, in 1989. According to the staff's illustrative medium-term scenario--traditional new money approach--the ratio of debt to GDP will only decrease to 102.5 percent by 1994 and the debt-service ratio will show only a moderate decrease in the same year. It is important to note that these results are based on an increase of real GDP of only 3 percent over the whole period, which implies almost no improvement in per capita income, a sustained increase in international oil prices of up to $18.50 a barrel for Ecuadoran crude in 1994, no increases in world interest rates, and an annual growth of non-oil exports of about 8 percent. Even with these assumptions, Ecuador would require some $2,360 million of new money through 1994 to fill the financing gap. If international oil prices go down $1 a barrel or interest rates go up 1 percentage point, the result would be an increase in financial requirements of about $650 million for the five-year period in each case. These arguments confirm the magnitude of the debt burden, the vulnerability of the economy to the presence of external shocks, and the magnitude of the external debt overhang.

In these circumstances, the Ecuadoran authorities are of the view that it is not opportune for the country to approach its debt problem by relying exclusively on new money schemes. Thus, they have proposed to their commercial bank creditors a permanent debt rescheduling based on a medium-term scenario that is consistent with the economy's capacity to pay and that would improve the chances for growth over the medium term. This proposal, which includes market-based debt and debt-service reduction, was presented to the banks' Advisory Committee during the second week of August, and the economic subcommittee visited Ecuador at the end of that month. The banks are currently studying the proposal with a view to addressing the difficult debt-service situation of the country. The next contact between the banks and the Ecuadoran authorities will take place during the Annual Meetings. In addition, it is intended to implement structural reform policies to ensure more efficient investment and growth that might be the basis for a future extended Fund arrangement.

In this context, during the coming weeks negotiations will take place between the Ecuadoran authorities and a World Bank mission to reach an understanding about industrial and energy policies as well as export promotion incentives under the form of sectoral loans. Part of the receipts of these loans are expected to be used in market-based debt reduction transactions with commercial creditors. In addition, to complement the required resources for those transactions, Ecuador would wish to use, at a suitable stage, an amount equivalent to 25 percent of the resources of the stand-by arrangement and to ask for an increase in the amount of such an arrangement of up to 40 percent of the country's quota in the event of a successful financial agreement with the commercial banks.

In conclusion, the Ecuadoran authorities have made strong efforts to stabilize the economy and to re-establish more normal relations with external creditors while maintaining an environment that favors domestic saving and investment. Ecuador is also preparing to make structural reforms in the economy that would improve resource allocation and that would thereby facilitate a higher rate of economic growth and an improvement in the standard of living of the population. For these objectives to be achieved, adjustment of the economy will need to be accompanied by the type of arrangements in respect of the external debt mentioned above. I believe that the Ecuadoran authorities should be supported in their request for this stand-by arrangement covering the following 18 months, and I hope my colleagues will give the proposed decision their support.

Extending his remarks, Mr. Kafka informed Executive Directors that the Spanish and Ecuadoran Governments had reached agreement on a loan of $350 million to Ecuador, part of which could be used for debt reduction operations. Negotiations with commercial banks were proceeding normally; the subcommittee of the banks' Advisory Committee had found the data forming the basis of the Ecuadoran proposal submitted to the Committee a few weeks previously to be in conformity with its estimates and with the Fund's figures. Ecuador was paying the commercial banks about one third of the interest due pending the conclusion of an agreement.

Any delay in approval of the requested stand-by arrangement and subsequent disbursement could fatally disrupt the negotiations with the commercial banks, and, in fact, the banks were waiting for the Board decision to proceed with the negotiations, Mr. Kafka commented. It would be unfortunate if the Executive Board were less forthcoming in the case of Ecuador than it had been in others, because the country had been particularly badly treated by one of the major banks. The Ecuadoran authorities were serious in their endeavors and were paying as much as they could, even without an agreement with the banks.

Mr. Demaestri made the following statement:

Ecuador needs the assistance of the international financial community, and we are prepared to support its request for a stand-by arrangement through the end of February 1991 in an amount equivalent to 50 percent of quota on an annual basis. We also welcome the indication that 25 percent of the resources made available under the stand-by arrangement would be set aside for debt reduction operations.

Given Ecuador's projected transactions with the Fund during the period of the arrangement, outstanding Fund credit to Ecuador is unfortunately expected to decline. If all purchases were to be made under the proposed stand-by arrangement, outstanding Fund credit would fall by approximately 20 percent of quota between the end of August 1989 and the end of the stand-by arrangement. This will be especially unfortunate if the authorities are able to reach a satisfactory agreement with Ecuador's commercial creditors.

In this regard, we encourage Ecuador to request both an augmentation of resources in the context of this stand-by arrangement and an extended arrangement in the future to support its medium-term efforts. These additional financial resources are much needed by a country embarking on a program of short-term adjustment and a medium-term strategy that includes the implementation of a comprehensive structural reform program. Ecuador is also in need of significant debt and debt-service reduction, and these additional resources could help to promote appropriate debt and debt-service reduction operations.

The staff points out that the balance of payments outlook for the medium term is for continued sizable external financing gaps under traditional financing assumptions, which is reflective of Ecuador's very high debt-service burden and which has implications for private capital inflows, investment, and growth. Thus, the staff concludes that a return to balance of payments viability and reasonable rates of growth would be assisted substantially by debt and debt-service reductions. I agree with the staff on this point, although I would go one step further: debt and debt-service reduction will be required if Ecuador is to return to balance of payments viability and reasonable growth rates.

According to the staff's illustrative medium-term scenario, assuming a traditional new money approach, there would be substantial financing gaps between 1989 and 1994. External debt would continue to increase in nominal terms and, as a proportion of GDP, it would decrease only insignificantly. In 1994, the level of external debt would be above 100 percent of GDP, even assuming, as pointed out by Mr. Kafka, an increase in real GDP of 3 percent over the whole period, a sustained increase in international oil prices, no increases in world interest rates, and a considerable increase in non-oil exports. We, like Mr. Kafka, believe that these figures confirm the magnitude of the debt burden and the external debt overhang, making clear the need for debt and debt-service reduction.

The proposed stand-by arrangement is an important step toward resuming relations with the international financial community and achieving much needed debt and debt-service reduction. Of course, as recognized by the staff and the Ecuadoran authorities, the program could be improved in the future. More importance could be attached to the implementation of needed structural reforms. In this regard, there is room for additional tax reform measures. Other areas of possible improvement are in public sector pricing policies and in the financial, exchange, and trade systems.

In the area of macroeconomic policies, more fiscal adjustment might be possible, and the program could rely less on wage moderation to help sustain the deceleration of inflation and preserve external competitiveness. At this stage, further reductions in real wages would seem very difficult for the Ecuadoran people to accept. Real wages are at very low levels. They decreased substantially during the early 1980s, and, as mentioned in the background paper, including complementary earnings they are estimated to have remained broadly unchanged in 1984-87 and to have declined by approximately 15 percent in 1988.

Although it could be improved, the Ecuadoran economic program is, at this stage, an important step toward strengthening Ecuador's economic performance and, we hope, toward easing Ecuador's relations with external creditors and lessening the heavy debt burden by reducing external debt. The program should also be seen as a continuation of the efforts by the present Government since it assumed office to improve economic developments. Thanks to those efforts, the new program is being initiated in a much better situation than that prevailing in 1987 and early 1988.

Although unemployment has worsened and fiscal and external imbalances are still high, the current real effective exchange rate, which is under the 1987 level and substantially below the levels of the early 1980s, seems to be appropriate to maintain an adequate degree of competitiveness. Imports have declined considerably. The overall public sector deficit has been reduced, gross national savings have increased substantially, and the current account of the balance of payments, although still substantially negative, has steadily improved since 1987.

The relatively better economic situation and the positive economic trends recently observed constitute, in our view, a satisfactory environment in which the program to be supported by the stand-by arrangement can succeed.

In sum, the proposed program should be seen as a continuation and improvement of the economic actions implemented by the new authorities since August 1988. It constitutes an important step toward improving economic performance and laying the basis for the resumption of Ecuador's relations with the international financial community. Approval and appropriate implementation of the proposed arrangement could help Ecuador to reach an agreement with commercial creditors that would include significant debt and debt-service reduction, which is essential to reduce the debt burden and the debt overhang and to promote domestic confidence, investment, and growth.

Consequently, we support the proposed decision, the set-aside of resources for debt reduction operations, and Ecuador's intention to request an augmentation of the amount of resources if financing arrangements with commercial creditors provide for appropriate debt-service reduction.

