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Minutes of Executive Board Meeting 86/197

10:00 a.m., December 15, 1986

J. de Larosière, Chairman

Executive Directors	Alternate Executive Directors
	E. T. El Kogali
	Wang X., Temporary
	D. C. Templeman, Temporary
	E. L. Walker, Temporary
	H. G. Schneider
A. Donoso	
	M. Z. M. Qureshi, Temporary
H. Fujino	
	B. Goos
	Khong K. N., Temporary
	J. R. N. Almeida, Temporary
	M. Foot
	S. Simonsen, Temporary
	D. McCormack
Mawakani Samba	C. V. Santos
Y. A. Nimatallah	
G. Ortiz	L. Filardo
H. Ploix	S. de Forges
	G. Schurr, Temporary
	C.-Y. Lim
	B. Tamami, Temporary
	A. Vasudevan, Temporary
S. Zecchini	

L. Van Houtven, Secretary
A. Akanda, Assistant

Also Present

IBRD: K. Marshall, Latin America and the Caribbean Regional Office; M. Paz Estenssoro, Office of Executive Director. African Department: A. D. Ouattara, Director; J. Artus, J. E. Greene, J. Harnack, I. Ndoye, S. N'guiamba. Exchange and Trade Relations Department: M. Guitián, Deputy Director; C. Atkinson, S. Kanesa-Thasan. External Relations Department: H. P. Puentes. Fiscal Affairs Department: A. Cheasty. IMF Institute: B. Ketchekmen, Participant. Legal Department: J. M. Ogoola, J. V. Surr. Research Department: N. M. Kaibni, R. Pownall, S. S. Soladay. Treasurer's Department: W. O. Habermeier, Counsellor and Treasurer; T. Leddy, Deputy Treasurer; D. Gupta, R. B. Hicks, D. V. Pritchett. Western Hemisphere Department: E. Wiesner, Director, S. T. Beza, Associate Director; P. D. Brenner, H. M. Flickenschild, P. Kohnert, J. E. Leimone, A. Linde, C. M. Loser, J. Sol-Perez. Personal Assistant to the Managing Director: R. M. G. Brown. Advisors to Executive Directors: A. Bertuch-Samuels, L. P. Ebrill, K. Murakami, G. Pineau. Assistants to Executive Directors: F. E. R. Alfiler, H. S. Binay, F. Di Mauro, W. N. Engert, R. Fox, M. Hepp, O. Isleifsson, T. Morita, C. Noriega, W. K. Parmena, L. M. L. Piantini, S. Rebecchini, A. V. Romuáldez, D. Saha, C. A. Salinas, D. A. Woodward.

1. BOLIVIA - 1986 ARTICLE IV CONSULTATION; REVIEW UNDER STAND-BY ARRANGEMENT; STRUCTURAL ADJUSTMENT ARRANGEMENT; AND PURCHASE TRANSACTION - COMPENSATORY FINANCING FACILITY

The Executive Directors considered the staff report for the 1986 Article IV consultation with Bolivia and the midterm review under the stand-by arrangement, together with a request for a structural adjustment arrangement (EBS/86/263, 11/26/86; and Sup. 1, 12/12/86), and a request for a purchase under the decision on the compensatory financing of export fluctuations (EBS/86/264, 11/26/86; and Sup. 1, 12/15/86). They also had before them a background paper on recent economic developments in Bolivia (SM/86/290, 12/2/86).

The Managing Director made the following statement:

> There follows for the information of Executive Directors the text of a memorandum that I have received from the President of the World Bank to serve as the basis for my statement on the matter to the Board. This text summarizes the main points covered by the Executive Directors of the Bank and IDA in their November 25, 1986 discussion in Committee of the Whole of a paper entitled "Bolivia - Medium-Term Economic and Financial Policy Framework (1987-89)."
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> 1. The Executive Directors of the Bank and IDA discussed, in a meeting of the Committee of the Whole, the paper entitled "Bolivia - Medium-Term Economic and Financial Policy Framework (1987-89)."
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> 2. The staff commented on the deep-seated problems of Bolivia as well as the courageous program started by the Government to deal with these issues and restart a sustainable growth process within a stable framework. The difficulties of balancing these objectives were appreciated.
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> 3. The Government needs to deal with the restructuring of debt; the revitalization of the mining sector; the development of markets for hydrocarbons, particularly gas; the development of a strategy for agricultural development; and with the restoration of social services, particularly to deal with the impact of the current adjustment measures.
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> 4. Concern was expressed by several Directors that in some areas specific programs were lacking. This seemed to be the case in agriculture and in the revitalization of the private sector. Concerns were also expressed about the administrative and managerial capacity of the Government.

5. It was explained that Bolivia was emerging from a very chaotic situation and the Government was moving rapidly to restore stability and reactivate the economy. Given the scale of the tasks it had not yet been possible for the Government fully to articulate its programs. However, the effort was continuing and further progress had been made even since the preparation of the policy framework paper. A major effort was being mounted, by the Bank and other donors, to strengthen management, restore fundamental financial controls, and establish effective public investment criteria.

6. There was general recognition of the fragility of the financial plan. Success of the program would depend on a generous response of the donors and generous rescheduling terms by commercial banks and official creditors.

7. Many speakers expressed concerns about the social impact of the adjustment program, particularly where combined with the income aspect of the anti-cocaine drive. These problems have to be seen against the background of many years of neglect of social services and poorer regions. The Government is very much aware of these problems and is developing programs to strengthen social services and expand their coverage. The determination of the Government to eradicate cocaine production was noted. A special program to deal with coca growers is expected to be tabled at the Consultative Group meeting, to obtain external support for this effort.

Mr. Donoso made the following statement:

The Bolivian authorities deeply appreciate the support and cooperation provided by the Fund during the period of implementation of their ambitious program to bring growth to the country. Bolivia is already benefiting from Fund resources in the context of the stand-by arrangement. The authorities wish to stress the importance they attach to the excellent technical advice they have received in the process of defining and applying their adjustment plan.

The staff papers relating to the review under the stand-by arrangement, the request for arrangements under the structural adjustment facility, and the request for a purchase under the compensatory financing facility fully reflect the comprehensiveness of Bolivia's program of adjustment, the difficulties faced by the country, the policy measures contemplated for the next years and the delicate external financing environment that will constrain Bolivia's development for some years in the future.

There is little to add to the work presented by the staff, which the authorities consider an accurate description of both the present situation and possibilities of the Bolivian economy.

I wish to emphasize the adverse conditions under which the adjustment program is being implemented. The consolidation of the program is occurring at a time when Bolivia faces a great deterioration of its terms of trade. In the staff paper relating to the purchase under the compensatory financing facility, it is estimated that export earnings in SDR terms declined by 13 percent in 1985 and by a further 26 percent in 1986. The predominant factor behind the shortfall in export earnings is the decline in world prices for metals and energy. In 1986--the shortfall year--unit prices for metals are estimated at 48 percent below average prices of the two preceding years.

At the same time Bolivia has embarked upon a decisive effort to suppress production and processing of coca leaves, which has had an additional negative impact on the economy.

By any measure the first stage of the adjustment program has been very successful. Prices and interest rates were freed, and a flexible exchange rate policy was adopted. The trade and payments regimes were liberalized, while a more efficient policy with respect to import tariffs was established.

Strong measures were applied to control the fiscal imbalances including a wage freeze, a realistic pricing policy for public enterprises, the layoff of surplus labor and closure of inefficient enterprises, and a determined effort to increase tax collections and reduce public expenditures.

An overall deficit of the nonfinancial public sector equivalent to 3.8 percent of GDP is expected for 1986, represents less than what the public sector could finance with external resources. Thus, the public sector has been able to reduce internal indebtedness. This achievement in public finances has made possible a strong monetary policy. It determined accumulation of international reserves which is the main counterpart of the increase in monetary aggregates. The control of inflation has been dramatic. From a rate of price increases of 24 percent from August 1984 to August 1985 inflation went down to an expected 65 percent in the 12 months until December 1986. Reflecting the abatement of inflation, domestic interest rates have gradually declined since late 1985.

