INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 86/120

10:00 a.m., July 21, 1986

J. de Larosière, Chairman
R. D. Erb, Deputy Managing Director

Executive Directors	Alternate Executive Directors
	J.-C. Obame, Temporary
C. H. Dallara	M. K. Bush
	L. Hubloue, Temporary
	T. Alhaimus
	M. Sugita
G. Grosche	A. Bertuch-Samuels, Temporary
Huang F.	
J. E. Ismael	
A. Kafka	J. R. N. Almeida, Temporary
T. P. Lankester	R. Fox, Temporary
H. Lundstrom	
M. Massé	L. Leonard
	W. N. Engert, Temporary
	A. Abdallah
F. L. Nebbia	
Y. A. Nimatallah	J. E. Suraisry
	G. Ortiz
H. Ploix	
J. J. Polak	J. de Beaufort Wijnholds
C. R. Rye	
	O. Kabbaj
A. K. Sengupta	A. S. Jayawardena
S. Zecchini	N. Kyriazidis

J. W. Lang, Jr., Acting Secretary
A. Akanda, Assistant

Also Present

IBRD: P. Eigen, Latin America and the Caribbean Regional Office. African Department: A. D. Ouattara, Director; A. I. Abdi, J. Artus, E. L. Bornemann, E. A. Calamitsis, E. Martey. Exchange and Trade Relations Department: W. A. Beveridge, Deputy Director; M. Guitián, Deputy Director; E. H. Brau, A. B. Petersen, F. L. Osunsade, N. Streefkerk. Fiscal Affairs Department: M. Frenkel. Legal Department: F. P. Gianviti, Director; H. Elizalde, J. M. Ogoola. Middle Eastern Department: A. S. Shaalan, Director; M. A. El-Erian. Secretary's Department: A. P. Bhagwat. Treasurer's Department: D. Williams, Deputy Treasurer; J. C. Corr. Western Hemisphere Department: E. Wiesner, Director; S. T. Beza, Associate Director; J. Ferrán, J. E. Gonzalez, J. Jaramillo-Vallejo, P. Kohnert, J. Leimone, C. M. Loser, J. Pujol. Personal Assistant to the Managing Director: R. M. G. Brown. Advisors to Executive Directors: L. P. Ebrill, S. M. Hassan, G. D. Hodgson, G. Nguyen, A. Ouanes, I. Puro, D. C. Templeman, A. Vasudevan. Assistants to Executive Directors: B. Bogdanovic, F. Di Mauro, S. King, M. Lundsager, T. Morita, W. K. Parmena, J. E. Rodríguez, V. Rousset, C. A. Salinas, H. van der Burg, E. L. Walker, B. D. White.

1. TANZANIA - OVERDUE FINANCIAL OBLIGATIONS - SUSPENSION OF DECLARATION OF INELIGIBILITY

At the request of an Executive Director, the Executive Board reconsidered Decision No. 8529-(86/68) G/TR, adopted April 23, 1986, which stated that Tanzania would be declared ineligible to use the general resources of the Fund if it did not become current in its financial obligations to the Fund by July 23, 1986.

The Director of the African Department said that Tanzania's overdue obligations to the Fund as of July 18, 1986 amounted to SDR 22.9 million. In addition, charges on Trust Fund payments amounting to about SDR 3.8 million would fall due between July and September. The authorities had been urged to make every effort to clear the existing overdue obligations and to remain current with the Fund thereafter so that the proposed adjustment program could be negotiated and presented to the Executive Board. Discussions between the authorities and the commercial banks on possible bridge financing had indicated that since the banks could provide only part of the financing, an amount equivalent to some SDR 6 million, or about $7.2 million would be needed from other sources. Bilateral donors represented one possible source, and financial commitments from those donors could be paid in cash through guarantees of commercial banks in the donor countries. However, Tanzania would be declared ineligible to use Fund resources on Wednesday, July 23, 1986 if the arrears were not cleared by that date.

Mr. Abdallah added that his Tanzanian authorities had informed him that they would be making a payment to the Fund from their own resources within the next two days and that the bridging finance from the commercial banks would be made available for payment to the Fund by Monday, July 28.

The Chairman observed that if events unfolded as outlined by Mr. Abdallah, the payments would arrive too late to prevent the declaration of ineligibility that would automatically become effective on July 23 if Tanzania had not cleared its overdue obligations to the Fund by that date. In the circumstances, a brief postponement of the effective date would seem reasonable.

Mr. Lankester remarked that the issue was not only one of timing. Even with the expected bridging finance, a gap would remain, and it would be difficult for bilateral donors to provide the needed resources in the time frame envisaged. He wondered whether the authorities could not make up the difference from their own resources.

The Director of the African Department reiterated that the authorities would apparently be making a payment from their own resources within one or two days; however, he did not know how much would be paid.

Mr. Abdallah remarked that he understood the authorities' contribution plus the bridging finance would be sufficient to clear the current overdues. Donor support would be required to help Tanzania meet the obligations to the Fund that would arise between July and September; in that context, the authorities had received encouraging signs from the donor community.

The Director of the African Department noted that the authorities were trying to pay the total amount owed through July 18 from their own resources and bridging finance, although the latter would apparently not be made available until July 28. In the meantime, an additional amount of SDR 4.2 million would become due between July 21 and the end of August.

Mr. Abdallah urged his colleagues to agree to postpone the effective date of the declaration of ineligibility to facilitate the effort to obtain the bridging finance and additional resources and, thus, to clear the arrears to the Fund.

The Chairman, in response to a query from Mr. Suraisry, confirmed that a postponement in similar circumstances had recently been granted in the case of Sierra Leone.

Mr. Rye suggested that the date for automatic declaration of ineligibility be extended by one week to July 30.

Mr. Obame, Mr. Kafka, Mr. Jayawardena, Mr. Kabbaj, Mr. Alhaimus, and Mr. Suraisry supported Mr. Rye's proposal.

Mrs. Walker said that she continued to be concerned that while part of the current arrears were expected to be cleared by July 30, financing to cover the arrears that would come due at the end of July and August might not be made available in time to prevent the emergence of a new arrears problem.

The Deputy Treasurer added that in the absence of full repayment, including repayment of the obligations that would come due by end-July and August, the Fund would begin again the process of notification of overdue obligations. The problem was that the paper on the use of Fund resources could not be brought to the Executive Board.

The Director of the African Department replied that there would have to be a cooperative effort between Tanzania and the donors for enough bridging finance to clear arrears due at the end of July. The total arrears would be SDR 26.9 million and the balance after bridging finance would be SDR 6.2 million; it was imperative that Tanzania mobilize donor support to obtain the necessary resources within the next few days.

Mr. Abdallah, responding to the Chairman's query about the possibility of Tanzania having adequate resources by end of August, confirmed that the authorities' ongoing appeals for assistance from donors took account of the total arrears through the end of September.

Mrs. Walker considered that the effective date of the declaration of ineligibility should be postponed only if it was clear that the arrears would be addressed in their entirety. It would place the Executive Board and the authorities in an awkward position if a postponement were approved only to be followed by the emergence of new arrears. She wondered whether it would not be preferable to wait for another day to ascertain the status of the negotiations with donors before agreeing on a new effective date for the automatic declaration of ineligibility.

Mr. Abdallah said that it was unlikely that any new information would be available in only one day. However, he would communicate to his authorities the strong view of the Board that overdue obligations to the Fund due at the end of September must be paid to ensure the approval of the stand-by arrangement. In passing, he added that the commercial banks would also insist that the full financing gap be met.

The Chairman asked those Executive Directors representing potential donors to report to their authorities the outcome of the Board's discussion, conveying if possible the sense of urgency involved in the effort to fill the financing gap.

The Executive Board then adopted the following decision:

> The Fund decides to suspend to July 30, 1986 the coming into effect of the declaration of ineligibility set forth in paragraph 4 of Executive Board Decision No. 8259-(86/68) G/TR, adopted April 23, 1986.
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> Decision No. 8340-(86/120), adopted July 21, 1986

2. CHILE - 1986 ARTICLE IV CONSULTATION, AND REVIEW UNDER EXTENDED ARRANGEMENT

The Executive Directors considered the staff report for the 1986 Article IV consultation with Chile and the review under the extended arrangement (EBS/86/137, 6/27/86). They also had before them a report on recent economic developments in Chile (SM/86/165, 7/8/86).

The staff representative from the Western Hemisphere Department made the following statement:

> The Chilean economic situation remains basically the same as presented in the staff report for the 1986 Article IV consultation and review under extended arrangement issued on June 27, 1986 and the recent economic developments paper issued on July 8, 1986. Since the issuance of the reports the staff has received the following supplementary information.

Data for end-June 1986 show that the net international reserves of the Central Bank exceeded the program target by just over US$100 million, and the net domestic assets of the Central Bank were below their limit by Ch$20 billion. In addition, the ceiling on the short-term external indebtedness of the nonfinancial public sector and the Banco del Estado was observed with a margin of US$218 million. Information on the remaining quantitative performance criteria for end-June is not yet available.

Provisional data show a trade surplus of US$703 million in the first semester of 1986; the surplus is somewhat higher than originally projected and contrasts with a surplus of US$407 million in the same period of 1985. The improved trade performance reflects mainly higher than projected exports, particularly of copper and manufactures. Imports were somewhat less than projected.

Preliminary information indicates that real GDP increased by 3.5 percent from the first quarter of 1985 to the first quarter of 1986. Consumer prices increased by 1.3 percent in June, and the 12-month inflation rate has come down from 26 percent in December 1985 to 18 percent in June 1986.