Mrs. Filardo made the following statement:

This chair strongly supports Ecuador's efforts in initiating steps in the right direction, not only to correct the internal and external disequilibria of the economy, but to re-establish more normal relationships with its creditors. I agree with Mr. Kafka's remark that if the Board does not approve the stand-by arrangement today, it will discourage the authorities from making further progress.

Economic developments in Ecuador in the recent past have been dramatic. During the last few years, the country's performance has been severely affected by shocks of different origins: a decline in oil prices in 1986, the earthquake in 1987, and the suspension of oil production as a consequence of the earthquake. These were the main reasons for the difficulties in maintaining a good adjustment track record from 1983 to 1985, and the source of arrears with the various creditors. Notwithstanding the constraint of Ecuador's cash flow, the authorities have demonstrated their seriousness in recognizing the preferred status of the Fund.

The authorities have now initiated a program that will allow them to gradually stabilize the economy after those severe shocks, to improve Ecuador's relationship with its external creditors, as Mr. Kafka has indicated, and to promote a better environment for saving and investment. We welcome and encourage these steps, especially in the current circumstances in which an overwhelming number of countries that are in arrears with commercial banks and in which, in the past few years, many countries have also incurred arrears with multilateral institutions. Different alternatives must be explored to solve the apparently growing problem of arrears and to avoid contaminating other borrowers. When a government is willing to collaborate, even with some difficulties and constraints, the country must be supported and the authorities convinced of the need to implement a medium-term, strong, growth-oriented adjustment program, which would not only put the economy on a reasonable path but would permit the country to negotiate a financing package with substantial debt relief.

In the case of Ecuador, it is clear that the economy needs to grow and that per capita income has to increase. It is also evident that Ecuador has a tremendous debt burden, as indicated by its debt/GDP and debt-service ratios. But Ecuador is also experiencing internal and external disequilibria. To solve these fundamental problems, the country needs not only to persist in obtaining debt and debt-service reduction from its creditors but to implement a very strong program that will promote an efficient allocation of resources in the economy, along the lines suggested by the staff.

As Mr. Kafka has indicated, even with the implementation of the program and the attainment of all potential available rescheduling for the clearance of 1987-88 arrears and obligations for 1989, projections indicate a financing gap, very low reserves, and continued arrears. Furthermore, the external sector remains extremely vulnerable to possible external shocks, as reflected in the medium-term projections of the report, even on assumptions that seem to be very optimistic. Therefore, the program presented by the Ecuadoran authorities must be considered a first step in the process of developing a more comprehensive program that would include policies for the improvement of competitiveness, structural reforms, as well as stronger adjustment measures to correct the disequilibrium and to obtain resources under the extended Fund facility, as is the authorities' intention. For instance, serious distortions remain in the financial system, namely, subsidized interest rates for certain economic sectors and the allocation of credit to selected activities. Other reforms that should be considered are the stabilization of the exchange rate and the liberalization of price controls to increase the efficiency of the economy and to eliminate existing supply bottlenecks.

We are firmly convinced that the Fund has to play a fundamental role in supporting Ecuador to sustain its economic policies, to re-establish more normal relationships with its creditors, and to regain external viability in the medium term. We support the proposed decisions on the stand-by arrangement and exchange system.

Mr. Nimatallah made the following statement:

Ecuador has taken commendable policy initiatives since mid-1988, including a large devaluation, a strengthening of the public finances, and a tightening of credit policy. However, despite these measures and the full resumption of oil exports in the recent past, Ecuador is still faced with serious domestic and external imbalances. The public sector's financing needs remain high, while capital inflows have declined. The persistence of relatively low real growth of the non-oil sector, acceleration in the rate of inflation, continued accumulation of external payments arrears, and limited prospects for an autonomous restoration of external viability in the medium term call for bold adjustment efforts over a number of years.

In light of these serious macroeconomic and structural problems, I welcome the authorities' adjustment program as a useful first step in this process of adjustment and support the proposed decision on the stand-by arrangement. I also support the approval of the multiple currency practices and other exchange restrictions until February 28, 1990. Given the deep-seated nature of the underlying difficulties, I strongly urge the authorities to initiate the needed structural reforms without delay, so that efficiency of resource allocation can be improved and sustained economic growth restored. Since the program supported by the Fund would crucially depend on the overall structural reform package, the speedy formulation and implementation of such a reform package is vital. The thrust of structural adjustment mentioned in the paper appears to be inadequate to redress these serious problems. Could the staff shed more light on this matter?

Since I am in general agreement with the thrust of the staff appraisal, I will restrict myself to a few specific comments on the financial program. It seems, from the staff report, that should a revenue shortfall occur, the authorities would consider curtailing capital expenditures. Such a step would be inconsistent with the objectives of growth and efficiency. I would urge the authorities to more actively explore the possibility of adjusting administered prices, including those of petroleum products, and of curtailing current expenditures to meet such an eventuality. Investment expenditure is needed to enhance the productive capacity for growth.

To improve resource allocation, the program rightly attaches importance to allowing realistic prices to prevail, including interest and exchange rates, and I agree. While some commendable flexibility has been introduced, further steps need to be taken to accelerate this process of liberalization. As a means of restoring competitiveness, I also encourage the authorities to consider restoring the early 1988 level of the real effective exchange rate, which seems to be more realistic for facilitating the authorities' efforts to reduce exchange and trade restrictions.

With regard to balance of payments prospects, I notice that, despite domestic adjustment and expected Paris Club and commercial bank rescheduling, a large residual financing gap remains. It is not clear what steps are contemplated if the desired additional financing fails to materialize to fill this gap, and if debt relief turns out to be less than anticipated at present. Given the seriousness of the medium-term balance of payments outlook, it seems appropriate to consider Ecuador a suitable candidate for debt reduction operations.

Mr. Grosche made the following statement:

I believe that Mr. Kafka is right when he states that it was not only international oil prices and the earthquake of March 1987 that pushed the Ecuadoran economy off track. It was also, in my view, primarily slippages in the implementation of sound economic policies that made things as bad as they are. It is therefore highly welcome that the authorities have started to bring the economy back on a sounder financial footing, thereby laying the basis for steady growth. We are wholeheartedly in favor of having sound policies supported by the Fund, but I consider that the present program lacks substance, and the approach chosen for ensuring the financing of the program has not yet produced any tangible results. I find it difficult to grant outright approval today. One would have liked more time to reflect thoroughly on such an important case, and a postponement, perhaps until after the Annual Meetings, would perhaps provide us with information on the banks' reaction to the Ecuadoran debt reduction proposals. However, before making up my mind, I would like to listen to what other speakers and the staff have to say.

Among the points on which I have the most difficulties, I will comment first on the program. The authorities have formulated specific quantitative targets and performance criteria only for the remainder of 1989. For 1990, only very broad objectives have been suggested. The medium-term financial outlook lacks precision. I share most of Mr. Nimatallah's comments, particularly on structural policies. In my view, this is one of the weakest approaches that I have seen in the recent past. The guidelines on Fund support for debt and debt-service reduction operations make particular reference to the strength of economic policies required for justifying Fund involvement. More specifically, while I welcome the modifications introduced in April to the interest rate determination system, the move toward positive real interest rates was more the result of declining prices than rising interest rates. Positive rates in real terms are crucial for domestic capital formation, and the mere intention of the authorities to review the working of their interest rate system before the end of the year seems vague. Given that domestic cost and price pressures are still high, an exchange rate policy that aims at maintaining external competitiveness through devaluations seems unavoidable. But priorities should be set correctly; devaluations are only second-best solutions. The authorities should strive to reduce inflation further through appropriate domestic policies, and thereby maintain competitiveness. Excessive devaluations will put additional pressure on prices and hamper private capital inflows. Nevertheless, I can support the proposed decision on the exchange system.

With respect to the financing of the program, information is lacking on the status of the negotiations--if indeed there are negotiations between the banks and the authorities--and on whether a financing package consistent with external viability will be agreed within a reasonable period of time, as stated in the Fund guidelines. I have the impression that, again, the staff is interpreting these guidelines quite broadly and is not addressing properly the points mentioned therein that have to be taken into account when granting outright approval. At least, management could have consulted with Executive Directors at an early stage, as envisaged in such cases.