The economic program through the end of 1987 is part of a three-year program for the period 1987-89 developed by the Bolivian authorities with the cooperation of the staffs of the Fund and the World Bank.

This program contemplates the introduction or strengthening of measures in many areas: implementation of the recently approved tax reform; the reorganization and decentralization of state enterprises; the reform of the financial system; and the improvement of public investment planning and execution capacity.

The general framework in which these measures will fit will be the one already defined by the actions taken to liberalize the economy and introduce fiscal discipline, complemented with specific actions to enhance the role of the private sector in the economy. The authorities are confident about their ability to reach the objectives of a yearly rate of growth of 3 1/2 percent, reductions in the rate of inflation to 5 percent a year in 1989, and overall balance of payments equilibrium.

The support of the international financial community is crucial to the development of the program. Disbursements from multilateral institutions are already expected to rise to more than US$200 million in 1987 and to remain at that level for some years. An agreement with the Paris Club has been reached. The authorities are optimistic about the results of the Consultative Group meeting held recently in Paris and they are actively seeking an agreement with the commercial banks.

Certainly, a key element for a successful implementation of Bolivia's program and to assure its access to external resources will continue to be the Fund support and technical cooperation.

Approval of Bolivia's requests will also be a tangible expression of support for the efforts of a country that I assume my colleagues will consider well deserved.

Mr. Almeida made the following statement:

Economists will have a difficult task explaining how the Bolivian authorities were able to achieve such significant success in so short a time, but there is no question that rational expectations had an important role in that achievement. The public believed that the authorities were going to implement adjustment measures, and that after a long period of monetary and fiscal chaos there was in fact no other option than adjustment. For their part, the authorities had the determination to fulfill those expectations, despite the usual initial skepticism of trade unions that has been seen in similar situations in neighboring countries.

The behavior of the external accounts was a perfect textbook case. There was no devaluation per se, but simply a freeing of the exchange rate, which changed the expectation of a permanent exchange crisis to assurance of a regular market situation and the virtual disappearance of the premium in the parallel market. In that sense, the resulting depreciation was a less important phenomenon than the creation of the certainty that unrealistic exchange rates would not prevail any more. As a consequence, it was possible to liberalize the external trade system, which became virtually free of restrictions, and import tariffs were standardized at 20 percent; the authorities understood that competition could contribute to better efficiency and that the possibility of contraband could be ignored in a country with a limited administrative infrastructure.

The authorities used income policies extensively. The possibility of dismissal of workers was reintroduced for both the private and public sectors, and restrained wage policies for the public sector were put in effect. In the Central Government, taxes were increased and nonessential expenditures were curbed. A tight credit policy was implemented, and the freeing of prices and interest rates helped to keep inventories low. It was no wonder that the public sector borrowing requirement (PSBR) decreased from 28 percent in 1984 to 4 percent in 1986. All these policies were undertaken at a time of collapsing prices for tin and hydrocarbons, which together accounted for 83 percent of exports and 55 percent of public sector revenues.

Although the staff is rightly enthusiastic about the country's progress, it has not been able to resist increasing the quantitative performance criteria for the usual stand-by arrangement from four or five to seven, and adding the submission of the 1987 budget to Congress as another performance criterion. I find the latter to be a totally improper condition. In addition, there are three structural benchmarks for 1987, which makes a total of 11 constraints to be observed by a country that, as the staff itself recognizes, has a very limited public sector management infrastructure. I wonder if this is not too much of a strain. I also wonder who these constraints will help.

The medium-term scenario is complicated by the uncertainty in the outlook for natural gas exports. Further adjustment might be needed after 1992, when the gas export agreement with Argentina expires. The authorities are rightly trying to diversify their exports at this time.

The favorable effects of the stabilization program were not sufficient to reverse the deterioration of output and employment that had plagued the economy during the past five years, but I am happy to see that both the structural adjustment arrangement and the current stand-by arrangement envisage moderate growth rates for the next three years. The key factor in the reactivation of the economy will be a return of investment to more reasonable levels, financed by a combination of external and domestic savings, the latter to be boosted mainly by public sector savings. In other words, the country, particularly the public sector, is undertaking much of the required sacrifice, and we can only hope that the international financial community will step up its efforts to help this valiant country in the present circumstances.

Mrs. Filardo made the following statement:

I agree with Mr. Almeida that it is improper to establish as a performance criterion the submission of the 1987 budget to the Bolivian Congress.

The Government, which took office in August 1985, has wisely initiated a package of wide-ranging economic policies to redress the severe imbalances in the economy that have been characterized by a strong contraction of GDP for the fifth consecutive year, a decline in GDP per capita by 30 percent since 1980, an inflation rate of 24,000 percent during August 1984-August 1985, the highest deficit in five years of the current and global balance of payments position, and a deficit of the nonfinancial public sector of about 23 percent of GDP that was financed by the Central Bank.

The Government embarked upon a significant reorientation of its economic policies toward a free market approach, under which exchange and interest rates, prices, and the trade and payments systems were liberalized, and monetary and fiscal policies were rigorously tightened. Unfortunately, adverse exogenous and internal factors, such as the collapse of tin and oil prices, the floods in early 1986, and the suppression of production and processing of the coca leaf, were the main causes of considerable losses in income, production, and employment. Notwithstanding those unfortunate events, the authorities responded with a renewed economic package that included a comprehensive stabilization program and structural reforms initiated under a stand-by arrangement with the Fund in June 1986, and also two loans from IDA, which remain undisbursed.

Currently, we have before us new requests for financing from the authorities aimed at continuing and strengthening the country's market-oriented adjustment model. We highly commend the Government for its perseverance and courage in accomplishing the entire program, and support its requests. As the staff observes in its report, this program has been the most sweeping reorientation of economic policy in Bolivia during the past 30 years.

The performance criteria under the stand-by arrangement were met with ample margins, except for payments arrears on public and publicly guaranteed debt to external creditors, and the authorities were able to restore the viability of the economy. Their most commendable achievement was to break, in an extraordinary way, the inertial inflation which was the consequence of a severe tightening of fiscal and monetary policy alongside flexible interest and exchange rate management in order to attract an inflow of capital and to increase nontraditional exports. Nevertheless, demand policy restraint, together with the external shocks, has contributed to a deeper recession. GDP is expected to decline by about

3 percent in 1986, and unemployment to be more than 20 percent; with the exception of the agricultural sector, the overall level of unemployment is expected to be over 50 percent.

I would like to express my concerns about the dollarization of the economy, the time needed to transform the structure of production and the export capacity of Bolivia, the management of the external debt, and the social and political implications of the package that is to be implemented.

The background paper mentions that the dollarization of November 1982 had a severe and lasting impact on the financial system. Financial institutions were forced to accept repayments of dollar-denominated loans at the official rate of $b 145 per U.S. dollar. However, the Central Bank was unable to meet the banks' foreign exchange requirements. Although a measure was introduced in August 1985 requiring banks to revalue the remaining U.S. dollar-denominated assets and liabilities at the prevailing official rates, the settlement of foreign debt of domestic banks has remained unresolved.

Apart from the consistency of macroeconomic policies, one of the main reasons for the inflow of capital has been the recent option for Bolivians to continue to hold cash and time deposits denominated in U.S. dollars. These deposits, as the background paper emphasizes, have been the fastest growing component of money and quasi-money since 1985, although the effective rate of return on the dollar-denominated deposits has turned out to be lower than on the peso-denominated deposits. Given the fact that for June 1986 dollar-denominated deposits were 27 percent of money and quasi-money and 51 percent of quasi-money alone, and since Supplement 1 to the staff report indicates that in the two-month period ending November 1986 private peso-denominated deposits grew substantially, it would be interesting to hear the staff's views on the real situation of money and quasi-money and the financial situation of the banking system. It would also be useful to know whether the staff considers that dollarization could pose a great danger to the economy since the external sector is weak and only the banking system seems to assume the foreign exchange risk.