The central region of Chile was struck by severe rainstorms and flooding in the third week of June. The total damage has been estimated at Ch$10 billion--0.3 percent of projected 1986 GDP. Of that total, losses of Ch$3 billion were experienced by CODELCO because of the temporary disruption of certain mining operations and losses of about Ch$3 billion were experienced by the rest of the public sector. The reconstruction costs would be covered by external insurance payments to CODELCO and a reallocation of expenditures within the program budget.

In accordance with the understandings, the authorities raised travel allowances effective July 1, 1986 from US$500 to US$750 for travel to Latin American countries, and from US$1,500 to US$2,250 for travel to other countries. Also, effective July 10, 1986, the interest rate subsidy on swap operations was reduced from a range of 2-2.6 percent to a range of 1.8-2.5 percent.

Mr. Nebbia made the following statement:

The staff reports accurately reflect the policies that have been applied and the performance of the Chilean economy during 1985 and early months of 1986, and provide a fair evaluation of the progress already made in the context of the Fund-supported economic program. My authorities are in general agreement with the staff's appraisal, and they wish to thank the staff and the management for the continuous advice and cooperation that has been provided by them in order to help the economy to keep moving within the agreed policies and targets.

As mentioned by the staff, Chile has made considerable progress toward achieving the objectives of the medium-term economic program that was initiated in 1985 and that has been supported by an extended arrangement from the Fund. The performance under the program in 1985 was particularly encouraging. At the end of the year, Chile observed all the indicative targets and limits established for dates preceding the approval of the extended arrangement, as well as the whole set of quantitative performance criteria targeted for August and December 1985. Consequently, Chile was able to effect all the purchases agreed upon in said period.

Progress already made in 1985 was achieved in spite of the further deterioration experienced by Chile's terms of trade and the adverse impact of a major earthquake that struck the country in March of that year. Economic activity was somewhat stronger than the 2.0 percent tentatively estimated at the time of our February review, as real GDP grew at an annual rate of 2.4 percent, reflecting a level of gross capital formation and export volume in excess of those originally envisaged. The rate of inflation for the year, which reached 26.4 percent, was broadly in line with a targeted 25 percent, and well below the 35.0 percent observed in the 12-month period ended in June 1985, while the unemployment rate was brought down from 14 percent by the end of 1984, to less than 12 percent in the last quarter of 1985. In addition, the current account deficit in the balance of payments was narrowed to US$1.3 billion from some US$2.1 billion recorded in 1984, reflecting an improvement of US$0.4 billion in the trade balance, a reduction in net nonfinancial service payments of US$0.2 billion, and some net savings in interest payments.

It is the view of my authorities that these positive developments would not have been feasible without the coherent set of macroeconomic policies that were implemented, consisting of a rigorous adjustment in public finances, a cautiously accomodative monetary policy and flexible management of the exchange rate policy. In the implementation of this program the assistance and support from the Fund, the World Bank, and the international commercial banks as well, have been most helpful.

During the first months of 1986, Chile's economic performance continued to improve in response to the continuing effect of the program policies and to a somewhat more favorable external environment. On the domestic front such improvement was reflected in a further strengthening of the industrial sales and agricultural economic activities, with the first recording an expansion of 5.0 percent in output during the first quarter of the year, and the second showing the largest volume of fruit exports ever recorded, leading to a recently estimated GDP growth of 3.5 percent for the first quarter of 1986, as compared to the same period in 1985.

At the same time, inflation continued to decline. For the first five months, the cumulative rate of increase in the consumer price index amounted to 7.4 percent, a figure that needs to be compared with 12.9 percent recorded in the same period of 1985. Regarding public sector finances, a further improvement took place during the first quarter of this year, with the nonfinancial public sector deficit having amounted to the equivalent of only 0.4 percent of GDP, or about one half the level of the program projection, and the public sector savings recording the equivalent of 1.2 percent of GDP, or 0.3 percentage points of GDP better than expected.

Meanwhile, in the external accounts the outcomes were also stronger than originally projected, as the trade balance and the current account of the balance of payments improved, reflecting the drop in the world price of petroleum, a broadly based decline in the level of imports and a higher than expected short-term private inflows. On the basis of these developments, the current account deficit for the first quarter reached about US$380 million, US$60 million below most recent projections, while the overall balance of payments position recorded a deficit of US$100 million, almost US$90 million less than had been programmed for the period.

The economic prospects for the remainder of 1986 have generally improved reflecting increased confidence and improving external conditions, mainly lower petroleum prices and interest rates. However, uncertainties still remain in crucial areas such as the behavior of copper prices in international markets, or regarding the sustainability of current gains associated with petroleum prices. In this context, the authorities remain fully committed to continue pursuing the required structural adjustment policies needed to achieve the objectives of the economic program.

Current projections of economic performance in 1986 have therefore changed somewhat from those presented in late 1985. On the external front, the authorities are now projecting a current account deficit of the balance of payments amounting to some US$1,180 million, or 7.1 percent of GDP, instead of the originally envisaged amount of US$1,300 million, or 8 percent of GDP. Consistent with these new figures, the trade surplus is projected to increase from US$788 million in 1985 to US$955 million in 1986. These new projections are based on an average copper price of US$0.664 a pound, which is 1.5 cents below the level previously estimated, a moderate weakening of the noncopper non-oil terms of trade, an average price for petroleum of US$16 a barrel for the remainder of the year, and a LIBOR and prime rates estimated at levels of 7.0 percent and 8.5 percent, respectively, for the second half of the year. However, the overall balance of payments is now expected to record a surplus of US$50 million, compared with US$15 million expected initially, reflecting, in addition to the current account developments, a higher level of short-term private flows, but reduced medium- and long-term capital inflows, on account of lower than projected levels of financing from multilateral organizations.

Such outcome on the external accounts is consistent with a revised rate of growth of GDP in the order of 4.5 percent for 1986, and with a further reduction on the rate of inflation, to no more than 18 percent, measured by the December 1985-December 1986 change in the consumer price index.

Moreover, the projected current account deficit for 1986 is consistent with the expected level of domestic savings, and with an additional reduction in the overall deficit of the nonfinancial public sector, from 2.6 percent of GDP in 1985 to a revised figure of 2.2 percent of GDP in 1986.

The authorities are firmly committed to further strengthening the public sector finances by means of keeping expenditures within the budgeted levels as a key instrument of structural adjustment. It is their view, that such policy will lead to a further strengthening of domestic savings, while it will allow for an adequate level of public investments in export and import competing sectors.

Within the context of public finances and in the more general framework of structural reforms, the authorities have decided to increase the scope of reprivatization for a number of currently state-owned enterprises. New targets aimed at such a goal have been recently established for at least six major enterprises, ranging from 49 percent to 100 percent, well beyond the general scheme of selling to the private sector up to 30 percent of the overall shares of each company that otherwise would have prevailed for those entities.

Monetary policy will continue to be managed cautiously and in line with the objectives of output, inflation, and balance of payments as stated in the program. Credit expansion will remain consistent with the achievement of a more balanced fiscal position and within the targets allowed by the program.

Wage policy will remain unchanged from that followed in the preceding years. It will continue to be aimed at strengthening external competitiveness, raising the level of employment, and maintaining inflation low. A public sector wage increase, which averaged about 15 percent, was granted in December 1985, and no further increases have been announced since then. In addition, the authorities continue to abstain from interfering with wage negotiations in the private sector.

In order to sustain the emerging strength of the balance of payments during the forthcoming months, the authorities are prepared to continue with the flexible and pragmatic management of the exchange rate followed during the last four years. To that end, the peso will continue to be devalued daily on the basis of the difference between domestic inflation in the previous month and the external rate of inflation relevant to Chile. In addition, the authorities will monitor closely developments in the balance of payments, including changes in the terms of trade, in the foreign exchange markets, in the availability of external financing, as well as in the interest rate movements.

This policy, which ensures a reasonable degree of competitiveness for both export and import-substitution industries, has also contributed to a gradual but persistent narrowing of the size of the spread between the exchange rates in the official market and the parallel market. Such a spread, as for the first half of July, has remained rather stabilized below 5 percent, reflecting the overall increased strength of the external accounts and the growing confidence on the economic policies being implemented.

The recent decision of the authorities to further increase by 50 percent the current travel allowances, will also contribute to ease the pressures over the parallel market.

Regarding external debt policies, the strategy of the authorities is aimed at maintaining debt at a level that can be serviced in an orderly fashion. In line with that general objective, a number of measures have been already implemented in order to control new external indebtedness, so as to reduce over time its ratio to GDP; to shift financing from foreign bank loans to official creditors, including multilateral sources; to limit the use of short-term debt; and to avoid the extension of official guarantees on private external debt.

The mechanism created by the Central Bank in late 1985 allowing private residents and nonresidents to purchase selected external claims on Chilean public or private debtors at a discount, provided that the foreign exchange was not obtained in the official exchange market, has yielded significant and positive results, with a total of US$274 million of external debt instruments being brought back since the inception of the program in March 31, 1986. More recently, the Central Bank has introduced some modifications to said scheme, widening the scope of both, the external debt that could be purchased and the domestic use of the assets, or the proceeds from their sale. Therefore, enhancing the capability of the system to exchange foreign obligations into domestic obligations and hence, reducing the external debt service payments of the country, as well as alleviating the pressures on its international reserves.

Finally, the Government has now completed the restructuring of principal payments falling due to commercial banks during 1985-87, and is currently assessing the financial needs that the country will face over the period 1987-88. The whole exercise of restructuring, and the above-mentioned mechanism for the purchase of Chilean external debt at a discount, have been of a significant contribution in reducing the rate of growth of the country's external debt and in improving its maturity structure, and as a most welcome consequence, the total debt to GDP ratio is now projected to decline to 117 percent in 1986, rather than to increase to 123 percent as it was initially estimated. This is the first time since 1982 that the growing tendency of this ratio has been curbed, reflecting a sound combination of a sustained economic growth and a reduced pace in the building-up debt process.