I am grateful to Mr. Kafka for having provided us with more information, particularly on the next meeting with the banks. Does this mean that negotiations will take place during the Annual Meetings? I would like to ask Mr. Kafka whether his authorities expect a response to their proposal to the banks and when negotiations are expected to start in earnest. I hope that after the Annual Meetings, it will be possible to make a judgment on the time frame that is needed for completion of a satisfactory package.

Despite the weakness of the program, we could go along with it, mainly because of the steps taken by the authorities since the beginning of the year, which go in the right direction. The next review, however, has to present a full-fledged, quantified program for 1990. If the staff and Mr. Kafka cannot provide us with indications that the financing of the program will be assured in a reasonable period of time, a postponement of our discussion today or approval in principle might be the correct course of action. Approval in principle would indicate the full support of this institution for the policies under consideration, would determine the amounts available at a later stage, and most important, would signal to the banks that it is as much up to them as to the authorities to indicate that they will act in order to be able to draw on the credit enhancements that will also be financed by the amounts provided by this institution. Meanwhile, I am willing to listen to other speakers with an open mind. We sympathize with this country and recognize its many difficulties.

Mrs. Filardo expressed her concern that Executive Directors, by withholding approval, would limit assistance to Ecuador, thereby holding the country hostage as had been done in the past by the Executive Board.

Ms. Powell made the following statement:

Since August 1988, when the new Government took office, the Ecuadoran authorities have been attempting to reverse a deteriorating economic situation. We welcome the actions they have taken to tighten macroeconomic policies and the move to a more flexible exchange rate policy. Although economic performance was mixed in 1988, the benefits of the shift in policy have begun to show up this year with inflation decelerating and some improvement in the external position evident. But this is only a start. It is clear that Ecuador needs to continue with these adjustment efforts. In particular, it is essential that the authorities continue to follow restrictive macroeconomic policies and a flexible exchange rate policy if the aim of further reducing inflation and strengthening the external balance is to be achieved.

We are in broad agreement with the thrust of the macroeconomic policies to which the authorities have committed themselves under the program, although we believe that the program could have been more ambitious, and we would have liked to see a lower inflation target. We recognize that the authorities are in the process of considering further measures, but we find it difficult to assess the strength of the adjustment effort with only limited information on the shape of the program for 1990. We would look for a strengthening of the program when performance criteria are set for 1990.

It is also our view that the authorities should be seriously considering greater structural adjustment. The economy remains highly regulated and the extensive controls on prices and in other areas can only lead to distortions and make it more difficult to reduce inflation and diversify the economy.

We welcome the measures that have been taken to strengthen the fiscal position of the nonfinancial public sector through revenue increases, including price adjustments of public sector enterprises and improved tax collection. We urge the authorities to move ahead with plans for additional tax reform. We also think it is very important that adjustments continue to be made in the prices of public sector enterprises to ensure their financial viability.

On monetary policy, we note that with the decline in inflation, interest rates have become positive. We urge the authorities to ensure that interest rates remain positive. This is important for both controlling inflation and encouraging the domestic savings needed to finance investment. We would also urge the authorities to reduce credit subsidies, which have a distorting effect on investment. We note the authorities' commitment to maintain, at the very least, the real effective exchange rate at the May 1989 level, and to make efforts to improve upon the level of competitiveness during the remainder of 1989.

As highlighted by the continuing large financing gaps projected in the medium-term scenario, it is crucially important that Ecuador follow policies that encourage a more competitive and diversified economy. In this context, we wonder whether further adjustment in the real effective exchange rate is not needed. Also, the Ecuadoran economy is highly protected and there are widespread controls on prices; moves to liberalize trade and to allow market forces to play a greater role in the allocation of resources could be helpful in encouraging needed adjustments and should be considered in working out a program for 1990.

We welcome the resumption of partial payments to banks and the start of discussions with banks on the financing package. However, even on the assumption of rescheduling by banks, including 1987-88 interest arrears, and by the Paris Club, a substantial financing gap remains. Moreover, the medium-term scenario by the staff indicates a continuing large gap. We agree with the staff that, in the circumstances, the prospects of a return to balance of payments viability and real rates of growth would be strengthened by debt and debt-service reduction, as well as rescheduling and new money.

While we are prepared to support the Ecuadoran request for a stand-by arrangement and the use of resources without financing assurances being in place, we agree with Mr. Grosche that consideration should perhaps be given to a temporary postponement, possibly until after the Annual Meetings, in order to have an idea of the likely response by the banks. Nevertheless, we are very concerned about the potential implications of the Ecuadoran case for the Fund's policy on financing assurances. Negotiations with the banks are at a very early stage. Moreover, given the magnitude of the financing package and of the debt reduction operations that seem to be required, as well as the distinct possibility that banks may wish first to finalize arrangements with larger countries, reaching agreement may be a slow process. In our view, it is quite possible that there will be little progress in negotiations before the first review, and there may well not be an agreement by the time of the second review. There is also considerable uncertainty over the kind of agreement that it will be possible to negotiate. Resources may not be available to fully close the projected financing gap, and the authorities may well need to adjust policies to generate more domestic savings.

Many Executive Directors, including this chair, have expressed concern about Fund financing of a program that is not fully funded beyond a relatively short period. These concerns should be brought forcefully to the attention of the Ecuadoran authorities and the bank Advisory Committee. We also feel that the progress of negotiations with banks should be closely monitored, and if it appears to stall, this should be brought to the attention of the Executive Board. Down the road, it might well be that an informal Board meeting could be convened to look at possible alternatives should lack of progress on negotiations seem likely to strain the guidelines on financing assurances. More generally, we believe that it would be highly desirable, in cases like Ecuador's where discussions with banks are still at a very early stage and financing gaps are large, if the norm were to have prior consultations on an informal basis with the Board. I understand that this possible step was discussed at some length during the review of financing assurances earlier this year.

Mr. Prader made the following statement:

We welcome the actions taken and planned by the authorities, but we have two major difficulties with the program: first, its strength. As other speakers have already pointed out, the program is not consistent and comprehensive. The design of the program thus seems to weaken its very purpose, namely, to gain the confidence of external creditors.

It is questionable whether the Ecuadoran request for a stand-by arrangement meets the criteria established by the guidelines for the Fund's involvement in the debt strategy. It is not based on a medium-term adjustment program with a strong element of structural reform. For the time being, all we know about possible structural reforms is Mr. Kafka's statement referring to the preparations of the authorities to implement them, and the staff's information that the Ecuadoran authorities have expressed interest in following this arrangement with an extended arrangement once a comprehensive program for structural reform has been formulated. This seems to indicate that the program is to serve only as a stopgap during a transitional period until a comprehensive adjustment program can be worked out. To present a more convincing case, would it not be more prudent to wait until this "real" program is ready?

My second reservation relates to the medium-term financial viability of the program. We appear to be confronted with another case of an underfinanced program. From the staff report we learn that a sizable and increasing financing gap is emerging, while the staff expects that, based on past experience, Ecuador should have no difficulty in eventually servicing the debt to the Fund. Before taking a positive position on the stand-by arrangement, I would like to have a realistic assessment from the staff of whether the assumptions of the Ecuadoran authorities about the financial response of the banks to the program will actually materialize. More specifically, despite the expectation of continued large net inflows from multilateral and bilateral official sources, the financing gaps up to 1994 would average slightly over 3 percent of GDP. The authorities intend to close this gap by debt reduction operations. Is that a realistic assumption?

In the absence of a satisfactory answer, I could not agree to an outright approval and would prefer to postpone the discussion until after the Annual Meetings, when we will know more about the reaction of the banks. My second preference would be approval in principle.

I recognize, of course, that Ecuador is in an extremely delicate situation as illustrated by the tough action of one major commercial bank toward it. Ecuador does not fall under the category of so-called systemic cases and, consequently, in the present stage of the debt crisis is in danger of being let down by the banks. However, it is an open question whether the Fund and other multilateral institutions will have to compensate for the shortfall in commercial bank financing and take upon themselves the additional risk. In this case, the realism of the concept of the catalytic role of the Fund would have to be reconsidered.

Mr. Kyriazidis made the following statement:

The recent economic history of Ecuador is an unhappy one. The precipitous decline in oil prices in 1986 and the earthquake of 1987, combined with slippages in economic policies, reversed the earlier progress in reducing inflationary pressures and strengthening the external position. The economic situation under the impetus of expansionary financial policies continued to deteriorate during the first half of 1988. The change of stance of the Government that took office in August 1988 must be welcomed. A number of selective measures have been taken since then which, in conjunction with higher oil prices, have indeed produced significant results, such as the substantial deceleration of inflation since April of this year and the improvement in the balance of payments which has allowed the Ecuadoran authorities to resume partial interest payments on external debt. All these are welcome developments. However, the measures taken so far constitute only initial steps, while the Government appears understandably to be still in the process of elaborating a comprehensive program.