Another issue relates to the management of the exchange rate, which has to be kept competitive in real terms in order to increase nontraditional exports. Thus far, the inflow of capital has caused the appreciation of the exchange rate by 23 percent in real weighted terms. Nevertheless, my impression is that confidence in the economy has not been fully re-established and any adverse capital movements could hinder the whole process. I wonder if the staff considers that the Central Bank might be ready to implement an additional devaluation of the currency to avoid the widening of the gap between the official and parallel rates. Also, it would be helpful to know why the staff assumes that multicurrency practices could emerge.

The time required for the transformation of the productive structure of Bolivia in order to increase export capacity, one of the main elements needed to restore the viability of the economy, will be very long. For instance, after a sizable contraction in 1984-85, manufacturing output started to reflect some signs of recovery only during 1986. However, the development of the agricultural sector has been adversely affected by weak extension services, the land tenure system, and a poor marketing system, in addition to the importance for exports of the production and processing of the coca leaf, its export value having been higher than that of all other exports. Therefore, one of the main objectives for agricultural development should be to rebuild the sector and to find alternative production crops in the key coca growing areas, admittedly a more difficult task. Although nontraditional exports have increased substantially, I wonder whether we are not being too optimistic in relying on the agricultural sector as the basis for the recovery of exports in Bolivia. This leads one to conclude that the recovery of production, employment, and income requires patience, sufficient time and financial resources.

As Mr. Donoso remarks in his opening statement, the support of the international community is crucial to the development of the program and of the whole process of adjustment. On page 27, the staff report states that "even with...projections that envisage the availability of a substantial amount of concessional external financing, Bolivia's medium-term outlook for the balance of payments remains difficult." In this connection, one of the main features of the external debt arrangements is the negotiation with commercial banks, one possibility in the latter respect, as noted on page 29 the staff report, being for Bolivia to reduce its debt burden by buying back some of its debt, directly or indirectly, at a discount. Although this scheme would depend on the terms of the buy-back and the rescheduling of the remaining outstanding debt, I would appreciate staff comments on the sources of the money that would be used to buy back the debt, and clarification on whether any projections have been made to analyze the impact of the scheme on the balance of payments. In any event, given the enormous efforts on the part of the authorities, it is extremely important to have generous concessional flows and debt relief from donors and commercial banks, and a strong and rapid response from multilateral institutions, especially the World Bank group.

We are very pleased to learn from the supplement to the staff report that the Consultative Group met on December 3-4, 1986, when donors agreed to attend to the financial needs of the investment program for 1987 and to tackle one of Bolivia's fundamental problems, namely, drug trafficking. Perhaps the staff could inform the Board of the details of the financial package and the reactions, if any, of the commercial banks. It seems to me that the financial package is still too fragile because it is not clear how commercial banks are going to support the country.

Finally, we should consider the social impact and the political unrest that the implementation of the program might cause. So far, unemployment has been increasing because of the closure of tin and other mines and the dismissal of people from private and state-owned companies, the latter owing to the restructuring of those companies to achieve a more efficient allocation of resources. Bolivia is one of the poorest countries in Latin America, whose per capita GDP has been decreasing for the past six years--not to mention the frequent changes in government. The medium-term economic framework presented in the staff report indicates that the Government intends to address the social problems; the supplement to the staff report states that a special working group of the Consultative Group would handle contributions to the emergency social fund that was established in November 1986 and that will require US$325 million. This is welcome information, but I would like the staff to comment on the coverage of the social program; how the figure of US$325 million was reached; and how the unemployment problem is going to be tackled.

To conclude, we are of the view that the whole package undertaken by the Government has so far been very successful and will continue to provide a challenge for the authorities.

Mr. Goos made the following statement:

I can fully associate myself with the staff appraisal, not only with respect to the high praise that the authorities undoubtedly deserve for their continued pursuit of an impressive adjustment course, but also to the concerns and recommendations expressed by the staff that cover adequately the policy areas of particular importance to the eventual success of the economic strategy. In view of this agreement, I will be rather brief.

Let me express our appreciation of the country's excellent performance under the stand-by arrangement so far, especially the better than expected results in the fiscal and external positions and in the reduction of inflation. In this connection, I should also mention the recent stabilization in the exchange rate. These achievements are all the more impressive since they have come about without recourse to administrative controls such as a price freeze. Compared with that success, it is of course most regrettable that the economy has remained in a deep recession and that unemployment has climbed to quite distressing levels. It appears, however, that with the reduction in domestic and external imbalances, and most notably the reversal in private external capital flows, the economy is poised better than ever before for a sustainable recovery.

Against this background, the cautious reorientation of fiscal policy toward investment and employment envisaged under the program seems to be fully justified. I am pleased to note that there are already signs of an economic revival. Of course, the projected increase in the fiscal and current account deficits can hardly be ignored in view of the precarious external position, but it is reassuring that the projections show a continued improvement in strategic underlying fundamentals such as domestic savings, inflation, and the external debt service ratio. Moreover, I feel greatly encouraged by the authorities' commitment to limit both the external current account and the fiscal deficit to the availability of concessional financing.

Notwithstanding these favorable projections and commendable policy intentions, I should underline three staff recommendations of particular importance. First, the need to seek an improvement in public sector savings beyond those projected for the coming years. This will also require, inter alia, very close monitoring of fiscal developments in order to counter promptly any possible slippages. For example, additional strains on the budget might develop in the immediate future as a result of the thirteenth monthly wage payment. There might also be budgetary pressures at a later date owing to the assumption of COMIBOL's debts by the Treasury.

The second point I should stress is the need to ensure the most efficient use of external resources, and to this end I encourage the authorities to continue their close collaboration with the World Bank.

Third, it is of paramount importance to reach an early normalization of relations with foreign creditors in order to pave the way for the substantial financial flows required in the years ahead.

As to the proposed structural adjustment arrangement, I feel that this arrangement and the policies set out in the policy framework paper constitute an appropriate response to the difficult structural problems in a framework of continued sound financial policies. Without minimizing the importance of the other measures that are contemplated, I particularly welcome the increased emphasis on export diversification and private sector activity, and also the continued attention to be paid to the institutional reform of the financial system. With regard to the latter, the forthcoming reorganization of the Central Bank constitutes a commendable step toward greater independence of the Bank from the Government that should enhance the credibility of monetary policy.

To conclude, I would like to commend the authorities for their continued commitment to adjustment, as evidenced by their policy undertakings for the remainder of the stand-by arrangement and those presented in the policy framework paper. Therefore, I have no difficulty supporting the proposed decisions, including the decision on the request for compensatory financing, which seems to meet all the relevant requirements.

Mr. McCormack made the following statement:

Since August 1985, the Bolivian authorities have been engaged in a thoroughgoing and courageous reorientation of economic policy. Progress has been substantial. The reduction in the measured rate of inflation is only the most dramatic indication of the scale of the adjustment achieved. There has been a major process of economic and financial liberalization and a determined policy of containment of fiscal imbalances. I am particularly impressed by the fact that except for the limit on external payments arrears, all performance criteria under the present stand-by arrangement have been satisfied with comfortable margins, which is indicative of the strong commitment of the authorities to their adjustment program.

The persistence of economic recession--six successive years of economic decline--is a cause for very serious concern. The social consequences of so severe and protracted a recession have rightly been noted by the Executive Directors of the World Bank. Given the deep-seated nature and magnitude of the initial imbalances, the present room for maneuver is extremely limited. The program proposed in the request for a structural adjustment arrangement points in the right direction and is ambitious in terms of the further adjustment efforts called for; therefore, it deserves our support. However, the medium-term scenario demonstrates the extreme fragility of the economic situation. Even assuming the implementation of appropriate domestic policies--which the recent record suggests is not an unreasonable assumption--and the availability of substantial external finance on concessional terms, the outlook for the balance of payments remains extremely difficult.

The staff report notes on page 31 that the program assumes greater efficiency in the use of imports than in the past and some import substitution. If one looks at the implied change in the gross incremental capital output ratio between 1978-81 and the program period there is a very considerable reduction. In the light of this reduction, it is vitally important that the authorities continue their cooperation with the World Bank to ensure that efficient use is made of the concessional resources coming on stream.