I would like to request, on behalf of my Chilean authorities, the support of Executive Directors for the proposed decisions, and thank again management and the staff for their efforts to help the Chilean economy to recover from its difficulties.

Mr. Almeida noted with pleasure that the staff report was basically optimistic about Chile's current situation and short-run prospects. The staff had even seemed to welcome a multiple currency practice, although it was only for capital transfers and not for current transactions. Despite all difficulties most macroeconomic indicators had improved remarkably in 1986. Public sector savings were particularly impressive having become positive in 1984 after two years of negative rates and had increased to 3.8 percent of GDP in 1985, a level far better than targeted. The authorities had shown continued determination and flexibility in implementing economic policy; it had been particularly impressive that with the decline in oil prices in May 1986 the authorities had increased taxation to offset most of the reduction in profits with respect to domestic production by the state oil company. The authorities should also be commended for having targeted a higher balance of payments surplus and smaller fiscal and current account deficits when encountering favorable external circumstances. And the authorities had shown ingenuity in their scheme for the privatization of state enterprises, although the pricing of the stock of those enterprises was unclear, and staff clarification would be helpful.

The staff forecast in 1986 was based on conservative assumptions on interest rates and oil prices, Mr. Almeida said, and it was possible that the balance of payments would turn out better than expected. The projections for oil imports had been made under the assumption of an average price of US$17 per barrel in 1986, a level substantially higher than the US$13.20 per barrel assumed, for example, by the Venezuelan authorities, who would be selling the oil. While he could accept the short-term forecast, he did not share the staff's optimism about medium-term prospects. Despite a series of arrangements with the Fund since January 1983, most of the Chilean balance of payments adjustment had been made on the import side as exports had stagnated. More important, there had been no diversification of exports; in 1986, copper would still account for 46 percent of exports, the same as three years previously. Although public sector savings had increased, the level of gross national savings remained low, and there was no indication that it would increase in the medium term.

The most favorable scenario projected by the staff assumed only a 6.3 percent annual increase in real imports over the next four years and a very small decrease in total external debt, from 119 percent of GDP in 1986 to 92 percent in 1990, which might even be too optimistic, Mr. Almeida noted. Indeed, all four scenarios presented by the staff were based on optimistic assumptions of either stable real copper prices or a 6 percent real increase. Neither assumption in his view was realistic. A key problem in the medium term was the question of net factor payments abroad, a subject not discussed in the staff report. National accounts data showed that those payments had increased from 4.5 percent of GDP in 1981 to 11.9 percent in 1985; and there was no indication that they would decline over the next few years. It would be useful if the staff could indicate whether it considered the current estimates under the program scenario for the next four years to be sustainable.

Mr. Engert commended the Chilean authorities for the substantial progress they had made in their adjustment program. The good results had followed from the coherent macroeconomic policy approach taken by the authorities, which included a strong fiscal effort, a relatively cautious monetary stance, and flexible exchange rate management. Also helpful had been the structural measures supported by the World Bank aimed at diversifying exports, strengthening public sector savings and the efficiency of public investment, and improving the financial condition of the corporate and banking sectors. It was encouraging to note that the objectives of the program had been revised, and that the quantitative targets for the remainder of 1986 had been tightened in view of the better than anticipated performance in the early part of the year and the improved outlook for the Chilean economy.

Despite the progress made, the vulnerability of the Chilean economy to external developments and the large external debt made it essential that the authorities follow through on their intentions under the extended arrangement, Mr. Engert continued. It would be important for them to monitor developments very closely and to be prepared to take further action, if necessary, to achieve the program targets.

He wondered why 18 percent had been chosen as the target inflation rate for 1986, and whether a more ambitious target might not be more appropriate, Mr. Engert said. He was also curious about the mechanism to allow investors to take advantage of the discount on Chilean paper to invest in Chile; it would be helpful if the staff could comment on the appropriateness of such an approach for other members of the Fund with high debt burdens.

Mr. Lankester remarked that the Chilean authorities had continued to implement the adjustment program vigorously and had met all performance criteria comfortably. In addition, private sector confidence in the authorities' economic policies had grown, as evidenced by the 12 percent increase of private investment in 1985 and a reversal of the capital outflows of 1982 and 1983; there had also been a strengthening of direct inward investment. And the recent fall in the spread between the offical and parallel exchange rates was encouraging.

The economy had continued to perform well since the previous review of the program (EBM/86/39, 2/28/86), Mr. Lankester observed. Inflation had decreased; growth had accelerated, supported by exports and investment; unemployment had declined; and the current account deficit had narrowed. With the fall in oil prices and international interest rates, further progress could be expected in all those areas. It was encouraging that the improvement in the terms of trade had enabled the authorities to reduce slightly the target for the current account deficit; it had been disappointing that faster progress had not been envisaged in the original 1986 program. He urged the authorities to take advantage of the improved external environment to press ahead with their adjustment efforts, particularly in the structural area. The authorities' decisions to further reduce import tariffs and to eliminate the minimum financing requirements for imports, other exchange restrictions and multiple currency practices in the near future were welcome; he was also encouraged by their privatization plans.

Fiscal performance had continued to be impressive, with a substantial increase in public sector savings in 1985 and a projected halving of the overall nonfinancial public sector deficit in two years, Mr. Lankester continued. The long-term objective was to eliminate the deficit by the end of the extended arrangement period. In that respect, it was rather disappointing that the improvements in public finances in 1985 would not be consolidated in 1986, particularly in view of the very strong performance of the public sector in the first quarter of 1986 when the deficit had fallen to only 0.4 percent of GDP, only about half the projected level. The reduction in the deficit planned for 1986 as a whole was currently less than originally planned; if adjustments were made for assets sales and other net capital revenues, the overall deficit would remain virtually unchanged. Admittedly, the outlook for revenues had worsened somewhat and, despite the increase in gasoline taxes, the fall in oil prices had resulted in a net loss to the public sector. And despite those adverse factors, the original target for the 1986 deficit would still be met due to the authorities' cautious expenditure policies.

However, he would welcome staff comment on the scope for a larger fiscal adjustment at the next review of the program, particularly in view of this comment on the need for a more restrictive policy stance to achieve the program's objectives than envisaged at the time of the program's inception. He recognized however that the proposed elimination of the losses of the Central Bank in 1986 represented an impressive and welcome adjustment amounting to almost 2.5 percent of GDP.

Continued fiscal adjustment would need to be supported by cautious monetary policy, Mr. Lankester remarked. He had initially viewed the acceleration in monetary growth since mid-1985 with concern. However, that was due in large part to an improved performance of private social security funds indicated that they would also be a source of substantial monetary growth in 1986. But he would welcome staff comment on the performance of social security funds and on why they should be content to hold such a large part of their portfolio in extremely liquid form, thereby contributing to monetary growth. It was encouraging to note that efforts would be continued to strengthen the banking system and that, as progress is made the Central Bank would eliminate the indicative rate on 30-day deposits. He was surprised that the fall in oil prices had not led to a downward revision in the expected inflation rate for 1986, although he recognized that some of the benefits of the fall in prices would have been pre-empted by the prudent increase in gasoline taxes aimed at preventing too large a deterioration in fiscal performance.

Despite the encouraging performance of the economy in 1985 and prospects for 1986, the economic situation would nonetheless remain difficult, with a continuing heavy debt burden and debt ratios significantly higher than in many other countries, Mr. Lankester observed. The authorities had little room for manuever and the external situation could possibly turn out worse than anticipated. The projection of a 6 percent per annum real increase in copper prices was surprising and perhaps optimistic. The uncertainties surrounding copper prices and other key assumptions in the projections highlighted the importance of introducing measures to diversify the export base; he would have preferred more discussion by the staff on efforts toward that end.

The exchange rate policy of the authorities seemed broadly appropriate, Mr. Lankester continued, but he would welcome clarification of the belief of the authorities that a relevant measurement of competitiveness would require more complex calculations than those implicit in the effective exchange rate estimates. He wondered whether the authorities were considering a refinement of the competitiveness indicator or whether they felt that other nonprice factors should be taken into account. In any event, the authorities' intention to adjust the exchange rate policy as required to achieve the program's external objectives was welcome. Finally, he noted the equity debt swap operation had been successful, and might be even more so in future, and other countries in the region could learn some lessons from that operation. It would be helpful if the staff could further discuss the viability of that mechanism for Chile and other countries.

Mr. Sugita welcomed the progress made in achieving the objectives of the Chilean adjustment program initiated in 1985. All the performance criteria had been observed through the first quarter of 1986, and available data indicated the likely observance of the second quarter targets. Although the most important factor influencing that favorable outcome might have been strong fiscal adjustment, efforts in other areas including monetary and exchange rate policies and the reform of the financial system had also contributed significantly. The strong adherence of the authorities to the adjustment program and their skillful implementation of it were commendable.

The adjustment had already brought about some reduction in both the external imbalances and inflation, Mr. Sugita said. Further progress in 1986 was envisaged, and it was particularly noteworthy that prospects were good for a resumption of growth in per capita private consumption of over 1 percent in 1986 after four years of decline. The implication seemed to be that, in some cases, adherence to a strong adjustment policy could bring about a turnaround in economic performance in a relatively short period by restoring confidence in economic management. The inflow of short-term capital that had been realized in 1985 in the form of a drawdown by residents of private assets abroad might also have been a reflection of restored confidence in the economy by the private sector.