Thus, while we welcome the progress made so far, as well as the policy intentions of the authorities as outlined by the staff and Mr. Kafka, we have some difficulty in accepting the proposal for a stand-by arrangement as it now stands. Indeed it does not appear to us to be consistent with the guidelines that we have adopted.

There are two points that I wish to raise in this connection. Fund intervention in heavily indebted countries, as we agreed a few months ago, should be based on a strong program, and I do not believe that the proposal before us corresponds to this description. I am most particularly disturbed by the absence of performance criteria beyond the end of December 1989 as well as by the effective absence of quantified targets for 1990 or any specific program and timetable for structural reform. The proposal thus appears to anticipate a program rather than to be based on an already formulated one which the Board could discuss and approve. This seems to be rather unusual in view of this institution's principles and practices.

The second disturbing point is that the financing gap is large and remains so throughout the period covered by the medium-term projections, while financing assurances are very weak. The issue is serious in view of the uncertainties involved and the vulnerability of the Ecuadoran balance of payments to changes in oil prices and interest rates. I acknowledge, of course, the fact that the proposed stand-by arrangement is not going to increase the Fund's exposure to Ecuador as it will simply in practice help to refinance the Fund's outstanding credit to this country at about 160 percent of quota. But this is not a strong reason for deviating from our policies and guidelines. However, I am sensitive to the staff's argument about the support that a Fund arrangement can provide to the authorities in their negotiations with commercial bank creditors as well as the contribution it can make toward the disbursement of the second tranche of the World Bank's financial sector adjustment loan and its cofinancing.

In view of all these considerations, I would like to propose that we approve the arrangement, in principle, until a complete program with appropriate performance criteria is prepared and agreed between the authorities and the staff and the prospective financial arrangements are clarified. Such an approval in principle would give the signal to Ecuador's commercial bank and Paris Club creditors that the authorities require. This would also hold true vis-à-vis the World Bank. At the same time, the Fund would remain consistent in its practice and its guidelines. The only immediate consequence would be the postponement of the first drawing, because if I read the staff papers correctly, both the clarification of the financing arrangements and the establishment of a clear program with performance criteria for 1990 are already prerequisites for the second drawing. I can see advantages to this procedure, which would avert the creation of a dangerous precedent and prevent the appearance of inconsistency with our principles and practices without causing undue hardship on the member.

Mr. Ismael said that he was aware of Ecuador's mixed economic performance in 1988, apparently owing to the fact that the adjustment measures had been introduced only after the new Government had taken office in August 1988. Since that time, Ecuador had, however, made great strides on the fiscal side and was now actively negotiating with the commercial banks. He was further encouraged to note that for the remainder of 1989 and for 1990, the authorities had formulated a program that, in his assessment, adequately addressed existing problems and therefore provided a sufficiently good basis for continued adjustment and improved economic performance.

Ecuador deserved the Fund's support, but he strongly urged that, by the time of the next review, the program be stronger, more concrete, and more detailed, Mr. Ismael remarked. In view of the present special circumstances of Ecuador in its negotiations with the banks, he could support the proposed decisions.

Mr. Raza observed that the decline in oil prices in earlier years, the continued deterioration in terms of trade, and the earthquake in early 1987 had dealt severe blows to the Ecuadoran economy. The situation had been worsened by the failure of the authorities to undertake strong demand-management policies. A further decline in oil prices in early 1988 notwithstanding, the new Government had already initiated a policy of fiscal and monetary constraint and flexible interest rates aimed at containing inflation and correcting distortions in relative prices; together with the pursuit of a flexible exchange rate policy, those measures were expected to correct external imbalances. He was pleased to note that the strong policy actions had already started paying dividends.

He agreed with Mr. Nimatallah's view on the basic weakness of the program, Mr. Raza said. However, the strong actions already taken by the authorities and the improvements in the economy noticed during the past year or so had paved the way for successful implementation of the agreed action plan. For that reason, and in view of the authorities' commitment to continue to follow a strong, growth-oriented adjustment program aimed at correcting internal as well as external imbalances, he strongly urged the Board to agree to the request of the Ecuadoran authorities for a stand-by arrangement in an amount equivalent to SDR 109.9 million for the period through February 1991, with speedy disbursement.

Mr. Posthumus made the following statement:

> The program of Ecuador described in the staff report is a combination of strong and less strong adjustment measures. In the field of fiscal policy, some very commendable measures have been taken that would lead to a deficit reduction from 5.1 percent in 1988 to 3.4 percent in 1989. Also, a sizable increase in public sector savings is projected for this year. In the area of monetary policy, subsidized credits funded by the Central Bank and by commercial banks are large, although the report is not clear as to how large. The effectiveness of

monetary control is limited. Furthermore, a large proportion of producer and consumer prices are subsidized, leading to distortions but perhaps also to suppressed inflation. Notwithstanding very high foreign loan disbursements in 1989, there is a sizable overall balance of payments deficit. The proposed adjustment program for the remainder of 1989 aims at a recovery in the rate of real economic growth to 3.5 percent, which is perhaps desirable but which seems to me not to be financially sustainable and is in fact not expected. Nevertheless, arrears are to rise still further.

While it is clear that the debt and debt-service burden is unsustainable, the question arises whether the program is sufficiently strong to make good use of the opportunities that would arise if the creditors would be prepared to accept a substantial debt and debt-service reduction. I doubt that it is. There is no clear scenario that shows the way to medium-term viability. There is in fact no medium-term adjustment program with a strong element of structural reform, as the guidelines require. In this situation it is uncertain whether a Fund-supported program should be accepted at this time, and it is not clear whether the necessary financing assurances will be fulfilled in the foreseeable future.

What then can the Fund do? It seems to me that there are four alternatives to the course of action which the staff proposes. One is postponement--we win much even if we win only time. Another alternative is to approve the present program but to indicate that it is not the kind of program that warrants either set-asides or augmentation in relation to debt and debt-service reduction operations. The argument would be that there is no medium-term adjustment program and no structural reform. After the first review, at the end of this year, when the program for 1990 has been decided upon, a revision of this decision might be considered.

A third alternative is to approve the present program, including set-asides and possible augmentation, in principle. Thus, by the end of the year, when the performance criteria for 1990 have been set, a future decision can be taken. This is what the banks always want, because we do not then approve the arrears to the banks. In both latter alternatives, a strengthening of the adjustment program for 1990 would be expected from Ecuador, and the review would be more significant than usual. The final alternative is abstention, and I hope that this will not be necessary.

I certainly would like to go along with Mr. Kafka when he asks for support in this case; but the problem is that no country is being supported in a real sense if its program is weak. Our role in the debt strategy would weaken, and it would not even assist in obtaining debt and debt-service reduction from the creditors.

Mr. Enoch said that the Government that had taken office in August 1988 had implemented a number of important measures. Fiscal policy had been tightened, the currency had been devalued, the authorities had adopted a more flexible exchange rate policy, and credit policy had been tightened. Notwithstanding those actions, substantial imbalances remained, inflation was a serious problem, and there had been an accumulation of arrears, especially to commercial bank creditors.

It was in that context that the authorities were seeking the support of the Fund, including support for debt reduction operations, Mr. Enoch continued. At the heart of the program was a further tightening of fiscal policy. In particular, revenues were to be increased and significant cuts in current expenditures were planned. The success of that policy was crucially dependent on the maintenance of tight wage policies in the public sector. It was in that respect that the authorities' plans were most ambitious; they adhere to them resolutely.

If the plans for fiscal policy were impressive, the measures planned in the areas of monetary and exchange rate policy were somewhat less so, Mr. Enoch commented. The staff estimated that real interest rates were just positive at present, but interest rates remained hedged around with restrictions that limited flexibility. Restrictions in maximum lending rates and the use of extraordinary levels of reserve requirements as an instrument of monetary policy were both causes of inefficiency, and the latter amounted to forced lending. While he welcomed the increased use of open market operations as an instrument of monetary policy, the authorities could have gone much further in eliminating both the restrictions referred to earlier and subsidies on credit, which remained pervasive.