In the light of these considerations, I note the conclusion on page 29 of the staff report that "Bolivia's particular circumstances may require an innovative solution to Bolivia's commercial bank debt problem." I wonder if the staff could elaborate on the mechanics of this solution, including the amount of discount that might be involved and the commercial banks' reactions to the innovation.

A crucial element of the proposed program is that fiscal policy should be aimed at increased public sector savings in order to make room for higher investment outlays by the public sector without recourse to the domestic banking system, which would facilitate access by the private sector to bank finance for capital formation. The proposed tax reforms, involving a significant broadening of the existing tax base through the new value-added tax and the introduction of property taxes, are very welcome, as is the planned improvement in tax administration. The authorities are to be commended on their pragmatic decision not to withdraw any existing taxes until replacements for those taxes are implemented. I would similarly commend the cautious stance of the authorities with respect to cutting or deferring expenditures if necessary while the tax reform--with its attendant uncertainties over revenue yields--is being implemented.

The broad orientation of monetary policy is positive. In particular, the market determination of interest rates can be expected to promote the efficient allocation of financial resources. I would, however, note that quite difficult decisions will have to be made soon to cope with the monetary and exchange rate impact of capital reflows if competitiveness is to be maintained. There are difficult technical issues involved in sterilizing capital inflows, especially when the policy instruments available to the Central Bank are not really susceptible to fine-tuning and, as with variation of reserve requirements, involve significant discrete changes with consequent announcement effects. I wonder if the staff could elaborate on the precise factors influencing the conduct of monetary policy and what views it has on the appropriate pace of remonetization, especially in view of the high real interest rates and the fact that by historical standards, real money balances still seem to be low.

The proposed reorganization of the Central Bank to limit its activities to "pure" central banking is important. However, there is an inherent difficulty: inevitably, the excesses that resulted in hyperinflation will tend to lead the authorities to limit the role of the Central Bank. It is, however, important not to petrify the Central Bank in a network of very specific restrictions on its authority. I tend to believe that an effective central bank depends less on specific restrictions on its power than on having a broad general mandate supported by very strong provisions guaranteeing its independence from central government and private interests. In the long run, I do not think it makes much difference whether banking supervision is conducted by a strong independent agency or by a separate section within a strong central bank. However, if the Central Bank is to be strong and staffed adequately, considerations of external economies suggest that banking supervision might remain with the Central Bank. On the question of the development loan department and its eventual development as an independent institution, the eventual separation of those two activities is important--the potential conflicts between a development lending agency and a central bank are considerable.

I have no difficulty in supporting the decisions on compensatory financing and the stand-by and structural adjustment arrangements.

Mr. Foot made the following statement:

I can be very brief because I agree with nearly all the staff material before us today. Bolivia's successful start to this very brave program cannot be commended too highly. The authorities are only too aware that there are many hurdles still to overcome. The progress to date has been very gratifying and the Fund's continued wholehearted support is fully justified. The response of donors also appears to have been encouraging.

Perhaps the only point on the adjustment process that I would stress is the need to reorganize the Central Bank in the light of the need not only to improve the supervision of banks--and I think Mr. McCormack's remarks on that point are worth noting by the authorities--but also to speed up Bolivia's response to offers of aid, in which the Central Bank's current role is sizable. Bolivia clearly needs to increase the capacity of the economy to absorb an increased volume of multinational funds.

I do not understand the issue raised by the first two speakers today on the problem of setting the performance criterion that a budget should be submitted to the Congress by a certain date. It seems that national sovereignty would be infringed only if the Fund tried to set a deadline for the Congress to pass a budget or if it tried to interfere with the Congress's consideration of that budget. However, it does appear that a timely and coherent set of budget plans is not an unreasonable request, and I would be interested to know if the authorities themselves had any difficulty with this particular approach. If they did not, then I believe that there is a danger that one could view the action more seriously than is actually justified.

Bolivia seems to have fully and clearly met all the tests laid down in the current rules for compensatory financing. So far as the structural adjustment arrangement is concerned, my authorities were perhaps not as satisfied with the presentation of the proposals in this case as with other presentations--these reservations do not apply to the substance. However, I will not elaborate on this issue further because it seems to be a more appropriate subject for bilateral discussion ahead of the review of the workings of the structural adjustment facility.

I am happy to support all the decisions, including that relating to the waiver under the stand-by arrangement.

Mr. Templeman made the following statement:

Since the Board has examined current economic developments in Bolivia recently, I will concentrate my remarks mainly on the medium-term outlook. We can endorse Bolivia's medium-term policy framework for the economic adjustment and structural reform that underlies the request for a structural adjustment arrangement. The framework contains realistic but modest economic growth objectives, ambitious but credible inflation targets, and a level of current account deficits that may be financeable with the help of Bolivia's donors and creditors, depending on the firm implementation of prudent financial policies and structural reforms.

Macroeconomic performance under the stand-by arrangement in 1986 has been better than expected with respect to the rate of inflation and the balance of payments position, but disappointing with respect to real growth and employment. Undoubtedly, real negative growth for the sixth year in a row reflects the poor past performance of savings and investment. Some progress is being made in raising the ratios of private sector and total gross domestic investment to GDP; however, private savings seem to be falling short this year and could become negative. This pattern highlights the importance of having policies aimed at resisting excessive wage awards, ensuring private sector access to credit, and maintaining confidence in the private sector.

In the past two years, remarkable progress has been made: in reducing by 24 percent the size of the public sector deficit relative to GDP; in cutting the ratio of spending to GDP by 10 percent; and in rebuilding the public sector revenue base by 14 percent after central administration tax revenue fell to less than 3 percent of GDP in 1984. For 1987, the prospective rise in the PSBR to 6 percent of GDP owing to uncertainty about the revenue produced by the reformed tax system and the expected decline in revenue due to a drop in the price of natural gas underlines the importance of the authorities' commitment to adjust spending, if necessary, to avoid any domestic financing of the deficit.

Developments in the external accounts this year have generally been favorable, with stability in the exchange rate and increased international reserves reflecting a lower than expected current account deficit and larger than expected private capital inflows. However, the outlook for the balance of payments and foreign debt positions for 1987 and beyond remains a very sobering one.

The staff report notes that the real effective exchange rate appreciated by nearly 24 percent during the first eight months of 1986. However, the rate is at about the same level as at the time of the major devaluation in September 1985, and currently there is only a very small spread between the official rate and the parallel rate. Nonetheless, we believe that the commitment of the authorities to avoid appreciation in the event of larger than expected capital inflows and to prevent a spread of more than 5 percent between the auction and parallel market rates is essential to the program.

Over the medium term, estimated debt ratios, which will fall to only about 95 percent of GDP by 1992, and debt service ratios, which will remain in the 75-85 percent range in the early 1990s, provide a measure of the gravity of Bolivia's debt outlook. Continued debt relief from official creditors and commercial banks over the next few years seems unavoidable. The fact that Bolivia has made no payments to the banks since March 1984 shows the need for the prompt resolution of the problem of arrears to the banks and other creditors by early next year, as contemplated under the program. In this connection, we welcome the staff's positive assessment of the outlook for Bolivia's ability to repay the Fund.

Substantial net new capital in the form of concessional development assistance from the multilateral development banks and from bilateral donors--within their own budget constraints--offers virtually the only appropriate medium- to long-term source of debt financing in the light of existing problems with debt to private sources. We are pleased by the resumption of credit from the World Bank group, but are puzzled by the expected decrease in disbursements after 1987.

Many of the structural elements of the program were initiated as an integral part of the stand-by arrangement and currently also provide the basis for the request for a structural adjustment arrangement. It is interesting to note that from the outset, Bolivia's "shock" approach to fighting inflation concentrated on opening the economy to competition by the immediate freeing of prices, wages, and the exchange rate. The breadth of reforms already under way or contemplated is impressive, including tax reform, reorganization of state enterprises, banking and financial market improvements, liberalization of trade and foreign investment, tariff modifications, and wage and labor market reforms. In fact, given the introduction of a wide range of structural reforms in late 1985 and in early 1986, the main job ahead is the implementation of the reforms already begun, the introduction of some supplementary measures, and the adaptation of those reforms as experience is gained. In 1987, the main effort in the tax area must focus on implementation of the tax reforms, including the property taxes, the value-added tax and its complementary income tax.