It should be noted that only one year had passed since the adoption of the comprehensive program, Mr. Sugita observed. Continued efforts were clearly required to consolidate the gains that had already been made. For 1986, the decline in interest rates and petroleum prices had created a favorable external environment, and it was appropriate that the targets for 1986 had been revised and tightened accordingly. Still, there was considerable uncertainty about the future development of exchange rates, oil prices, and copper prices. In particular, copper prices might not reflect the optimism of the staff's standard medium-term scenario, because the growing use of optical fibers and microwave networks were quickly replacing conventional copper lines. It was reassuring that the authorities were well aware of those uncertainties and had strongly committed themselves to a medium-term economic program.

The authorities' efforts to re-establish a solvent private financial system with the support of a structural adjustment loan by the World Bank were satisfactory, Mr. Sugita said. However, the extension of the period during which the Central Bank would complete its purchse of substandard portfolios was a source of concern. It was surprising that the purchase operation involved a form of subsidy based on the interest differential between the portfolio purchased by the Central Bank and instruments sold by the Central Bank. He wondered whether such subsidies could not be eliminated without changing the thrust of the scheme.

He supported the authorities' cautious decision to limit debt to a level that could be serviced in an orderly fashion, Mr. Sugita noted. The mechanism established for the purchase of external debt at a discount had a number of interesting features, and the recent expansion of the scope of those mechanisms was welcome; the expansion could help reduce the external debt, promote inward direct investment, and induce a reflow of the funds held abroad by Chilean residents. That mechanism might have wide applicability for other countries in similar situations. The staff should collect and report data on the development of the discount with which foreign debt was traded on world capital markets because that would accurately indicate the degree of confidence the capital markets had in the country's economic management.

Mr. Bertuch-Samuels agreed with others that the authorities had made further substantial progress under the extended arrangement and was happy to note that all quantitative performance criteria for end-March 1986 had been met and that the revised program targets for 1986 involved a further strengthening of adjustment policies. It was particularly encouraging to note the strong expansion of economic activity, the continued fall in the consumer price index, and the substantial improvement of the balance of payments position. Despite the decline in revenues, the authorities had continued to free resources for private sector use by curbing expenditure in line with the program target. In addition, a further increase in public sector savings only slightly above the original target was planned for 1986.

The renewed confidence created by sound fiscal and monetary policies appeared to have contributed to a significant increase in financial assets held by the private sector and in private fixed capital formation, Mr. Bertuch-Samuels continued. Moreover, improved competitiveness and tight demand management had resulted in a marked increase in the trade surplus. He associated himself with Mr. Lankester's comments concerning the potential for a more ambitious fiscal effort during 1986, given the better than expected performance in the first quarter of 1986.

The medium-term projections presented in the baseline scenario were subject to a great deal of uncertainty in respect of key variables such as the development of Chile's terms of trade--in particular copper prices--and international interest rates, Mr. Bertuch-Samuels commented. Chile's balance of payments was characterized by a high degree of vulnerability to exogenous developments. The need to further reduce the country's external debt burden continued to be a priority objective. Notwithstanding the substantial economic progress achieved so far and the general agreement by the Fund on the authorities' current policy stance, it would be only prudent for the authorities to monitor the appropriateness of economic policies closely and be prepared to take corrective action should external conditions turn out to be less favorable than expected.

Mr. Rye said that it was heartening to see that Chile's economy had progressed so well despite the difficult external environment and a number of natural catastrophes, including recent floods, which had inflicted substantial damage to infrastructure. The decline in the public sector deficit had been impressive; taking into account the elimination of the losses of the Central Bank in 1986, the deficit would amount to only 2.7 percent of GDP for the year as a whole. He urged the authorities to continue their efforts to reduce the deficit by reforming the tax system.

Other aspects of the Chilean economic management were equally commendable, including the tight credit policy and the pursuit of an appropriate although predictable exchange rate policy, Mr. Rye commented. The success of the program had been evidenced by a decline in inflation to 18 percent over the 12 months to June 1986, and the satisfactory growth rate of 3.5 percent maintained over the year to the first quarter of 1986. However, Chile's longer-term external position remained precarious, and it would be necessary for the authorities to monitor developments closely and be prepared to take further action to help achieve the program targets.

Mr. Suraisry noted with satisfaction that considerable progress had been made under the 1985-87 economic program. The combination of appropriate adjustment policies, the financial support of the Fund and the World Bank, and favorable external developments had produced positive results in all areas; in some, the progress had been better than anticipated.

The authorities were broadly following an appropriate strategy. In particular, the pursuit of firm demand management policies together with adequate structural adjustment measures was appropriate, Mr. Suraisry said. His main recommendation was that the authorities stay the course and avoid the temptation of using the continued economic and financial improvement to justify a relaxation of the adjustment effort. As indicated by the staff, the balance of payments position was vulnerable to external developments; there were uncertainties regarding oil and copper prices, and the debt service ratio remained high by any standard. In such circumstances, there was no room for complacency. A close monitoring and periodic assessment of economic policies was important if the authorities were to sustain the progress achieved thus far.

External indebtedness represented a major challenge to the authorities, Mr. Suraisry observed. A total external debt of about 119 percent of GDP in 1985 made Chile one of the most highly indebted members of the Fund; it also complicated economic management and limited the options available to the authorities in conducting their economic policies. In that context, the efforts being made to resolve the debt problem were welcome. In particular, permitting private residents and nonresidents to purchase specified external claims on Chilean debtors at a discount was an imaginative idea that should not only help to reduce the size of external debt, but should also encourage capital repatriation; countries in similar situations might benefit from that approach. However, the mechanism should be monitored very closely to ensure its success and enable the authorities to respond to any adverse impact it might have. It must be remembered that Chile's external debt remained extremely high and, in the absence of a cautious debt management policy, the new mechanisms he had described might not produce the desired results. He supported the performance criteria on external debt.

The efforts to re-establish a solvent private financial system should help create confidence in Chile's economy, Mr. Suraisry continued. He noted the staff's observation to the effect that the solvency and liquidity of the private banking system was being improved through the purchase by the Central Bank of part of their substandard portfolio. It would be useful to know the extent of the Central Bank's involvement in that operation. He noted that, if the private banking system suffered from difficult financial problems, significant deep involvement by the Central Bank could weaken the Central Bank and put a strain on both monetary and fiscal policy. It would be helpful to know whether or not the Central Bank was involved in the management of those banks to which it was providing assistance. Without such involvement, the problem of the private financial system would be solved only temporarily.

Ms. Bush observed that Chile's adjustment efforts had proceeded well since the Executive Board's initial review of performance under the first year of the extended financing facility. All performance criteria had been met or exceeded in 1985; in addition, the rate of inflation and the size of the public sector deficit had been significantly better than expected. It was interesting to note that the authorities had attributed the strong economic performance to the implementation of macroeconomic policies under the Fund and World Bank programs with support from the commercial banks; however, without the authorities' commitment to following up the recommendations, those policies would not have been successful. While the economy had responded favorably thus far to economic measures and the outlook for the remainder of 1986 had improved, there continued to be uncertainty about future developments resulting from the possible impact of exogenous factors and the high external debt carried by Chile. In that light, the authorities' commitment to continue the necesary adjustment policies was welcome and it was expected that additional measures would be taken should external developments prove less favorable than anticipated.

A central element of the extended arrangement had been its emphasis on strengthening Chile's savings and investment performance, Ms. Bush observed. That aspect remained important for promoting sustainable growth and reducing reliance on external borrowing. During 1986, the program envisaged an increase of 1.8 percent in GDP through continued curbs on current expenditures and a substantial increase in private sector savings. It appeared that the privatization of the social security system had contributed to an increase in private savings; an added benefit had been the purchase by the pension fund of shares of public enterprises which had spurred further privatization. On the revenue side, noting the imposition of a tax on the domestic consumption of gasoline and diesel oil and acknowledging the need to compensate for the effect of the decline of domestic oil prices on central bank finances, she urged the authorities to avoid using those revenues to support additional expenditures.

A significant contribution to the improvement of government finances had been the increase in operating surpluses of the key public sector enterprises, Ms. Bush commented. That development was welcome since improvements in the profitability of those institutions were critical to the effort to generate a more sustainable turnabout in the government fiscal position. The authorities' intention to increase the scope of reprivatization of a number of state-owned enterprises was welcome. It was encouraging that the Government had begun selling shares held by the Chilean Development Corporation and its affiliates as well as shares of other public sector enterprises and that the resources obtained from those sales were being used to support lending operations to the private sector. It would be useful if the staff clarify whether the increased reprivatization of state-owned enterprises would be implemented in the same manner as for other enterprises.

The recent measures to re-establish the solvency of the private financial system had bolstered the position of the private banks, Ms. Bush continued. The recent purchases by the Central Bank of part of the substandard portfolios of private banks had been helpful, the legislation that had enabled government finances to recapitalize banks up to 49 percent of their capital in reserves was an important recognition of the problems of those banks. It appeared that the Central Bank's losses would be fully recovered, through recapitalization but further elaboration by the staff on that point would be useful. Since the state could participate in the capital of those private banks for only five years, it would be useful to know how it intended to phase out its capital holdings in those banks. She noted that two banks had been transferred to private sector management and wondered if that presaged a transfer of ownership.

She was encouraged to note that the Central Bank's operating losses--equivalent to 1.3 percent of GDP in 1985--would be eliminated in 1986, Ms. Bush said. The commitment to eliminate the preferential exchange rate by the end of 1986 and the swap subsidy in July was an important step in the continuing effort to reduce the operating losses of the Central Bank. If the Chilean fiscal situation were viewed on an aggregate basis, then the deficit of the Central Bank plus the nonfinancial public sector would show a much larger adjustment for 1986, a reduction of about 2.3 percent of GDP compared with a 0.4 percent of GDP programmed reduction. She asked what the potential impact of the purchase of substandard portfolios of commercial banks would be on the Central Bank.