Similarly, on exchange rate policy, he did not understand why the authorities were not prepared to proceed immediately to exchange rate unification, especially as the existing spread between the official and free market rates was only 5 percent, Mr. Enoch observed. Maintenance of a separate intervention rate left the way open for that spread to widen and for price distortions to become entrenched. The timetable for phasing out prior import deposits seemed to be unambitious, and the staff report made no reference to measures to encourage direct foreign investment, despite the fact that that was specifically emphasized in the guidelines on the debt strategy.

The authorities were seeking Fund support for debt reduction, Mr. Enoch noted. The figures in the report left no room for doubt that debt reduction would provide substantial benefits for Ecuador. The debt ratios that prevailed, and the staff's medium-term scenario in the absence of debt reduction, demonstrated the severity of Ecuador's problems. The staff's judgment that Ecuador simply could not sustain full debt-service payments to its commercial bank creditors also seemed realistic.

However, debt reduction alone would not solve Ecuador's problems, Mr. Enoch stated. A sustained and comprehensive adjustment effort was essential, and he had some doubts as to whether the measures contemplated in the program were sufficient. The staff report stated that the authorities were planning to request an extended arrangement that would involve substantial structural adjustment measures. There would therefore clearly be merit in delaying the current program until further progress had been made in discussions with the authorities on those crucial adjustment measures. That conclusion was reinforced by considerations relating to the Fund's policy on financing assurances. There was as yet no real indication of the attitude of the banks. Ecuador's relations with its commercial bank creditors had not always been harmonious, and while he welcomed the resumption of contacts with the commercial banks, including the resumption of partial interest payments, and recognized Mr. Kafka's point that the banks had not always treated Ecuador very well, it was clear that negotiations remained at a preliminary stage. Given that situation, there seemed to be little prospect of an agreement that satisfied Ecuador's financing needs within a reasonable period of time, as required by the Fund's guidelines.

There were many uncertainties surrounding the program, Mr. Enoch commented. He had already explained a number of doubts about the adequacy of the measures planned. The commercial banks' reaction was unclear, and even if they agreed to debt reduction, it was not certain that the resources were available to permit sufficient debt reduction to allow Ecuador to achieve medium-term viability, nor was it clear that the guidelines had been followed in the present case. Those guidelines required a demonstration that there was an urgent need for resources to be disbursed at present. That case had not been convincingly made, especially as Ecuador's reserves stood at over four months of imports. Moreover, when the Mexican program had been first brought to the Board, it had been stressed that because of the increased risk being incurred by the Fund because of the lack of financing assurances, there would be full quarterly reviews of the program. That again did not seem at the present stage to be in prospect for Ecuador.

He agreed with Mr. Grosche that a full review of the program, and not just of progress on financing, was needed before each disbursement, Mr. Enoch said. Therefore, and in the light of comments made by Mr. Grosche, Ms. Powell, and Mr. Prader, he would seek postponement of a decision on the program. He noted from Mr. Kafka's statement that negotiations with the banks were expected to resume during the Annual Meetings; a delay until later in the year would enable some progress to be made in those negotiations. It would also enable the staff and the Ecuadoran authorities to work together on measures, in particular structural measures, as indicated by other speakers. A more convincing case for Board approval could be made once the structural measures had been addressed and once targets had been specified for 1990. In conclusion, therefore, he joined others in seeking a postponement of the decision.

Mr. Fogelholm made the following statement:

> Ecuador is the fifth case in which the revised debt strategy is to be used. Consequently, we should in this case--as indeed in all cases--demand a strong adjustment program and clear indications that the negotiations toward a financial agreement with the banks are proceeding satisfactorily so that the country will be able to attain external viability with growth.
>
> During recent years, Ecuador has been hard hit by external events that have had a profound impact on its economy and caused serious domestic and external imbalances. But some of its problems are clearly home grown, as reflected in its not very satisfactory track record in dealing with its economic difficulties, particularly in recent years. Nonetheless, we should give Ecuador credit for having promptly serviced its obligations to the Fund.
>
> The program, no doubt, contains a number of positive elements, among them the hike in gasoline prices, adjustment of the exchange rate, and corrective measures in the fiscal area. But while these measures will improve the situation in 1989, we have serious doubts about whether the program is strong enough to instigate economic development that would be sufficient to lead to external viability in the medium term.
>
> Even if the Government has implemented, or is in the process of implementing, important policy measures in the current year, these can hardly be considered prior actions in the usual Fund meaning. Therefore, some of the more important policy measures envisaged in the program should at least have been given a timetable for implementation. We would particularly emphasize the need for a further adjustment of gasoline prices, to bring them more into line with world market prices, as well as structural measures such as the liberalization of imports and domestic prices. Moreover, while the authorities' intention to pursue a restrictive incomes policy this year is welcome, we are concerned about its attainability in 1990 in light of the prevailing distortions in the wage and salary system.
>
> The program before us has been designed only for the short term and many central policy measures beyond the current year, including structural measures, are not included. In view of the concerns just expressed, this is clearly inadequate, and

we would like to ask the staff why the program has not been extended to cover the whole stand-by arrangement period.

The staff report indicates that external viability is not attainable over the medium term even after extensive official and private sector debt rescheduling. The baseline, medium-term scenario also shows that there will be only moderate improvement in the balance of trade and nonfactor services account after 1990. This, in itself, speaks for the need for further adjustment measures, in particular the attainment of a positive real interest rate and a further depreciation of the exchange rate to strengthen exports. In this connection, I would encourage the authorities to speed up preparation of structural reforms directed toward the promotion of resource allocation and export diversification.

However, the alternative scenario--including debt and debt-service reduction--shown in Chart 2 of the staff report, gives a much more optimistic picture. As the underlying assumptions in this scenario are unclear to me, I would be interested to learn from the staff whether it believes this to be realistic, particularly in light of the shortcomings of the program. All in all, one can doubt the program's ability to generate a positive response from the commercial creditors, and its suitability for financial support from the Fund.

It is obvious from Mr. Kafka's statement that the discussions with the banks are only in their infancy, which implies that at this stage we have no indication whatsoever of how the banks are going to react to the proposal by the authorities for debt and debt-service reduction.

In sum, we have serious problems approving this arrangement as presented since we doubt that it will achieve its objective. Therefore, we cannot approve the proposed decision as put forward by the staff, but we can go along with the proposal to postpone the decision. However, should a postponement not be acceptable to the Board, I would--like Mr. Prader and Mr. Kyriazidis--have to propose that the decision be taken in principle only, owing to the clear absence of financing assurances and to the fact that the program will not lead to medium-term viability.

Let me add that we are somewhat concerned about the tendency to bring to the Board programs within the framework of the revised debt strategy that do not meet the requirements of the guidelines, in particular the requirement that they be of adequate strength. I also agree with other Directors that an informal briefing of the Board would have been warranted in this case.

Mr. Adachi made the following statement:

As previous speakers have noted, Ecuador's request for a stand-by arrangement is the most difficult one we have had to deal with since we embarked on the strengthened debt strategy. However, before addressing myself to the request, let me touch upon past economic policy developments. After being hit by a decline in oil prices in 1986, Ecuador sought economic adjustment under a stand-by arrangement. However, the program soon went off track, and only the first drawing was made. Then, in 1987, Ecuador experienced a further setback, stemming largely from the earthquake, and another stand-by arrangement was approved in early 1988, following emergency assistance. Once again, the arrangement soon became inoperative. The program was underfinanced because envisaged financing from commercial banks did not materialize despite the outright approval of the stand-by arrangement before the critical mass was obtained.

The economic situation continued to deteriorate further in the first half of 1988. Although in the last half of the year the new Administration adopted several adjustment measures, most notably the unification of the exchange market, the recovery of economic performance was less than expected. Early this year, the authorities strengthened the adjustment efforts by taking advantage of favorable exogenous developments, including the upsurge in oil prices. The fiscal position has been strengthened; monetary control has been tightened; and price controls have been relaxed. Such efforts to revamp the economy have resulted in a decline in the rate of inflation.

However, it is clear that much remains to be done. Inflationary pressure remains high, the balance of payments situation continues to be precarious, and external arrears remain. The authorities should redouble their adjustment efforts. In this context, we can basically endorse the policy recommendations made by the staff.

Having said this, this chair shares the concerns expressed by previous speakers regarding the stand-by arrangement. In particular, the issue of financing assurances is worrisome, especially as this chair was one of those that expressed strong concerns about the financing assurances for the 1988 stand-by arrangement. In 1988, the Board approved the arrangement in hopes of expediting the achievement of a critical mass. However, that was not realized, and today we have once again heard a similar argument that a Fund arrangement is critical to provide the impetus for external debt negotiations.