As to state enterprises, the reorganization of COMIBOL to take into account the poor outlook for tin, to reduce overstaffing, and to raise efficiency is particularly courageous. The privatization of part of the state petroleum company (YPFB) distribution system of the would also be a major step in the right direction. In general, the measures taken to impose financial discipline on state enterprises by freezing their deposits at the Central Bank, imposing a centralized wage policy, prohibiting central bank credit, and enforcing a more realistic pricing policy seem to be having good initial effects. Eventually, some of the more draconian measures may need to be relaxed in favor of more market-oriented discipline.

In the financial area, we welcome measures to limit the role of the Central Bank to monetary policy and to serving the Government as fiscal agent--with development lending eventually to be spun off. Other steps being taken to rebuild the accounting system of the Central Bank, to create a short-term public debt monitoring system, to reorganize the two largest state banks, and to explore the use of open market operations by the Central Bank and the possibility of creating a national securities market, on the whole represent an appropriately ambitious array of objectives.

With the exception of some liberalization of sugar imports and of reductions in customs tariff exemptions for wheat and the petroleum industry, there is relatively little further action needed to free Bolivia's payments systeme and customs duties, which should now provide a level playing field for domestic and foreign producers.

The measures already taken to permit layoffs, to restore collective bargaining in the private sector, and to impose strict limits on wage increases in the public sector represent important steps. However, some serious challenges involving employment-shifting and employment creation lie ahead.

In sum, comprehensive macroeconomic adjustment and structural reforms are now under way, offering improved prospects for sustainable economic growth, financial stability, and external balance. Therefore, I support the request for a structural adjustment arrangement, as well as the waiver and modification of the performance criteria on arrears recommended by the staff.

I also support the request for compensatory financing. There is no question about Bolivia's balance of payments need or the adequacy of its cooperation with the Fund. The evidence suggests that the export shortfall was largely outside the control of the authorities, brought about largely by the sharp drop in world prices for tin and gas. We do have some doubt about the possible lagged effect on "other" exports in 1986 due to the appreciating exchange rate during the period 1983 to late 1985. In connection with the Board's forthcoming review of the compensatory financing facility, I would cite the Bolivian case as one which sharply illustrates our concerns about two questions: the potentially adverse effect on adjustment of large, untranched drawings under the facility at or near the beginning of a program; and the appropriate role of compensatory financing in a country whose exports are suffering due to a declining trend in a major export industry.

Mr. Nimatallah made the following statement:

We are discussing today another interesting case of very high inflation, indeed, hyperinflation. Little more than a year ago, Bolivia's economy was in shambles, with an annual inflation rate of above 20,000 percent and with serious imbalances. Mr. Donoso's opening statement notes that: "The authorities are confident about their ability to reach the objectives of a yearly rate of growth of 3 1/2 percent, reductions in the rate of inflation to 5 percent a year in 1989, and overall balance of payments equilibrium." Therefore, I have full praise for the authorities' achievements, particularly for dramatically bringing down the inflation rate to such low levels. Bolivia's situation, although not unique in economic history, is of great interest to economists today, since it suggests that price freezes may be more relevant in cases of high inflation than in cases of hyperinflation. I am sure the staff will reflect on this in their prospective study on recent experience with high-inflation economies.

The fiscal measures taken by the authorities are also interesting to reflect on. I am intrigued by their policy of keeping fiscal expenditures on a daily cash basis, which confirms the view that budget balancing is a virtue. I wonder whether some of the major countries that have large fiscal deficits could look into the possibility of occasionally following that approach on an experimental basis for a short period. We ourselves are practicing it in Saudi Arabia, but on a monthly basis, and I am pleased to tell you that it is helping my authorities control expenditures effectively--as you know, our inflation rate is very low indeed. I consider that the Bolivian authorities are on the right track in taking no chances with inflation. They are resolutely controlling expenditure and liquidity, as confirmed in Supplement 1 to the staff report. I also welcome the authorities' intention to reinforce their tightly controlled fiscal policy with continued adherence to a tight monetary policy. The only question that I have is why they delayed the introduction of a new currency unit with far fewer zeros.

While controlling the rate of inflation remains a very important objective, it is also clear that the authorities are pursuing other objectives, such as economic growth and the development of the private sector. As the achievement of these objectives will take time, and since the economy is at a low ebb, it makes sense to set the authorities' efforts in the context of a structural adjustment arrangement. I think that it would probably be desirable to accelerate capital expenditures, when appropriate and financially possible, to speed up the provision of the basic requirements for growth, private sector development, and infrastructure.

I also believe that the recent tax reform package is a step in the right direction toward encouraging the private sector. It will broaden the tax base and reduce its heavy dependence on hydrocarbons. However, it appears that there is room for further improvement in tax administration to strengthen public finances.

Of course, in the light of the fact that Bolivia's external finances are likely to remain weak for a number of years, given the large external debt, it is important that there be full cooperation between the country and its creditors. Therefore, I welcome the progress that is being made toward normalizing Bolivia's relations with its creditors.

In general, I am in agreement with the direction of the Bolivian reforms and I agree with the assessments of the Fund and the World Bank on the expected performance of the economy. I praise the authorities highly for their commitment and courage, as evidenced by the exceptional measures they have taken to control inflation and put the economy back on a sound footing. I hope they will persevere in their efforts. I support all the proposed decisions.

Mr. Fujino made the following statement:

I am pleased to note that under the adjustment program supported by the Fund's stand-by arrangement, the authorities achieved substantial progress in stabilizing the economy in 1986. The fiscal policy was even tighter than originally envisaged, reflecting the tight wage policy of the authorities and a realistic pricing policy for the public enterprises. Demand management contributed to the continued decline in the rate of inflation and the 12-month rate of price increases is now projected to be about 65 percent at the end of 1986, compared with the program target of 85 percent. The auction market system for the determination of the exchange rate operated fairly well, and the premium of the parallel exchange rate vis-à-vis the official exchange rate virtually disappeared. The substantial increase in net international reserves was also attained partly through some repatriation of private capital. Accordingly, all the performance criteria were observed with substantial margins except those related to external payments arrears. Such favorable developments, in turn, will put the authorities in a better position to negotiate a debt restructuring agreement with the commercial banks.

In spite of the progress achieved so far, the economy remains in a deep recession with rising unemployment. The situation has been aggravated by recent exogenous developments, and under such circumstances, it is all the more important to consolidate the progress made in stabilizing the economy. In this regard, it is encouraging to note that as a result of the discussions between the staff and the authorities on the review of the stand-by arrangement, the program targets for the coming period have been tightened and strengthened beyond those envisaged at the time of the approval of the stand-by arrangement. At the same time, the attainment of sustained economic growth will require the implementation of comprehensive structural adjustment measures over the medium term.

Therefore, I very much welcome the adoption by the authorities of the three-year policy framework under which the authorities have access to resources of the structural adjustment facility.

I would like to make a few brief comments on the program for the coming year.

The keystone of the adjustment program continues to be improvement in public finances. The reduction of the public sector deficit will enable the private sector to utilize the financial resources released from the public sector. Vigorous implementation of the tax reform and determined control over current expenditures remain critical in this policy area. It is also important for the authorities to accelerate the implementation of investment programs as well as to secure the necessary outlays for high priority investment projects. On the latter point, it is encouraging to note that the authorities have worked closely with the World Bank in formulating the investment program for 1986 and 1987. It was appropriate to include in the program measures to improve the efficiency of the management in the public enterprises.

I welcome the authorities' policy to continue to leave the determination of interest rates to market forces. I would also like to stress the importance of institutional reform measures to strengthen the banking system.

The continued pursuit of a flexible exchange rate policy with a view to maintaining the competitiveness of Bolivian exports is critical for attaining the objectives of the program.

I agree with the staff that all the requirements under the decision on the provision of compensatory financing have been met. I support all the proposed decisions.