Chile's trade surplus had experienced a greater than anticipated improvement, due largely to lower petroleum prices and some reduction of world interest rates, Ms. Bush observed. The overall balance of payments deficit, which had been much better than programmed, had been due in part to short-term private inflows that might have reflected a further drawdown of private assets abroad. The decline in real interest rates in recent months appeared to have worked against such a development and comment by the staff on that matter would be helpful. The policies of maintaining the flexible exchange rate and easing the trade restrictions, including those adopted on July 1, 1986, were welcome; the authorities should eliminate the trade restrictions as soon as possible. Chile's use of debt equity swaps had been helpful in rapidly reducing the debt to GDP ratio, which had recently been projected to decline to 117 percent rather than to 123 percent of GDP as previously estimated. Those swaps had served to help increase direct foreign investment. Since such operations were positive developments, the increase in the limits on such transactions were welcome. Chile's auction system for managing debt equity swaps appeared to be useful both as an allocation mechanism and as a means of ensuring that its benefits were enjoyed by all parties to the transactions.

The staff's medium-term scenarios and sensitivity analyses for the external sector--and Chile's high external debt--underlined the need for continued prudent economic management, Ms. Bush continued. In view of that situation, Chile did not have much room for manuever on its external accounts; while improvements in the economy in 1985 and 1986 had been very positive, the tightening of program targets to reflect that limited maneuverability was welcome.

Mr. Kyriazidis asked the staff to comment on the disappointing performance of prices.

Mr. Jayawardena said that for a long time, the Chilean economy had been affected by the volatility of the world copper markets, particularly at a time when it had been the major export. Having recognized the long-term structural problem of declining copper prices, the authorities had adopted a medium-term adjustment program supported by the Fund through the current extended arrangement, by the World Bank with a structural adjustment loan, and by the commercial banks in a debt restructuring arrangement. The authorities' action was a classic instance of a well coordinated, coherent, and comprehensive medium-term approach, which was essential for tackling the problems faced by most developing countries. The success achieved by Chile in the first year of its extended arrangement with the Fund was encouraging and called for a reconsideration of the Fund's recent use of shorter-term programs with marginal support. The experience with shorter programs had not been favorable; in Chile's case, the determined pursuit of medium-term adjustment policies was a vital key to success.

Recent developments that had affected Chile had been due to circumstances beyond the control of the authorities, Mr. Jayawardena noted. It was significant that the program targets that had been achieved were stronger than originally envisaged because of the improved performance of the external sector. Two features of the adjustment program had been particularly impressive, namely, the strength of the fiscal adjustment and the strength of the external adjustment. The growth of public savings was commendable and had contributed to the improved performance of public enterprises. The reduction of tariffs from 35 percent to 20 percent in mid-1985 had again demonstrated that it was the developing countries that were currently reducing protectionist measures in a meaningful manner. The exchange rate policy had been well managed and had maintained the competitiveness of the peso. It was not surprising that exports had showed such dynamism in 1985; the diversification of the export sector aimed at reducing the historical dependence on copper had been impressive. Also commendable were the achievements in the balance of payments position.

Although the general thrust of the adjustment program was appropriate he would have preferred a stronger adjustment effort to mid-1987, Mr. Jayawardena said. It was encouraging that the adjustment measures continued to be comfortably on track and that the authorities were proceeding to arrange a second structural adjustment loan with the World Bank. He urged the authorities to pay attention to the pattern of income distribution under the ongoing adjustment program. The high government subsidies to families could not be encouraged, and it would be better to take all measures necessary to improve the trickle-down process of economic growth.

He had visited Chile and held discussions with the authorities in connection with the meetings of the Group of Twenty-Four, Mr. Jayawardena said. He had been extremely impressed by the professionalism of the authorities. As he saw it, they were clear about their objectives and understood the problems and interactions within the various economic sectors. They attached great importance to taking a medium-term perspective and that gave them considerable flexibility in making policy adjustments and responding to exogenous factors. He reiterated that a strong medium-term orientation offered a greater chance of success in solving current economic problems.

The staff representative from the Western Hemphisphere Department said that in the context of the slow increase in the rate of savings it was necessary to make a distinction between gross savings and national savings on the one hand, and between total savings and private sector savings on the other hand. Domestic savings as a proportion of GDP had increased by over 4 percent while national savings, the amount left after the payment of interest abroad, had increased from 2.9 percent to 5.5 percent of GDP. Those developments were the result of a significant effort on the part of the public sector to improve its performance and a perceptible increase in the private sector's ability to increase its savings. The real depreciation of the peso in 1985 had resulted in an increased interest burden on the private and public sectors; the difference in the growth of domestic and national savings was due to additional payments made abroad. In sum, therefore, the savings performance had been encouraging: the level of national savings had remained low but had been increasing; and indications for 1986 were that savings would continue to increase very strongly as reflected in the improvement of the current account together with the continued increase in investment.

The inflation objective for 1986 remained at 18 percent, the staff representative continued. At the time that the program had been approved in mid-1985, inflation had been at an annual rate of 35 percent. By June 1986, the 12-month rate of inflation had been 18 percent. The factors that had been considered in the projection of the rate of inflation at 18 percent had been the indexation of the exchange rate to the rate of inflation in the previous month and the significant impact of the real depreciation of the peso in 1985 and early 1986 on the prices of traded goods. The increased competitiveness had encouraged exports and improved the balance of payments, but there had been a cost in terms of a somewhat less than expected deceleration of the rate of inflation. The decline in petroleum prices in international markets had helped reduce the rate of inflation, and there were indications that the rate of inflation for the 12 months to the end of December 1986 might even be lower than the 18 percent envisaged under the program. The authorities were fully aware of the need to strengthen their efforts to reduce the rate of inflation. However, it should be noted that there were no price controls in Chile; a combination of exchange rate and monetary policies would have to be relied upon to meet the target for inflation. Thus, the decline in the rate of inflation was not disappointing; indeed, it was an indication that the program was working; it had caused a sharp deceleration of the rate of growth of nominal monetary aggregates, notwithstanding the real depreciation of the exchange rate.

Two important factors had to be taken into account in the analysis of the 1986 financial outcome of the public sector, the staff representative said. First, there had been a major earthquake in 1985, the cost of which the authorities had absorbed within the targets for 1985 but which had affected public expenditure in 1986, particularly investment. The damage caused by the earthquake had been equivalent to roughly 6 percent of GDP; the required increase in public investment in 1986 had been 0.5 percent of GDP. Second, the tax reform that had been undertaken to increase private sector savings had affected public sector performance. The authorities had also reduced the level of import duties in 1985 beyond that agreed with the Fund and the World Bank for 1985 to 1986. The authorities had viewed the reduction in import duties as a crucial element in improving efficiency and moving toward a more export-oriented growth. The reduction had had a short-term impact on revenues both in 1985 and 1986, but export growth and revenues in 1986 indicated that the performance of the public sector would be favorably affected in coming years. The estimated public sector deficit in 1987 and beyond would be discussed with the authorities in coming months.

The authorities had sought a market-oriented approach to the pricing of stocks sold by the public sector, the staff representative remarked. The share of the stocks owned by the public sector was being sold on the basis of tenders. There had been some private enterprises belonging to groups in which the state had intervened; those enterprises had been linked to two major banks in which the state had intervened in 1983. Thus far, there had been one major sale of stocks on the basis of negotiation, although it had been linked to the small number of shares quoted on the stock market. With respect to the sale of enterprises owned by the state, the Government would sell a small amount of shares in the stock market to determine prices prior to the sale of the enterprises or the general offer of stock. There had been special programs to encourage the sale of shares owned by the Government and by selected banks. A scheme called "popular capitalism" had been implemented to promote share sales, which would have certain tax advantages and increase the holding of private sector stock in the economy. That scheme had resulted in the sale of shares to 20,000 small shareholders. The intervention by the Government to assist banks that had been effectively bankrupt had helped in strengthening the organization of the banks and the holding of stocks in the economy.

The improvement in the Central Bank's finances by the equivalent of more than 2.5 percent of GDP would contribute to the effective adjustment of the public sector beyond the target indicated in the adjustment program, the staff representative noted. There was a paradox in Chile's need to strengthen the finances of its public sector: the public sector finances had been adversely affected by the reduction in petroleum prices, the public sector being the only producer of petroleum in Chile, while the reduction in petroleum prices had improved the general economy and the terms of trade. There had been some transfer of resources in principle from the public sector to the private sector owing to reduced prices; hence, the Government had considered there was a need to adjust taxation to absorb part of the transfer. Nonetheless, the benefits to the private sector of the reduction in oil prices had been larger than the benefits from the balance of payments savings because of the reduction in prices of the domestically produced oil. The petroleum company monopolized production but not imports and if they did not remain competitive in prices (adjusted for import duties) then private importers might import their own refined oil.

The authorities had emphasized the need to maintain a relatively high level of social expenditure, although they considered that the growth of employment would be the most important source of improvement in living conditions, the staff representative continued. The unemployment rate, which had been 12 percent on the basis of January-March 1986 indicators, had recently fallen to 11 percent; there have been a consistent downward trend in unemployment figures.