The large financing gap, as well as the very slow progress in external debt negotiations, raises serious doubts about the future scope for financing the program. Furthermore, we have not yet seen the authorities' concrete policy intentions for 1990. The medium-term balance of payments projection points to the vulnerability of the program, and I wonder why a contingency financing arrangement is not attached to the stand-by arrangement. Like Mr. Posthumus, we are seriously concerned about the lack of a medium-term and structural program. However, the fact that a review of external debt negotiations will be required for the second disbursement subdues our concern somewhat. In a relevant vein, like Mr. Ismael, I believe that the authorities should present a concrete 1990 policy package to the Board at the time of the next review. Furthermore, I wonder why the signature of an Agreed Minute with Paris Club creditors will be the condition not for the second disbursement but for the third disbursement, despite the fact that the Paris Club will meet next month. Nevertheless, we recognize the authorities' strong commitment to adjustment which Mr. Kafka emphasized this morning. Thus, we are ready, although reluctantly, to give Ecuador the benefit of the doubt as far as the relationship between the Fund arrangement and negotiations with commercial banks is concerned, and we will go along with the proposed decisions, although we are uncomfortable with them. I should add that my support should not be taken as a precedent.

Finally, I have to add that my authorities have expressed serious reservations about the menus that are under negotiation between commercial banks and Ecuador, since they strongly believe that cash buy-backs should not be a main menu item. In this context, I would like to hear the staff's views on the scope for debt-service reduction operations in this case.

Mr. Warner made the following statement:

I purposely waited before intervening in the discussion to permit the Board to focus at length upon the particular decision before us. I especially wanted to hear a number of speakers, because we have some concerns, which I will clarify later in my statement.

The adjustment efforts since 1985, as described in the staff report, represent a trail of missed goals and opportunities. My authorities are, however, encouraged by policy reforms undertaken by the Government since it took office a year ago. Progress in bringing down inflation and reducing the deficit of the nonfinancial public sector has been especially welcome. We are also pleased that the authorities have confidence in their ability to manage the economy and, therefore, have decided to come to the Board and make a request for a stand-by arrangement. But looking at the past record, it must be made clear, as speakers before me have emphasized, that should Ecuador's performance be unsatisfactory, the cost to the economy of

Ecuador would be extremely high. Therefore, I believe both the authorities and this Board must approach a new stand-by arrangement with great caution, depth of understanding, and perception.

As other speakers have noted, it is useful to recognize the transitional nature of the Ecuadoran program. The statement that an extended arrangement would follow is a cardinal element of the issue before us. A significant question raised by other speakers was whether Ecuador could obtain the expected level of external support from the creditor community if it pursues a program of this nature without further strengthening.

We also have to recognize that Ecuador's case raises the issue of prolonged use of Fund resources, perhaps even beyond a decade. In this regard, it would have been constructive for the discussion if we had been presented with an alternative medium-term balance of payments scenario, perhaps based on a stronger front-loaded program containing significant macroeconomic and structural reforms and showing a more satisfactory path of growth. Other speakers have touched on this point, which we also wish to emphasize.

Before commenting on the external financing aspects of this program, let me make a few observations with regard to the fiscal area. First, we agree with the staff on the importance of pressing ahead with additional tax reform measures. Second, on the expenditure side, we are concerned that the system for setting public sector wages is not consistent with the inflation objective. We also see some discrepancy in the staff report itself with regard to the increases indicated for public sector employees; I can provide details to the staff should it wish to pursue that matter. Third, the continued maintenance of extensive price controls is the weakest part of the program, notably the proposal to raise gas prices to the equivalent of $0.45 a gallon by the end of 1989. External creditors are thereby left with an impressive picture of massive subsidization of gasoline consumption. Fourth, we urge the authorities to eliminate the multiple currency practice before the end of the program and to undertake further substantial reductions of exchange and trade restrictions. This point was also emphasized by other speakers.

On the matter of external financing, we are not impressed by efforts made by the authorities to reach agreement with their commercial bank creditors. That point has also been made by many of the earlier speakers. In particular, we regret the long delay in resuming partial interest payments, and the unwillingness at the present stage to agree to a fixed schedule of interest payments, as has been done in other cases such as that of Costa Rica.

This discussion has indicated the Board's strong fundamental interest in Ecuador; that is not an issue. But colleagues are expressing concern about straining the financial assurances element of our guidelines. I hear very clearly that there is a basic interest in shaping an effective program under which the Ecuadoran authorities could undertake a debt and debt-service reduction operation. We respect the fact that Ecuador has had an uneven experience with commercial banks, as has been noted by other speakers. I do not think that this chair or others would condone some of the activity the commercial banks have pursued in recent months. But I also sense that this Board is concerned about postponing a decision or approving this request in principle. As Mrs. Filardo indicated, she is concerned about the improper signal to banks.

This Board does play a role; the Fund obviously takes decisions that have a profound effect on the relationship between member countries and banks, as shown by the recent success with regard to Mexico. So we do not want to send the wrong signal. But I sense that the Board is not prepared to take either the recommended decision or the strong posture that is sought by Mr. Kafka. That concerns me because the posture of this Board must be reasonably clear, if not totally clear, to the banking community every time we take one of these decisions.

Accordingly, I would like, in the course of what I would characterize as our secondary debate, to make the point that the Board is seeking time to achieve a stronger program. If we can close today's discussion with agreement on that point, it will be a good signal, indicating that notwithstanding the high quality of the staff's work, occasionally a case of this nature can be brought to the Board that might be slightly ill-timed. But doing so does not force the Board to make a decision that is contrary either to the interest of the member country or, more important, to the central role of the Fund, particularly under the debt strategy.

I would like to relinquish the floor at this juncture to see if my colleagues wish to join me in perhaps not just a classical postponement, but one that indicates that we want to take a short period of time to find something better. If that is the direction we are going in, then a short postponement, if we must characterize it that way, perhaps is the wisest decision. I would not want to give the impression that we are not prepared to give the right level of support to Ecuador, or any other member country, while it is negotiating debt and debt-service reduction arrangements with commercial banks. At the same time, our comments today indicate to the authorities that they are going to have to intensify their dialogue with the banks. An agreement in principle might give the wrong signal. Therefore, I am seeking a stronger program. If colleagues wish to move in that direction, I am prepared to do so; and if, as a result, we have to postpone our decision, then that signal would be appropriate.

Mr. Morshed made the following statement:

Since their assumption of office in August 1988, the new authorities in Ecuador have implemented a series of measures designed to restore macroeconomic stability within the country. Monetary policy restraint, exchange rate adjustment, changes in fiscal policy, and the enhanced operating efficiency of public enterprises, together with the increase in oil-related revenues following resumption of a more normal production level, have contributed to improvements in the fiscal and current account deficits. However, inflation and a high debt-servicing burden remain a significant threat to the prospects for the attainment of sustained economic growth. The balance of payments support available to Ecuador under the proposed stand-by arrangement therefore comes at an appropriate time. At this stage of the discussion, and as I am in general agreement with the broad thrust of the staff report, I would like to make only a few brief observations.

First, it is important to note that, in the prevailing environment, continued priority should be given to the achievement of macroeconomic stability. Exchange rate policy and trade policy must in the first instance be supportive of such an objective and, in this regard, must reinforce monetary and fiscal policies. The need for financial sector structural reform is evident, and the World Bank sectoral adjustment loan will, we hope, result in the adoption of measures that will, among other things, lead to an improvement in the structure of returns within the financial system and reduced financial intermediation costs. Structural reforms in other sectors over the medium term could also serve to enhance the economy's longer-term growth prospects.

Second, a reduction in the rate of inflation is clearly an important challenge facing policymakers in Ecuador. More realistic pricing of products subject to government controls is necessary to contain the expansionary fiscal influence, even though the immediate impact of such changes may be to aggravate inflationary pressures. However, it is somewhat disconcerting to note that an important by-product of the policies being pursued appears to be a substantial reduction in real wages. Following a 15 percent decline in real wages in 1988, the increase in minimum wages in 1989 is expected to be substantially below the expected inflation level. While some decline in real wages may be expected as a result of the adjustment effort, I wonder whether the large real decline anticipated is due to past or present structural rigidities in the labor market.