Mrs. Ploix made the following statement:

In dealing with Bolivia, one must always bear in mind the extremely difficult state of the economy and the chaotic situation in the entire country. In order to cope with those very deep-seated problems, the authorities have had to display a good deal of political courage and determination. That strong will has been evidenced by the agreement on the stand-by arrangement adopted in June 1986, and by the current request for a structural adjustment arrangement. The authorities deserve to be commended on the results of their efforts, which are impressive.

Since I support the proposed decision under the stand-by arrangement, I shall focus my remarks on the requests for compensatory financing and a structural adjustment arrangement.

On the domestic front, the shock therapy chosen by the authorities proved to be the right approach. That approach had drastic but strongly contrasting effects. On the one hand, the general liberalization of prices, exchange and interest rates was instrumental in bringing the rate of inflation under control through the restoration of confidence and the release of idle resources. On the other hand, the tight fiscal policy contributed to a further contraction of GDP. Could the staff comment on the relative benefits and costs of such an approach compared with an alternative policy involving price controls?

After five years of continued recession, every effort should now be made to restart the growth process. In this context, the first objective of the structural adjustment arrangement should be to promote the better use of domestic and external resources. Thus, a thorough overhaul of the economy is warranted, particularly in the public sector, where the World Bank will intervene significantly in the restructuring of the major state-owned entities. In this quest for more efficient economic structures and managerial instruments, the Fund has a major role to play in the fiscal area with respect to the implementation of the tax reform and in the monetary area with regard to the introduction of better policy instruments.

As to the external position, we have no difficulties with the request for compensatory financing. The estimated shortfall in export earnings is entirely attributable to a drastic decline in the price of metals--mainly tin and gas. Bolivia's situation illustrates perfectly the risks associated with excessive reliance on a narrow export base. Gas and tin sales amount to almost 75 percent of total exports. Such vulnerability should be reduced. In that connection, the World Bank could help the authorities in promoting nontraditional exports.

Finally, I would like to stress the importance of maintaining the confidence which has just been restored, as one may judge by a recent reversal of capital flows. In this connection, I was puzzled by a comment on page 38 of the staff report, implying that actual and future capital inflows could push up the exchange rate and result in a deterioration of competitiveness. Given the weakness of the current account and the satisfactory working of the new auction system for exchange transactions, I would appreciate further comments by the staff on this point.

A favorable climate is essential for strengthening the normalization of relations with the international financial community. Given its poor balance of payments outlook, Bolivia will remain heavily dependent in the medium term on external financing through new concessional flows or debt rescheduling. On this issue, I would like to urge the authorities to make their best efforts to finalize as soon as possible the bilateral arrangements implementing the general agreement reached with the Paris Club last August. I support the proposed decisions.

Mr. Lim made the following statement:

We are impressed with the radical changes in economic policy that the Bolivian authorities have undertaken in the past 18 months to arrest the decline in economic activity. The economy has clearly responded almost immediately to those policy changes. We note that, given the unfavorable external developments that the economy has had to face over the adjustment period, those responses would not have been possible were it not for the political resolve of the authorities to maintain their sound course of policy. For this resolve, they deserve commendation and support from the international financial community.

Such resoluteness has already resulted in the attainment of the major objectives of the adjustment program of price stability and improvement in the country's external position, and a comfortable margin on the performance criteria under the stand-by arrangement. This, in turn, should allow the authorities more flexibility to fine-tune monetary and fiscal policies.

At the same time, we should point out that there are key elements in the economic stabilization program that need to be addressed with undiminished determination. The rationalization of the nonfinancial public sector is one such element that would certainly address the structural imbalance in the fiscal sector. The more rapidly the authorities can move toward a market-oriented pricing policy for public sector goods and services and the more rapidly the size of the fiscal sector can be reduced, the greater will be the likelihood of resuming the real growth of the economy. Because such rationalization moves can have the immediate effect of dislocating public sector employees, pressures to relax those policies are likely to be great. Another area where relaxation is not warranted is the financing of the public sector deficit by the Central Bank. Undue relaxation in this regard can wipe out the gains made in curbing the rate of inflation.

If the present course of policy continues, we are optimistic that Bolivia can keep within the performance criteria under the present stand-by arrangement. Therefore, we support the completion of the review of performance under the stand-by arrangement.

It is clear that the request for compensatory financing is justified on the basis of its balance of payments needs and the fact that the anticipated shortfall has been brought about largely by the continuing unfavorable external conditions affecting its major exports. Bolivia's cooperation with the Fund has also been demonstrated in its compliance with the performance criteria under the present stand-by arrangement, and its adherence to an unrestricted exchange and trade system. We support the request for compensatory financing.

As to the request for a structural adjustment arrangement, we note the considerable progress of the authorities in normalizing relations with their foreign creditors, which should facilitate the arrangement of the financing required under the country's medium-term program. Ultimately, it will be the manner in which the authorities utilize those funds that will determine whether the objectives of growth, price stability, and external balance will be achieved. In this regard, it would be useful to have staff comments on the authorities' measures to ensure efficient management of external resources.

The medium-term objectives of growth and price stability appear achievable only if the present policy mix obtains international cooperation. Therefore, we also support the country's request for a structural adjustment arrangement.

Mr. Zecchini made the following statement:

Undoubtedly, recent economic developments in Bolivia are evidence of the significant achievements that have been made as a result of the implementation of one of the most drastic adjustment programs that has been seen in recent years. Hyperinflation has been suppressed in a very short time, the dissaving of the public sector in the period 1983-85 has been drastically curtailed, and net foreign reserves have accumulated at a significant pace. These achievements appear even more remarkable if they are considered against the background of the extensive liberalization measures that have been taken and the adverse trends in the commodity prices that have depressed export earnings.

The successful stabilization of the economy has entailed heavy costs in terms of a decline in real output and an increase in unemployment. In any event, the deflationary impact of the stabilization measures could not have been prevented even if it had been necessary to resort to a drastic tightening of policies to reverse the widespread negative expectations about the evolution of the economy.

Today, the major problem confronting the authorities is that of not tightening its policies further, because most of the adjustment effort has already been carried out and only needs to be consolidated. Instead, a strategy is required to create the conditions for a resumption of durable growth and a higher degree of utilization of potential resources. In this respect, we attach the utmost importance to the use of the structural adjustment facility because only in a medium-term perspective of structural changes can the economy resume its growth.

As to the medium-term strategy, the staff seems to put the emphasis mainly on the implementation of the efforts to liberalize the markets, including the exchange market; the reform of fiscal policy, with the corollary of restructuring and privatizing several public enterprises; and the continuation of a cautious stance in monetary policy. Undoubtedly, these elements are necessary ingredients in any development strategy. However, freeing the economy of administrative distortion and unproductive constraints, as well as freeing resources from public use for private use, does not guarantee an economic revival of private initiative, and consequently of economic development. This is particularly true in a less developed economy like Bolivia, in which economic agents have been accustomed to economic distortions and constraints for a long time, and in which the entrepreneurial class is so thin and income distribution so skewed around an extremely low average per capita income, as not to lead easily to financial conditions that can support the mushrooming of small enterprises. In brief, there is a need for a more diversified strategy to create a catalyst that would accelerate development.

In our opinion, there are two other components necessary to complete the development strategy: the promotion of fixed investment and an effective incomes policy combined with a far-reaching social policy.

With regard to the investment policy, the notion that any public investment is less valuable and productive than a private one has to be rejected as mere doctrinairism. The validity of this notion also has to be tested in individual cases, bearing in mind the externalities stemming from public investment. In this respect, we strongly endorse the commitment of the authorities to re-examine their investment program in order to increase its effectiveness, and we welcome the involvement of the World Bank in this task.

Moreover, priority should be given to the expansion of the overall volume of fixed investment. The promotion measures envisaged for private investment under the program seem appropriate to the extent that they do not subsidize specific enterprises, but rather aim at improving the general environment where production takes place--such as in labor market regulations--and consequently the profitability of investment. Some specific incentives could also be considered for the purpose of easing the formation of small enterprises by contributing to their capital base.

As to incomes policies, the centralized system of wage negotiations and a public wage freeze have led to a compression of real wages as well as of their scale. This compression has to be viewed as a temporary policy measure that over time becomes self-defeating and has to give way to a system of wage determination that better reflects productivity increases and their sectoral differences.