Monetary management by the authorities had been careful although M7, the broadest definition of liabilities to the private sector in the economy, had continued to grow in real terms, the staff representative remarked. During the period January-June 1985, M7 had increased by 6.5 percent in real terms, and in the first six months of 1986 had increased by 5 percent. At the same time, there had been a significant deceleration in the rate of growth of monetary aggregates in nominal terms over the same period. The nominal value of M7 in 1985 had increased by 25 percent, and in 1986 had increased by 14 percent. Most of the growth in M7 was attributable to pension plans, which had continued to absorb resources through the banking system while the rest of the private sector had maintained real balances relatively constant. M1, which had declined in real terms in the first half of 1985, had recently increased. Monetary developments should be seen in the context of the effective repayment by the public sector to the domestic banking system following the public borrowing abroad in excess of the public sector deficit. However, credit to the private sector from both the Central Bank and of the banking system had grown at a relatively moderate rate. There was a link between the growth of monetary liabilities and the improved performance of net international reserves. Those indicators suggested that there was a growth in demand for financial assets that had as a counterpart a small increase in credit to the private sector and some increase in net international reserves. While that trend would have to be analyzed carefully, a slowdown in the growth of nominal monetary magnitudes and continued growth in real terms was evident. Part of the growth of financial assets had been explained by letters of credit and similar notes issued by the Central Government to cover the subsidy granted to the private sector in the form of a preferential exchange rate. In 1986, the growth resulting from that source had been small and was diminishing; the current growth reflected mainly demand factors.

The authorities had initially taken the approach that pension plans should invest in safe investments in the financial system and public sector to strengthen the confidence in the system, the staff representative said. Therefore, the authorities had moved very carefully and had initially only authorized holdings in the banking system or treasury notes. In recent months, their position had become more flexible, and pension plans had been authorized to invest in stocks. However, a stock risk assessment commission analyzed the most important enterprises and prepared a ranking on the basis of the quality of various indicators; pension plans could invest only in high-quality enterprises. When the Government had authorized pension plans to invest in notes or investments other than those in the financial system, there had been a significant outcry by those contributing to the pension plans, because they had been afraid that moving away from the safety of the financial system and treasury notes would jeopardize their savings. Thus, contributors to pension plans, as well as the Government, were interested in maintaining a high quality of investment.

The subsidy for commercial banks resulting from the interest rate differential for commercial banks between the purchase of their substandard portfolios and instruments sold by the Central Bank was relatively small--0.2 percent or 0.3 percent of GDP, the staff representative remarked. The substandard portfolio purchasing scheme of the Central Bank was viewed as the most effective mechanism to support the private financial system in the current difficult circumstances. The crisis in the financial system had resulted not only from poor investments, but also from the deterioration in external conditions. The alternative to this purchase of portfolio by the Central Bank would have been intervention in or liquidation of some of the banks, which would have been costlier than the solution devised by the monetary authorities. The monetary authorities considered that the support of the private banks would not have a direct monetary impact because they expected to redeem the bonds or notes as the banks' portfolios were comprised partly of bonds or notes that would not pay any interest and partly of longer-term notes which would be paid effectively in 6 to 10 years. The total value of the substandard portfolios that would be purchased by the Central Bank was about 3.5-4 percent of GDP, which would not be a loss to the Central Bank because the shareholders would have to repurchase the portfolio and would not be able to distribute dividends before that transaction. The repurchase mechanism would take longer for the two major banks in very poor financial condition; however, the authorities and the staff believed that those banks could eventually become financially viable. The Central Bank's participation in the two banks would rise to 49 percent of the value of capital; since it would have five years to sell its participation, there would be a limit to the time that the Central Bank would have to participate in the ownership or capitalization of those two banks.

Interest rates had declined in recent months, the staff representative observed. However, the decline in domestic real rates had been slower than the decline in international real rates; despite a sharp reduction in subsidies on foreign capital inflows to the country, there had continued to be a significant inflow of capital. The system of subsidies on swap operations and related deposits were being phased out and would be eliminated by the beginning of 1987; despite the reduction of subsidies, capital inflows had increased significantly and private sector capital inflows in particular had been higher than assumed at the time of negotiations. Repurchases of assets or debts held abroad by the private sector were not reflected in those trends.

The discounts on debt repurchasing ranged between 30-35 percent, the staff representative from the Western Hemisphere Department noted. On the basis of existing regulations, the Chilean private sector would be able to buy the entire external debt, but such a target was unrealistic. The medium-term scenario envisaged that debt purchased at a discount would amount to more than US$1 billion in the next four or five years. Thus far, the purchase of discounted debt by the private sector authorized by the Central Bank had been about US$350 million; there also had been debt conversion of about US$100 million. Private sector investors has shown significant interest in the mechanism and were offering to pay the Central Bank a premium rate as high as 15 percent; that was to say that through the auction mechanism the private sector had been offering fees equivalent to 15 percent of the value of the asset. An interesting aspect of the scheme was that there had been no major impact on the spread between official and parallel exchange rates, which had remained at 3-4 percent; thus, the conversion had been generated mostly by private sector capital inflows, which had resulted in a reduction of the level of external debt owed by Chile. The rate of change from debts owed abroad to debts owed domestically would affect the current account significantly; a reduction on future interest payments had been incorporated already in the medium-term projection.

The Chairman inquired whether there would not be a reduction in the public sector debt resulting from the opportunity for foreigners to buy the shares of privatized enterprises.

The staff representative from the Western Hemisphere Department said that under the restructuring arrangement, the commercial banks would have to authorize any increase beyond 49 percent in the ownership of an enterprise by the private sector, because government ownership of more than 50 percent was viewed as part of the public sector debt. Enterprises were selling shares of ownership below 50 percent, thereby preventing ownership from becoming part of the private sector debt. The issue of guarantees provided by the Central Bank would not be modified but the direct public debt would effectively be reduced.

With respect to the measures of competitiveness in the economy, the staff representative remarked that the issue was whether the inflation rate of the main trading partners was a relevant price comparator.

inflation in major industrial countries such as the United States might underestimate the impact of the depreciation of the U.S. dollar on import prices for Chile; therefore, the authorities were concerned about over-depreciation. However, in the meantime the authorities had maintained the formula agreed with the Fund through June 1986, which had resulted in a further real depreciation in the first two or three months of 1986.

Developments in the international copper markets had moved much faster than the staff had projected, the staff representative continued. The projections, which might appear to be somewhat unrealistic, had been made in the context of the world economic outlook exercise and were consistent with projections by the World Bank. Copper prices had been somewhat lower than expected, affecting the medium-term outlook. If copper prices for the next five years remained the same as the average for the first half of 1986--$0.64 cents per pound--then real imports, rather than increasing by 5.6 percent per year over the period, would increase by 2.6 percent per year. However, if prices remained constant in real terms, as they had done during the first half of 1986, then the real growth in imports--using a mechanistic approach to those projections--would be 4.6 percent a year instead of 5.6 percent. However, domestic policy would have to be reformulated to promote higher output of import substitutes and exports, which would involve changes in aggregate demand and the exchange rate.

It appeared at first glance that there had been no diversification in the economy, the staff representative noted, as exports of copper had increased in volume terms. However, noncopper export volumes had also increased significantly since 1984/85, which reflected the effects of the exchange rate policy. Thus, copper exports had continued to improve but the value of total exports had been affected by the sharp decline of non-copper export prices in 1985.

The Deputy Director of the Exchange and Trade Relations Department recalled that a recent staff paper (EBS/86/41, Sup. 1, 2/24/86) had provided a brief survey of existing schemes for the conversion of debt into equity, including those of six members other than Chile. Those schemes provided for a measure of market price determination for external debt instruments, and the willingness of foreign commercial banks to participate in them was related to the size of the discount at which those debt instruments were transacted. In some sense, the rate of discount was a measurement of the market's perception of the appropriateness of the adjustment effort in the debtor country in question. In that connection, it should be noted that so far, the scope of those conversion schemes had been relatively limited; therefore, too much importance could not be attached to the discount. An interesting aspect of the debt conversion schemes was that, to the extent that they encouraged equity capital flows, they could affect not only the level of capital flows, but also their composition. From that standpoint, the schemes could be instrumental in changing the structure of assets and liabilities as well as in encouraging a resumption of normal capital inflows.

Mr. Nebbia considered that the rate of discount was not necessarily an indication of the market's perception of the adjustment effort. Many of the small and medium banks--and some of the big banks--were willing to sell their debt instruments. Although the rate of discount prevailing in the markets heavily influenced the small banks, in many cases it had nothing to do with the performance of the economy.

When the authorities had begun implementation of the adjustment program under the extended financing facility, they had been committed to improving the efficiency and competitiveness of the economy in a medium-term setting, Mr. Nebbia continued. The Executive Board had noted several times in the recent past that Chile had little room for maneuver; nonetheless, the authorities had met the program objectives and targets and had strengthened the adjustment effort. Further adjustment might put too much strain on the economy. Among the factors that had necessitated the revision of economic targets--in addition to the earthquake and revenue losses--was the consideration of growth. The rate of inflation had been reduced by 50 percentage points in 1986. An inflation rate of 18 percent had been projected for 1986 as a whole, which might prove to be too high. Since there would be no price controls in the economy, economic developments would be influenced by, among other factors, monetary and exchange rate policies. The increased tax on petroleum would simply compensate for losses in petroleum revenue. It should be noted that since the beginning of 1986, gas and petroleum product prices had declined by 20-45 percent despite the increase in taxes, which had resulted in the decline in real effective prices in the private sector. Achieving the medium-term target was a key objective for the authorities.

The staff representative from the Western Hemisphere Department said that if the discount scheme achieved greater importance and a significant market for it developed, a relationship would evolve between the quality of economic policy and the market rate of discount. Thus, it was important to follow appropriate policies for that market to bring about improvements in the structure and level of capital flows.

The Chairman made the following summing up:

Directors were in agreement with the thrust of the staff appraisal contained in the 1986 Article IV consultation with Chile. They welcomed the renewed commitment of the Chilean authorities to the objectives and policies of the extended arrangement as specified in the program for the second year under the arrangement.