Third, as explained by Mr. Kafka, Ecuador's oppressive debt-servicing burden appears to make it an appropriate candidate for debt and debt-service reduction operations. However, given the fact that the negotiation process has so far proved, in the cases considered by the Board to date, to be prolonged and complex, the attitude of commercial banks in dealing with smaller countries upon whom they can exercise greater leverage remains to be seen. An example of the attitude of banks may be reflected in the recent action taken by Citibank in May 1989 against Ecuador. Creditor governments and international financial institutions must therefore be especially careful in their monitoring of the debt reduction negotiation process.

Ecuador is another example of the substantial economic management problems caused in many oil exporting countries by the volatility in the price of oil. There is perhaps a need for greater research at a multilateral level on the problems of developing countries whose export performance is predominantly tied to one or two commodities that are traded in unstable international markets. This issue is particularly relevant in view of the limited possibilities for any meaningful economic diversification in the near term. In conclusion, I can support the proposed decision.

Mr. Kwon said that it was encouraging to note that the present Government of Ecuador had taken important steps to address the economic deterioration of previous years brought about by weaknesses in policy implementation and the decline in oil prices. For the reasons expressed by Mr. Grosche and other speakers, his chair had reservations about supporting the proposed program in its present state, particularly with respect to its concentration on the short term and the lack of strong structural measures. He was also concerned about the extent of the financing gaps, and he had serious doubts about whether those gaps could be filled.

Consequently, he sympathized with the calls by previous speakers for a postponement, but he also agreed with the concerns expressed by Mr. Warner, Mr. Kwon stated. He would therefore be prepared to go along with the policy package as recommended by the staff, and he would support a consensus in the Board for approval in principle.

Mr. Marcel remarked that he shared most of the concerns expressed by his colleagues, notably Mr. Grosche and Mr. Enoch. The issue of financing assurances had been raised, and, indeed, Ecuador was a very difficult case. The negotiating process with banks was at a preliminary stage, and many uncertainties remained on how the financing gap would be covered.

Ecuador was in a worrisome situation. If the steep deterioration of the economy seemed to have been stabilized recently, the country had not yet succeeded in reversing the trend on a permanent basis. Moreover, the recent track record of Ecuador was not fully convincing. Furthermore, he was of the view that the program was far from being as strong as those seen in comparable cases. Nevertheless, as the staff had pointed out, Ecuador had never been in arrears with the Fund and had made significant efforts in the recent period, and a cooperative effort on the part of the international community was needed to help the country deal with its deep-seated difficulties.

He was not enthusiastic about releasing the first tranche of the stand-by arrangement, and, like Mr. Grosche, he would have preferred to have been consulted informally before discussion of the present case; the credibility of the Fund's financing assurances policy was clearly at stake, Mr. Marcel observed. Because only the first drawing was being considered, he could give the benefit of the doubt to the Ecuadoran authorities and approve the proposed decision, but that approval would be given with reluctance. He would reserve his final position, and he requested Mr. Warner to provide more details with respect to his suggestion for a shorter postponement.

Mr. Warner suggested that a deferral, because of the time factor associated with it, would reflect the Board's deep concern to the authorities without tipping the balance in the dialogue between commercial banks and the Ecuadoran authorities. He could not give an exact definition of the time required to meet the concerns expressed by his colleagues on the Board regarding the need for a stronger program. The staff would need time to discuss the issue with the authorities and Mr. Kafka. His suggestion was that the Board show a strong consensus of support for the authorities while acknowledging the need for a stronger program. He would hope that the time required to establish a framework for such a program would be short, so that discussions between the Ecuadoran authorities and the banks would not be influenced adversely.

Mr. Monyake said that, initially, he had not planned to speak because the case before the Board seemed straightforward: that of a struggling country faced with a number of adversities and doing its best to put its economy in order. The program as outlined satisfied, more or less, the requirements. But the comments of his colleagues convinced him that other measures remained to be taken to improve the quality of the program. While his chair continued to believe that the Board could go along with the proposed decision, it also urged the authorities to strengthen the program as suggested. However, if the Board would find it difficult to support the decision, he found Mr. Warner's compromise acceptable.

Mr. Kpetigo observed that during 1986-87, Ecuador's economic situation had deteriorated, reflecting a decline in world oil prices and the earthquake. However, in 1988, a series of measures had been taken to improve Ecuador's economic performance. That year, measures in the fiscal, monetary, and exchange rate areas had been taken to strengthen the adjustment efforts. He could support the proposed decisions.

Mr. Zhang said that he concurred with the staff's analysis and appraisal of Ecuador's economic situation and developments. He supported the proposed decisions.

The Acting Chairman proposed that the Board adjourn briefly, whereupon the Executive Board adjourned for twenty minutes. When the Board reconvened, the Managing Director assumed the chair.

The Chairman observed that the case of Ecuador was a difficult one, as reflected in the carefully worded statements of Directors. While Ecuador had made progress in adjustment, it continued to have significant debt problems and would certainly be a candidate, when all requirements had been met, for debt reduction. But it was equally true that Ecuador had not been able to agree with the Fund at the present stage on the type of medium-term program required in debt reduction operations. Indeed, its difficult relations in the past with the banking community gave cause for concern in assessing possible financing assurances.

In view of that situation, the Board would have to make a constructive and realistic choice between the four possibilities under consideration, the Chairman continued. The possible courses of action were outright approval of the decision; postponement, as qualified constructively by Mr. Warner; approval in principle; and approval of a first purchase but with the requirement for a program review that would indicate the attainment of both the financing assurances necessary prior to the second purchase, and a medium-term perspective in the 1990 program in respect of the structural measures essential to entitle the country to debt reduction operations.

In point of fact, the choice was probably between postponement and the fourth alternative, the Chairman observed. Because the review would normally take place by end-February 1990, a postponement would lead to a relatively long delay during which misunderstandings could arise on the part of the member country, public opinion, and the banking community, thereby running the risk of undermining the Ecuadoran authorities' work toward a strong program. He therefore wondered whether Mr. Kafka could inform the Board as to whether it would be possible for the authorities to cooperate with the Fund so that the first review could be held earlier than scheduled, possibly by end-December 1989. That earlier date would imply a particular effort to define the medium-term program and the structural measures. Meanwhile, the country would endeavor to come to terms with the banking community. In that way, the Fund would be sending messages for both stronger bank support and a stronger program. All things considered, he saw merit in scheduling the review for end-December at the latest, because the first purchase could be approved for immediate disbursement. Incidentally, although that disbursement would entail a negative flow of resources to Ecuador, it would nevertheless give the country a strong signal of cooperation and would avoid possibly disruptive developments. If such a solution was found acceptable by the Board, the proposed decision could be modified accordingly.

Mr. Kafka said that his Ecuadoran authorities had informed him that they would regard any postponement as fatal to their program and their negotiations with commercial banks. While they could not accept approval in principle or a postponement under any circumstances, they could accept the solution described by the Chairman, and they would do their best to meet the requirements of that proposal. In other words, a full review would take place during December and a quantified program for 1990 would be presented at that time.

Mrs. Filardo commented that it had taken some time for the Ecuadoran authorities to agree to implement measures. However, she realized that the credibility of the Fund, and of the debt strategy, required a stronger program. She therefore could agree to the compromise solution, as proposed by the Chairman, to approve the stand-by arrangement on the condition that the Ecuadoran authorities would undertake the prompt strengthening of the program.

Mr. Fogelholm, Mr. Ismael, and Mr. Marcel said that they supported the Chairman's proposal.

Mr. Posthumus said that while he did not disagree, he considered that care should be taken in the wording of the proposal with respect to two issues: the program, which had to be strengthened, and the discussions with the banks on financing assurances.

The Chairman said that the staff would draft a decision that would be circulated to Executive Directors for their consideration at the next meeting of the Executive Board, which would take place that afternoon.

Mr. Kyriazidis said that he had some difficulty in accepting the Chairman's proposal, particularly with regard to approval of the first disbursement. His major concern was similar to that expressed by Mr. Posthumus, in that he would like to see a full macroeconomic program for 1990 with explicit, detailed structural reform measures and a timetable, to the extent possible, for their implementation. While the program was his major concern, he agreed that clarification of the financial arrangements was also important.

The Chairman added that it was also necessary to have a medium-term perspective that implied an effort on the part of Ecuador to work with the Fund in establishing an economic program that would lay the basis for economic viability beyond 1990.

Mr. Prader suggested that the modifications mentioned by the Chairman and Mr. Kyriazidis should be included in the decision. Otherwise, the review specified would not differ greatly from the first review scheduled under any program.

Mr. Enoch observed that the intention of the authorities of Ecuador to request augmentation of the stand-by arrangement, as cited in the third paragraph of the proposed decision, was not appropriate, because the program, as specified in the staff report, did not meet the requirements for such a provision.