Moderation in wage settlements seems advisable, and could be achieved under a free wage system as a counterpart to a government program including extensive social measures aimed at raising employment. In this respect, tax measures, such as the tax on wealth, may be viewed as part of an overall incomes policy that is ultimately directed to containing labor costs and to increasing job opportunities.

Since we support the proposed decision for the structural adjustment and stand-by arrangements, as well as for compensatory financing, we will comment briefly on three specific areas: trends in the real economy; the exchange rate system; and financial reform. In the first area, it is well known that statistics on the economy are not fully reliable and that a significant portion of economic activity takes place in the underground economy. Recently, important shocks have characterized this latter aspect of the economy. We wonder whether the staff, in the process of monitoring and recommending economic adjustments, has tried to assess the size and the trends in the underground economy, particularly the impact on GDP growth and fixed investment of a process of reconversion of the underground economy.

As to the exchange rate policy, it is important to stress that even in a country in which output and exports are heavily concentrated in commodities whose prices are determined in world markets and denominated in foreign currency, there is room for external adjustment through exchange depreciation. Exchange depreciation acts as an expenditure-switching mechanism that helps shift demand from imports toward domestically produced goods and services and helps promote nontraditional exports. In Bolivia, the liberalization of the exchange system, together with the implementation of exchange auctions, has allowed a depreciation of the real effective exchange rate and a substantial gain in external competitiveness. Therefore, during the program period it is necessary not to dissipate the benefits of this depreciation by allowing a reversal of the recent trend. To this end, some intervention in the exchange market might become advisable should capital reflows resulting from new confidence in the economy tend to generate upward pressure on the exchange market.

In addition, official intervention should be limited merely to creating orderly market conditions. More room should be left to market forces in exchange determination by pushing forward the process of liberalization. In this respect, and after taking into account the very narrow gap still existing between the official market exchange rate and the parallel rate, it is not clear why the program under review does not establish a timetable for the complete unification of the two foreign exchange markets. Such a measure appears more justifiable than limiting the percentage gap between the two rates to a maximum premium that will be kept constant through 1987.

As to financial policies, the introduction of a tax on wealth appears appropriate in order to re-establish the tax base in the face of a relatively large underground economy and of the narrow base of income taxation.

On the monetary front, two initiatives appear advisable. The first involves a reform of the currency unit after renewed confidence has been restored in the currency. The second initiative pertains to the development of money and financial markets as a means of channeling the rising flows of savings toward the most profitable uses. This development would also ease the task of the Central Bank in regulating the liquidity conditions of the economy, above all in the event that capital reflows were to prompt intervention in the exchange market and consequently result in an undesired injection of monetary base into the economy. In such a way, the possibility of an extensive use of open market operations could become a very helpful reality.

Mr. Vasudevan made the following statement:

The staff report shows the commendable effort made by Bolivia to reorient, and to persevere with, policies to bring about price stability, external viability, and structural changes in order to free the economy from its rigidities in the face of adverse exogenous developments. We note the substantial progress made in several areas, most notably in prices. But economic growth has suffered a setback, and it is in this context that the authorities' preparation of a three-year policy framework gains considerable importance. The staff report correctly states on page 26 that: "Most of the fundamental decisions and measures associated with the opening of the economy to market forces were taken in 1985 and during 1986. They need to be implemented with determination during the forthcoming three-year period and supplemented with other measures that, for various reasons, require more time to elaborate and put into effect."

It is of the utmost importance for growth objectives to be realized in 1987, and thereafter that additional concessional resource flows do occur and that the authorities make efficient use of such resources through the appropriate planning and execution of projects.

The medium-term balance of payments outlook is one of great uncertainty. We believe that unless financial flows occur and reschedulings of past debt take place, it will not be possible to close the financing gaps. We hope that the authorities will succeed in this regard, now that they are embarking on or have implemented a number of measures, including tax reform and tight wage policies, reorganization and decentralization of state enterprises, and free interest rate and flexible exchange rate policies.

We are glad to note that all performance criteria for end-September 1986 have been met, except for one pertaining to external arrears. We support the request for a waiver of this criterion since the program remains on track and other performance criteria have been met with considerable margins.

The request for compensatory financing is fully justified by the fact that export shortfalls were largely beyond the control of the authorities because of the sharp decline in the prices of Bolivia's main metal exports. Bolivia has also been cooperating with the Fund, as is evident from the adoption of the stabilization program since August 1985, and from the close observance of the understandings reached in the context of the stand-by arrangement. Therefore, we can support the request for compensatory financing.

The request for a structural adjustment arrangement based on a three-year policy framework is fully justifiable in the light of the strong adjustment process that is already under way. Although the medium-term balance of payments outlook is difficult and is critically dependent on the availability of concessional external financing, it will be possible to reduce the external current account deficit from 9.5 percent of GDP in 1987 to more manageable levels over the subsequent five years. We also note the brief assessment by the staff of Bolivia's ability to repay the Fund, which will not be impeded. Bolivia's track record in discharging financial obligations to the Fund has been good and we support its request for a structural adjustment arrangement.

The main test of success for the 1987 program lies in the revival of economic activity. If the expected growth rate does not occur, the economy will suffer severe social effects, given the strict financial and comprehensive structural policies that are being put into place. It is of the utmost important that public investments are timely because any delays in disbursements by external resources will certainly have a considerable adverse impact on the economy. I wonder whether any attempt has been made by the Fund and the World Bank to ensure that the public sector investment plan will accelerate as programmed. Is there any way in which delays--should they occur--could be offset by some counteracting mechanisms?

The staff has reported the likely introduction of a new currency at the beginning of 1987. Normally, announcements about the introduction of any new currency are made with great secrecy and speed. I wonder whether making a prior announcement will have financial implications. I would appreciate any staff comments on this subject.

There is a reference in the staff report to the possible creation of a bank superintendency that would replace the Central Bank's bank inspection department. I am not clear about the reasons for this measure, and I wonder whether such a new agency--which will be state owned--will not at times work at cross purposes with the policies of the monetary authorities.

Finally, the determination with which the authorities have implemented the adjustment program will bear fruit only if the international community gives it full support, not the least of which will be the support of the Fund in financial terms as well as by providing technical assistance. We support the proposed decisions.

The staff representative from the Western Hemisphere Department said that the performance criteria under the program had not been intended to be unduly restrictive. The Executive Board was demonstrating its flexibility by agreeing to waive or modify performance criteria, as exemplified by the current request for a waiver and modification, and the waiver previously granted in September 1986. As to the presentation of the budget as a performance criterion, the staff had not requested action that was beyond the control of the authorities. It had simply requested that the authorities prepare a budget and submit it to the Bolivian Congress. Indeed, Article 147 of the Constitution of the Republic required the submission of a budget to Congress within its first 30 sessions. The Congress had reconvened on August 6, 1986, and at the time of the discussions between the authorities and the staff in August and September, the authorities had been confident that they could comply with the requirement. Subsequently, there had been some complications, but the staff had been informed that the authorities intended to submit a budget to Congress in December. It should be noted that before 1986 Bolivia had not had a budget ex ante for about 20 years. Budgets had often been submitted toward the end--and even after--the budget year, thereby making them meaningless. The first time that a budget had been submitted to Congress almost on time had been in 1986, when it had been a prior action under the program agreed to by the Fund; that budget had been approved by Congress in March 1986. Thus, it was in those circumstances that the budget had been used as a performance criterion. Indeed, the Fund might even be seen as having strengthened the hand of the authorities in complying with the contitutional requirement vis-à-vis Congress.

It was true that dollar deposit accounts had grown rather rapidly since the stabilization in late 1985 and that a slight reversal of that trend had recently been observed, the staff representative continued. Those individuals who had deposited dollars or local currency with a dollar maintenance-of-value-clause--which was an option in the Bolivian system, in addition to actual dollar deposits--had in reality fared much worse in terms of effective returns, which showed the lack of confidence that had existed in the economy. Nonetheless, confidence had apparently been growing because yields on local currency deposits had been falling continuously relative to those on dollar deposits. The banks had carefully balanced their portfolios and, to avoid exchange risks, were now making sure that they did not engage in excessive currency switching in their own lending operations. The authorities were also giving thought to trying to influence that development by introducing reserve requirements on dollar deposits that, because they had not previously been required, had given banks an incentive to encourage dollar-denominated deposits. It was, therefore, likely that the bias in favor of dollar deposits would be eliminated in the near future.