Directors welcomed the comprehensive policy adjustments implemented in 1985 and 1986 aimed at reducing Chile's external imbalances and improving the conditions for economic growth. They noted the significant strengthening of domestic savings and the external current account achieved during the first year of the extended arrangement. Directors commended the authorities for the tightening of fiscal and monetary policy since the beginning of 1985, which had been necessary to reduce inflation and protect the balance of payments.

Commenting favorably on the reduction of the debt of the nonfinancial sector, Directors drew attention to the restrained expenditure policies and the stronger performance of the public sector enterprises, and the move toward reprivatization. They also noted, with approval, the exchange rate and external tariff policies pursued since 1985, which had helped to improve the external competitiveness of the economy in a situation of further deterioration of the terms of trade. Directors emphasized the importance of maintaining a flexible exchange rate policy.

Directors were encouraged by the continued progress observed in attaining the program targets in early 1986--all performance criteria had been met--and noted with satisfaction the adjustment made to the program for the remainder of the year to take advantage of the decline in oil prices. Nevertheless, they urged the authorities to take every opportunity to consolidate further the adjustment effort and to reduce inflationary pressures. In this regard, given the need to strengthen domestic savings, Directors strongly supported the authorities' intention not to allow increased expenditure should the new petroleum tax produce additional revenues.

Directors cautioned the authorities to closely monitor developments with regard to financial system credit, particularly in light of the rapid growth in the monetary aggregates. Directors expressed concern about the increase in the operating losses incurred by the Central Bank in 1985, which were related largely to the swap and preferential exchange rate subsidies. They commended the authorities for the strong measures put in place to eliminate these operating losses in 1986, and specifically to eliminate the preferential exchange rate and swap subsidies by early 1987. Several Directors observed that careful management would be necessary to eliminate Central Bank operating losses, while at the same time promoting the re-establishment of a sound and sufficiently capitalized financial system.

Directors expressed satisfaction that Chile had made progress in reducing the rate of growth of its external debt and improving its maturity structure. They commended the authorities' initiative in establishing mechanisms for the purchase of Chile's external debt at a discount, which had helped to reduce the external debt. Nevertheless, the medium-term forecasts, particularly with respect to copper prices--the copper price assumptions made by the staff were thought to be somewhat optimistic by several Directors--clearly indicated that Chile's balance of payments would remain under strain with the continuing heavy debt service burden. Thus, Directors urged that strong efforts be made to reduce the dependence on foreign borrowing in the medium term.

The close collaboration between the Fund and the World Bank in support of Chile's medium-term economic program was noted by Directors, who also drew attention to the cooperation shown by foreign commercial banks in meeting Chile's financing requirements for 1986.

Directors noted that Chile had maintained an exchange rate and trade system that was generally free of restrictions. They were encouraged by the establishment of a schedule for the elimination of the preferential exchange rate subsidy on virtually all foreign debt transactions and the increases in travel allowances as scheduled. At the same time, they urged Chile to continue making progress to eliminate remaining exchange restrictions and multiple currency practices.

The Article IV consultation with Chile will continue to be held on a twelve-month cycle.

The Executive Board then took the following decisions:

Exchange Measures Subject to Article VIII

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

2. Chile maintains multiple currency practices and exchange restrictions as described in EBS/86/137. The Fund welcomes the progress being made in eliminating these practices and restrictions. In view of the intentions of the authorities in this regard, the Fund grants approval for their retention until the earlier of February 28, 1987 or the conclusion of the midyear review of the second-year program under the extended arrangement.

Decision No. 8341-(86/120), adopted
July 21, 1986

Review Under Extended Arrangement

1. Chile has consulted with the Fund in accordance with paragraph 4(c) of the extended arrangement for Chile (EBS/85/122, Sup. 3), paragraph 4 of the letter of July 9, 1985 from the

Minister of Finance and the President of the Central Bank of Chile attached thereto, and paragraph 6 of the letter of January 20, 1986 (EBS/86/41), in order to establish suitable performance clauses for the second year of the arrangement.

2. The letter dated June 18, 1986 from the President of the Central Bank and the Minister of Finance, together with the annexed Memorandum on the Economic Policies of Chile, shall be attached to the extended arrangement for Chile, and the letters dated July 9, 1985 and January 20, 1986, together with the respective annexed Memoranda on the Economic Policies of Chile, shall be read as supplemented and modified by the letter dated June 18, 1986, together with its annexed Memorandum on the Economic Policies of Chile.

3. Accordingly, Chile will not make purchases under the extended arrangement:

(a) during any period in which the data at the end of the preceding calendar quarter indicate that the cumulative limits on the overall deficit of the nonfinancial public sector, as specified in paragraph 20 and Table 1 of the memorandum annexed to the attached letter of June 18, 1986, have not been observed, or

(b) during any period in which the continuous ceiling on the net domestic assets of the Central Bank of Chile, as specified in paragraph 21 and Table 2 of the memorandum annexed to the attached letter of June 18, 1986, is not observed, or

(c) during any period in which the data at the end of the preceding calendar quarter indicate that the target on the net international reserves of the Central Bank, as specified in paragraph 21 and Table 3 of the memorandum annexed to the attached letter of June 18, 1986, has not been met, or

(d) during any period in which the continuous ceiling on the stock of short-term external debt owed by the nonfinancial public sector and the Banco del Estado, as specified in paragraph 30 and Table 4 of the memorandum annexed to the attached letter of June 18, 1986, is not observed, or

(e) during any period in which the continuous ceilings or subceilings on the contracting and guaranteeing of medium- and long-term external debt by the public sector, or the continuous ceiling on the rescheduling of external debt by the public sector and by the private sector with the guarantee of the public sector, as specified in Table 5 of the memorandum annexed to the letter of January 20, 1986, are not observed, or

(f) during any period in which the understandings referred to in paragraph 31 of the memorandum annexed to the letter of January 20, 1986, are not being observed, or

(g) during any period after January 31, 1987 in which the midyear review contemplated in paragraph 5 of the attached letter of June 18, 1986, has not been completed, or while the understandings reached are not being observed.

4. Until July 14, 1987 purchases under this extended arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 500 million provided that purchases shall not exceed the equivalent of SDR 250.00 million until August 15, 1986, the equivalent of SDR 312.50 million until November 14, 1986, the equivalent of SDR 375.00 million until February 13, 1987, and the equivalent of SDR 437.5 million until May 15, 1987.

Decision No. 8342-(86/120), adopted
July 21, 1986

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

The Executive Directors considered a staff paper further reviewing Liberia's overdue obligations following the declaration of Liberia's ineligibility to use the Fund's general resources as of January 24, 1986 (EBS/86/155, 7/17/86).

Mr. Abdallah commented that unfortunately since January 24, 1986 there had been a further accumulation of overdue payments, resulting from continuing decrease in Liberia's major exports, iron and rubber, in the face of declining world prices. It was estimated that in 1985/86 GDP had declined by 2 percent, the overall balance of payments deficit had widened, the external arrears had doubled, and the fiscal position had remained weak, despite the authorities' efforts to reverse the economic deterioration through difficult austerity measures, including a 25 percent cut in wages and salaries, and cuts in the size of the civil service. Consequently, the budget deficit had been reduced from 15 percent of GDP in 1984/85 to 8 percent in 1985/86.

A number of steps were currently being taken to control government expenditure and improve revenue generation, Mr. Abdallah said. Those measures included: discontinuing the practice of offsetting extrabudgetary expenditure against prospective tax revenues; preinspection of imports to improve revenue collection; and discontinuing the issuance of duty drawback certificates and certain duty free privileges. Serious efforts were also being made to rationalize the operation of key public enterprises as a first step in privatizing some of them.

In the external sector, imports had been cut drastically in 1985/86 resulting in a current account surplus of $15 million, Mr. Abdallah noted. Nevertheless, the overall balance of payments deficit had widened considerably, reflecting current amortization payments and capital flight. The authorities had introduced a number of measures to help improve the situation, including a foreign exchange requirement whereby 25 percent of export proceeds would be surrendered to the National Bank of Liberia. The authorities intended to use some of the proceeds for reducing their arrears to the Fund.

The authorities fully recognized their obligations to the Fund and other creditors and were anxious to clear them as soon as they would be in a position to do so, Mr. Abdallah remarked. They intended to continue cooperating with the Fund in seeking solutions to their serious economic problems and they had requested a technical assistance mission to help them evaluate the present currency system. He hoped that with the help of the Fund and friendly countries Liberia would be able to overcome its economic difficulties, clear its arrears to the Fund, and restore good relations with the institution.

Mr. Obame noted that the authorities were making efforts to deal with the serious economic situation. He welcomed their recent fiscal measures. The authorities should strengthen their efforts in the context of a strong and comprehensive adjustment program that would lead to the resumption of adequate financing. The request for technical assistance by the Fund seemed appropriate. He supported the proposed decision.

Mr. Rye noted that the Executive Board had agreed that the Fund should be prepared to provide technical assistance as appropriate to ineligible members that would facilitate clearance of their arrears; the clearance of arrears should be a significant objective of such assistance. The staff should clarify that the technical mission that was to visit Liberia in August 1986 would actually facilitate the clearance of arrears; it was not clear that the mission would address that matter.

The staff representative from the African Department said that Liberia's economic and financial situation was extremely serious, and the authorities had been urged to undertake as soon as possible a strong and comprehensive adjustment program designed not only to address the country's immediate problems, but also to ensure progress toward economic and financial viability over the medium term. In that context, it was important to review and study the currency system, including the issue of the linkage of the Liberian dollar with the U.S. dollar, and to devise policy options for the future. Thus, technical assistance in that field was a critically important element of the comprehensive adjustment program.