The Chairman agreed that such an element would be considered only at the time of the first review, and therefore the decision would be amended accordingly.

Mr. Grosche said that he agreed with the point made by Mr. Enoch. Moreover, he would ask the staff to look into the question of disbursing into a situation where the program was not financed. While he had some problems with the proposed decision, he was open minded, and he would wait to see the language of the decision before expressing his views.

Mr. Kyriazidis said that he would reserve his position with regard to approval of the first drawing until seeing the text of the decision.

The staff representative from the Western Hemisphere Department said that, with regard to structural reform, the current Administration in Ecuador had already started a major effort to revamp the revenue system of the public sector. A law had been passed at the end of 1988 that would widen the withholding system for the income tax and improve collection procedures for the self-employed, both of which were significant problems in Ecuador. The law had also changed the procedures under which municipalities collected taxes. Thus far, those measures were yielding good results. In addition, the authorities were preparing a law that was expected to be passed before the end of 1989 that would simplify the income tax system. Many of the deductions would be eliminated, and the tax rates simplified. They were also working on widening the base of the most important indirect tax, the value-added tax.

With regard to the financial system, a number of steps had been taken in the past year with the support of the World Bank through a financial sector loan, and the authorities had been able to introduce a number of changes in procedures to recapitalize the banks and restructure some of the banks that had been having difficulties, the staff representative continued. Other efforts included, for example, policy initiatives that would reduce the level of subsidized credits, which in 1989 would amount to 50 percent, to less than 25 percent of total credits.

In its discussions with the authorities, the staff had focused on the areas that would need to be addressed to reach economic viability in the medium term, the staff representative said. Specifically, the authorities were concerned about the need to open the economy. On the trade system, they were working on the simplification of the tariff schedule, reducing the number and level of rates. In the program as already negotiated, a number of steps had been taken to reduce exchange restrictions, and the authorities were planning to reduce import licensing and quota restrictions. They were also concerned about measures affecting the energy sector, investment laws, and public sector pricing.

As to medium-term prospects, the staff had presented its forecast under a traditional new money approach, which highlighted the problems Ecuador would face in the future, even with adequate policies and reasonable assumptions regarding the availability of external financing, the staff representative noted. The staff had also presented a medium-term scenario in chart form which indicated a more viable picture, including the reduction of about 35 percent of Ecuador's debt to commercial banks, which could be accomplished in a number of ways. The scenario also showed that the current account deficit would be reduced not only because of the interest payment reduction but also because of the positive effect that the reduction would have on the private sector and the favorable impact on investment.

At the time of the staff's negotiations with the authorities on the program, it was not clear when Ecuador would meet with the Paris Club, and for that reason the third purchase had been made subject to the Paris Club agreement, the staff representative from the Western Hemisphere Department explained. The staff was aware at present that the Paris Club would meet in October.

Mr. Kafka commented that he had been struck by the fact that of the criticisms that had been voiced, there seemed to be an impression that no strong prior actions had been taken by the Ecuadoran authorities. That impression was incorrect. When the Government had taken office in the middle of 1988, the fiscal deficit had amounted to 9 percent of GDP and a 100 percent premium for the free market exchange rate existed over the intervention rate. The deficit had been brought down to 5 percent in 1988, in 1989 it was expected to be a little over 3 percent, and in 1990 it was estimated to be slightly over 2 percent. The exchange rate premium had been reduced to 5 percent. The authorities had done a great deal, all of it prior to the stand-by arrangement.

The Acting Chairman made the following summing up:

> Executive Directors commended the Government which took office in August 1988 for the prompt adoption of measures that had been taken to reverse a deteriorating economic situation marked by an acceleration of inflation and the accumulation of external payments arrears. They were encouraged by the recent slowdown in inflation; they observed, however, that the economic situation continued to be very difficult, requiring a substantial and comprehensive adjustment effort and a much more resolute approach in tackling needed structural reforms.
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> Most Directors were of the view that existing policies needed to be strengthened significantly to achieve the objectives of the program. They urged the authorities to take

additional corrective action without delay. The absence of specificity in the economic program beyond the end of 1989 was particularly deplored as well as the inadequate and piecemeal approach in tackling structural weaknesses in the economy. Moreover, large external financing gaps would persist in the medium term, and the prospect of obtaining financing assurances of the external gap during the period of the stand-by arrangement was not assured.

Directors welcomed the fiscal adjustment incorporated in the program for 1989 and the authorities' plans to reduce further the fiscal deficit in 1990. The fiscal deficit in 1989 was to be reduced mainly through a combination of price adjustments of public enterprises, improved tax administration, and expenditure restraint. The scheduled increases in public sector prices were considered a first step in the process of reducing price distortions. Directors welcomed the first results apparent from the tax reform measures introduced in December 1988, and they urged the authorities to push ahead with the simplification of the tax system and to strengthen collection procedures. Directors noted that the success of the program would depend on the containment of wage increases and other expenditures. Wage moderation also was important in the effort to reduce inflation and to ensure an adequate level of external competitiveness.

Most Directors doubted whether the fiscal policy in place and the planned monetary restraint would be adequate to achieve the program's inflation and balance of payments targets. While the recent changes in the interest rate system had introduced greater flexibility in interest rate determination, Directors believed that the policies of the authorities should be bolder and stressed the importance of achieving and maintaining interest rates that were sufficiently positive in real terms. They also were of the view that subsidized credit operations should be reduced and that interest rates on such credits should be adjusted more frequently.

Directors underscored the importance of pursuing a flexible exchange rate policy to strengthen Ecuador's external sector, and in this connection they expressed concern about the real effective appreciation of the sucre which had occurred between August 1988 and May 1989. While encouraged by the authorities' commitment to prevent any further appreciation of the sucre, Directors stressed that the authorities should be prepared to take any additional steps that might be needed to attain their balance of payments objectives.

Several Directors noted that an adequately flexible exchange rate policy would facilitate the reduction in exchange and trade restrictions. The recent simplifications in the exchange and trade system were welcomed, but Directors remarked that these changes would need to be followed by further liberalization. They also observed that exchange and trade reform should be supported by domestic price flexibility if resource allocation is to improve and if the economy is to be diversified. With the firming of financial policies, Directors urged the authorities to reduce reliance on price controls.

Directors generally supported the program's objectives of reducing the external current account deficit and increasing net international reserves. However, they expressed concern about the size of outstanding external payments arrears, their likely increase in the coming months, and the medium-term outlook for the balance of payments. They emphasized the importance of Ecuador and its commercial bank creditors reaching agreement promptly on a suitable financing package, and they welcomed the resumption of partial interest payments to commercial banks as an indication of the authorities' commitment to re-establish normal relations with the banking community. In the circumstances of Ecuador, many Directors remarked that a return to external viability and the resumption of significant real rates of economic growth would be assisted by debt and debt-service reduction. However, many Directors commented that before debt and debt-service reduction operations could be considered, there would need to be a strong economic program that would lay the basis for medium-term economic viability.

All Directors emphasized the willingness and determination of the Fund to assist Ecuador. However, the Board in its broad majority believed that a major strengthening of Ecuador's macroeconomic and structural policies for 1990 and also in a medium-term framework was required, as well as progress toward achieving the financing assurances for the period covered by the stand-by arrangement as well as for the medium term.

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

The Executive Board then took the following decision :

1. The Fund takes this decision relating to Ecuador's exchange measures subject to Article VIII, Sections 2 and 3, in the light of the 1989 Article IV consultation with Ecuador conducted under Decision No. 5392-(77/63), adopted April 29, 1977, as amended (Surveillance over Exchange Rate Policies).

2. The following exchange measures maintained by Ecuador are subject to Fund approval under Article VIII: exchange restrictions in the form of a limit on the availability of foreign exchange for imports, in the form of a foreign financing

requirement for the import of permissible capital goods and as evidenced by certain external payments arrears; multiple currency practices arising from unremunerated prior import deposit requirements, and from a spread of more than 2 percent between buying and selling rates in the intervention market. In the circumstances of Ecuador, and with the exception of the exchange restrictions evidenced by payments arrears, the Fund grants approval for their retention by Ecuador until February 28, 1990.

Decision No. 9256-(89/127), adopted
September 15, 1989

The Executive Directors agreed to continue their consideration of Ecuador's request for a stand-by arrangement in the afternoon.

APPROVED: May 25, 1990

LEO VAN HOUTVEN
Secretary