Ms. Bush commented that the prospects for the economy were not promising. Arrears had continued to grow, and no payments had been made to the Fund despite repeated assurances by the authorities that they would give priority to servicing their debt to the Fund. The authorities had apparently made very little progress, if any, in formulating and adopting a budget for fiscal year 1986/87. She wondered whether there was any indication that an appropriately structured budget might be nearing completion and whether provision for debt servicing had been made in it.

The situation in Liberia was serious, and without a strong domestic adjustment effort external donors and creditors would have little incentive to support the efforts of the authorities, Ms. Bush continued. Her authorities were prepared to communicate with other donors and creditor governments to make clear to the authorities the seriousness with which the international financial community viewed the economic situation and the need for Liberia to formulate and adopt a comprehensive adjustment program.

She hoped that other Executive Directors would support the effort to encourage representatives of their countries in Liberia to convey the same message to the authorities, Ms. Bush remarked. As had been indicated in the handling of previous cases of overdue obligations to the Fund, it was necessary to be creative in making every possible effort to clear the arrears and, if additional pressure from industrial and developing countries could help bring that about, her authorities would be willing to facilitate that process. The authorities should make a clear effort to demonstrate to the Executive Board that they accorded high priority to paying the Fund.

The authorities themselves might attend the coming Article IV consultation discussion by the Executive Board or send a written description of the intended elements of their adjustment program, Ms. Bush said. That program should be worked out with the Fund and the World Bank and should form the basis for a renewed effort to eliminate the arrears to the Fund. Such an effort would require the involvement of a number of governments, the Fund, the World Bank, and commercial banks. It was particularly important that the World Bank be involved at an early stage so that its financial participation in the adjustment effort could be utilized as early as possible. The authorities should be much more conscientious about providing clear evidence of the priority that they accorded to obligations to the Fund.

Mr. Nimatallah commented that the Executive Board did not appear to have taken the problem of Liberia's arrears seriously, especially after the declaration of ineligibility. An opportunity to address the problem had been missed during the discussion of issues relating to actions following declaration of ineligibility (EBM/86/92, 6/6/86). He had recommended the adoption of some additional measures, but no action had been taken by the Board.

Mr. Leonard said that the proposed decision was the best possible solution at the present stage.

Mr. Jiang stated that the proposed decision was acceptable.

The staff representative from the African Department noted that although the fiscal deficit remained unsustainably large, there had been some reduction in the deficit in 1985/86. The staff had made a number of recommendations to the authorities with a view to gaining a substantial reduction in the overall deficit. The staff favored in particular the adoption of a budget that would balance onshore expenditure with onshore revenue, thereby leaving most of the offshore resources to service the country's external debt obligations. However, even under that scenario Liberia could at best discharge the external debt service falling due to international organizations, including the Fund, but not its obligations to official bilateral creditors and private financial institutions. Thus there was a distinct financing problem, which should be addressed by a strong and comprehensive adjustment program--there was still no evidence that the authorities were prepared to undertake such a program--and a coordinated and substantial external technical and financial support program. Obviously, the second element would not materialize if there was no evidence that the authorities would be prepared to implement the first element. A 1986 budget was being prepared, and preliminary figures had been received in the Fund; however, he could not confirm that the budget under review by the legislature conformed with the broad objectives favored by the Fund mission.

The Chairman said that the case of Liberia was a cause for concern. The fact that no payments had been made to the Fund showed a lack of commitment by the authorities to correct the situation. The current account of the balance of payments had registered a turnabout in 1985/86 and had generated a surplus of $15 million--which was significant, since it represented more than one percent of GDP. However, the overall balance of payments had registered a deficit of $109 million for 1985/86 as a result of higher amortization payments. He wondered to whom those amortization payments had been made. It was indeed a serious situation if there was a problem of capital flight and overdue payments to international institutions in addition to the Fund. The country should demonstrate its commitment to regularizing its relations with the Fund by making payments to the Fund. The authorities needed a strong and comprehensive adjustment program. Appropriate domestic policies were required to reduce capital flight. Coordinated external support for Liberia could emerge only when Liberia had shown clear evidence of its commitment to formulate and implement appropriate domestic policies. He would convey to the authorities in his communication to them the serious concern and disappointment of the Executive Board at Liberia's recent actions, the need for the authorities to give tangible evidence of their commitment to improving their relations with the Fund, the need to put together a comprehensive and convincing financial and economic package, and the desire of the Fund to continue a dialogue with the authorities to help them in formulating economic and financial policies and eventually coordinating efforts by the authorities and donor countries to support needed adjustment policies in Liberia. The planned technical asistance mission would help the authorities to evaluate the currency system.

He agreed with Ms. Bush that members' representatives in Liberia could usefully encourage the authorities to make needed policy changes and to pay the Fund, the Chairman commented. Such efforts would underscore the fact that Liberia's arrears to the Fund were not merely a technical matter that need be examined only occasionally by the Fund, but they would also reflect the deep concern of governments.

Mr. Nimatallah said that the problem was more serious than the Executive Board apparently perceived. Liberia, like Guyana, was giving priority to other creditors and regarded the Fund as no longer useful because it had declared the country ineligible for further assistance. The authorities apparently were not serious about formulating a comprehensive program; they were merely putting together partial financing packages from various sources. It was not sufficient to have a six-month review that failed to show any definite improvement in the situation. The problem would have to be looked at in a new way. In that connection, there might have to be much closer coordination between the Fund and development institutions. The authorities should be placed under greater pressure to implement the comprehensive program.

Mr. Kafka commented that the differences between Liberia and Guyana should not be overlooked. Guyana had embarked on an adjustment program that although not very advanced had been enough for them to make some payments to the Fund.

The Executive Board then took the following decision:

1. The Fund has reviewed further the matter of Liberia's continuing failure to fulfill its financial obligations to the Fund.

2. The Fund deeply regrets the continuing failure of Liberia to fulfill its financial obligations to the Fund and again urges Liberia to make full and prompt settlement of those obligations.

3. The Fund again calls on Liberia to adopt as a matter of urgency a comprehensive economic adjustment program.

4. The Fund will review the matter of Liberia's overdue financial obligations to the Fund again within six months of the date of this decision.

Decision No. 8343-(86/120), adopted
July 21, 1986

4. MEXICO - REPORT BY MANAGING DIRECTOR

The Chairman said that useful discussions had been held with the Secretary of Finance of Mexico and his economic and financial team during the previous week. He had just received information from the Secretary of Finance that the economic package for Mexico had been reviewed by the President of Mexico and his Cabinet and that they had agreed on the broad lines of economic policies for the period 1986-87 in support of a request for assistance from the Fund over that period. The Secretary of Finance would arrive in Washington the following day for the signing of the letter of intent and then travel to New York to discuss with the commercial banks their participation in the support of Mexico's program. He would accompany the Secretary of Finance to New York. The President of the World Bank would also be present at the discussions.

Arrangements would have to be made to enable Mexico to meet its liquidity requirements until the financing package was fully in place, the Chairman continued. As he had informed the interested Executive Directors by telephone, he had sent a message the previous day to the ministers of finance and governors of central banks of a number of countries to emphasize the need for interim financing for Mexico. In a message to the President of the Bank for International Settlements he had indicated the desirability of its participation in bridging finance. The World Bank had also agreed on the importance of bridging finance to support Mexico's economic program. Preliminary responses to his efforts had been constructive and positive.

Mr. Grosche asked about the time horizon for the bridging operation. He wondered which institutions would participate in the conference in New York.

The Chairman said that the precise length of the bridging operation had not been worked out. It could possibly extend to the end of 1986, although there might be segments that could be reimbursed at an earlier date. Commercial banks would be invited to the meeting in New York, where they would be apprised of the authorities' program. The Mexican authorities would make the initial presentation, and then he and the President of the World Bank would explain the input of their respective organizations.

Mr. Ortiz remarked that some central banks had been invited to attend the program since it would be appropriate for them to have a first-hand explanation of the contents of the Mexican program.

The Chairman said that he had not gone into details of the program thus far since it would have been inappropriate to have done so before the Mexican authorities had approved the program. After receiving confirmation from the authorities, he had called on available Executive Directors to apprise them of the situation. The letter of intent was being discussed with the authorities, and discussions would not be completed until the following day. But he could meet informally with the Executive Directors to present the gist of the program.

Mr. Ortiz agreed that an informal presentation of the outline of the program should be made.

5. JAMAICA - OVERDUE FINANCIAL OBLIGATIONS - REPORT AND COMPLAINTS UNDER RULE K-1 AND RULE S-1

The Chairman observed that according to Decision No. 8319-(86/104) G/S, adopted June 25, 1986, the report and complaints under Rule K-1 and Rule S-1 regarding Jamaica's overdue obligations to the Fund were to be taken up by the Executive Board on July 23, 1986. Because neither he nor the Deputy Managing Director would be able to chair a meeting on the scheduled date, he asked Executive Directors whether the discussion could be rescheduled for July 25, 1986.

The Executive Directors accepted the Chairman's proposal.

The decision was:

Paragraph 1 of Decision No. 8319-(86/104) G/S, adopted June 25, 1986, relating to placing the complaints and notice of the Managing Director on the agenda of the Executive Board for July 23, 1986, shall be amended by substituting July 25, 1986 for that date.

Decision No. 8344-(86/120) G/S, adopted
July 21, 1986

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/86/119 (7/18/86) and EBM/86/120 (7/21/86).

6. 1986 ANNUAL MEETING - EXECUTIVE BOARD - REPRESENTATION EXPENSES

The Executive Board approves the recommendation of the Committee on Executive Board Administrative Matters concerning representation expenses at the time of the 1986 Annual Meeting as set forth in EBAP/86/172 (7/15/86).

Adopted July 18, 1986

APPROVED: April 9, 1987

LEO VAN HOUTVEN
Secretary