Despite the brisk growth of deposits since the stabilization, the level of money supply was roughly 50 percent of what it had been in 1981 in real terms, the staff representative said. Although the economy had been shrinking considerably since 1981, there was ample scope for further growth of the money supply, which would have to come about largely through the extension of credit to the private sector and from further capital inflows. Future capital inflows had not been estimated in either the balance of payments or the monetary survey in the staff report because there had been insufficient data to estimate their responsiveness to the interest rate differential that currently existed. There would, of course, be no injection to the money supply through the extension of credit to the public sector; indeed, in 1988 and 1989--the second and third years of the structural adjustment arrangement--small public sector surpluses were anticipated. Thus, in addition to possible capital inflows, all domestic money supply creation would be through private sector credit expansion.

As to the effective exchange rate, it was true that since January 1986, when the exchange rate had greatly depreciated in the wake of the collapse of international tin and oil prices and the demand-management slippage of December 1985, there had been an appreciation in real terms, the staff representative stated. However, recent information, based on a basket of currencies of trading partners and competitors, showed that the effective exchange rate in October 1986 had depreciated by a little more than 8 percent over the rate in September 1985. Although that depreciation might not have sufficiently reflected the loss of competitiveness since that time, it was true that the exchange rate had indeed depreciated further after the initial stabilization in September 1985.

It would take some time to convince the authorities that under the current exchange arrangements, there were no longer two separate foreign exchange markets, the staff representative observed. Since there were no restrictions on access to foreign exchange in the official market, there could not be--for any length of time--a sizable divergence between the parallel market rate and the official market rate. Accordingly, the divergence had generally been substantially below the 2 percent threshold beyond which a divergence would be considered a multiple currency practice. Thus, the exchange markets were unified de facto. However, the experience with tight exchange controls, when most foreign transactions had to be conducted in the parallel market at a substantially more depreciated exchange rate, had left a lasting impression, and the authorities had continued to believe that there had been two segregated markets since mid-1981, when exchange rate controls were imposed.

The staff had no further information on developments regarding the management of external debt beyond that in the staff report, the staff representative went on. The authorities and the banks remained in contact. Given the very low income levels in the country, which implied that the country should not take any recourse to nonconcessional financing, there had never been any suggestion that in Bolivia's situation there should be an increase in bank lending. Accordingly, under the current program, the staff had not assumed that the banks would increase their exposure through new loans, although the problem of past due interest might require some increase in exposure as a result of refinancing loans; however, no information was available on the status of that alternative. Because no fresh funds from banks were required, the solutions that had been offered by the staff were not crucial for establishing the viability of the balance of payments in a technical sense. On the contrary, at the time an agreement was reached and Bolivia was required to make cash payments, there would be a net outflow from Bolivia. The staff had recommended that the authorities overperform on the accumulation of international reserves until they were able to reach agreement with the banks, an approach that the authorities had taken thus far.

The buy-back of bank debt by Bolivia had been an innovative idea that both the authorities and the coordinating committee of the banks had accepted in principle, the staff representative said. The buy-back would be part of a two-stage approach to the solution involving, first, the buy-back, and second, the restructuring of the remaining bank debt. However, prior to commencing with the two-stage approach, some technicalities would have to be resolved, such as the agreement by the banks to the a waiver of the sharing provision in the 1981 refinancing agreement that obligated any bank receiving payment from Bolivia to share the proceeds with all other banks in the consortium. The price for the buy-back would be determined after formal ratification of the amendment to the 1981 agreement. The staff had no information on the price of the buy-back but it had been informed of small trades of Bolivian bank debt taking place at prices below 10 cents to the dollar; the total stock of bank debt was over US$680 million.

The emergency social program had been designed after the negotiations for the stand-by arrangement had taken place, the staff representative remarked. The program would not involve a large bureaucracy and would rely on existing institutions. According to the decree issued on November 28, 1986, the expenditures of the fund that would handle that program could not be more than 1 percent of the total cost. A prominent local businessman had been appointed chairman of the fund, and Bolivia was actively seeking contributions from the international donor community for the US$325 million needed to finance the program. Most of the financing would go toward employment generation programs and social programs in the health, nutrition, and education sectors.

In his own opinion, the staff representative noted, it appeared unlikely that projected disbursements from the World Bank would decrease over the three years of the structural adjustment arrangement. At the time the program had been formulated, the Bank staff had conservatively estimated that disbursements would decrease because no new lending programs had been developed. However, it appeared that Bank disbursements would probably be maintained at the level of US$70 million a year. The Inter-American Development Bank, which had been very active in Bolivia, was willing to increase its disbursements from the current level of US$100 million a year to US$140-150 million over the program period. In addition, Bolivia was obtaining funding from regional development banks, such as the Andean Development Corporation and the Fund for the River Plate (FONPLATA), and from organizations such as the International Fund for Agricultural Development. The staff was confident that disbursements from the multilateral development banks would be maintained over the program period, particularly in view of the news of the World Bank's more active lending program.

The Bolivian situation had demonstrated that a new currency did not have to be introduced at the beginning of a stabilization program, the staff representative remarked. The authorities had not introduced the new currency hastily and, in fact, it had been necessary for the Congress to approve the decree announcing the currency unit. The proposed name of the currency had changed several times, but the Congress in the past month had decided that the currency would be called "the Boliviano," and that it would be introduced on January 1, 1987. There had been no need to maintain secrecy because prices had stabilized, and the ratio between the old and new currencies would be 1 million:1 without exception.

The staff had depended heavily on demand management in formulating its recommendations because there had been tremendous imbalances in the public sector accounts that had required the Government to resort to cutbacks in employment and other current expenditures, the staff representative commented. Demand management had created some unemployment and had reduced demand in the economy, but the elimination of the "inflation tax" should have had an expansionary impact. The major reason for the continuing recession probably had to be sought in the terms of trade losses.

The staff had been concerned about the effect of capital inflows on the exchange rate because those inflows had been far greater than had been expected in the first half of 1986, the staff representative continued. Those inflows had continued to increase in the third quarter of the year. However, the staff was not overly concerned because the effective exchange rate was currently more depreciated than in September 1985. Nonetheless, should that trend continue, the authorities would have to be persuaded to tighten their international reserve target.

The Fund would have to rely on the World Bank to ensure the efficient management of external resources, the staff representative noted. The Bank had begun a very intensive dialogue with the authorities, and a Bank mission scheduled for early 1987 would examine the public sector investment program. If external resources were used efficiently, the country's growth objectives could be attained, and debt service in relation to goods and services or GDP would decrease over time.

There was little information on the underground economy, the staff representative remarked. The Bolivian delegation to the recent Consultative Group meeting in Paris had mentioned that the value of cocaine produced in Bolivia was about US$2 billion a year. On that basis, it had been estimated that US$600-700 million a year was coming back into the country. There were no reliable estimates on otherwise legal informal sector activities. If underground activities were transferred to official channels, there might be a sudden resurgence of measured output, for example, in nontraditional exports leaving through unofficial channels.

The staff was concerned about the slow implementation of the public sector investment program, the staff representative commented. The reason was that the human infrastructure was not adequate and that the loan pipeline of almost US$1 billion, including US$425 million from the Inter-American Development Bank, consisted almost entirely of old projects. Many of those projects had been negotiated a number of years ago and would have to be re-evaluated; the resources allocated to some of them might need to be reassigned. The donors had indicated flexibility in this respect, but it would take time to work out the technical details. The authorities and donors were cooperating very closely in order to expedite the public investment program and they had hopes of reaching the level of 7.5 percent of GDP indicated in the program.

The superintendency of banking would be created as part of the reform of the Central Bank, the staff representative observed. The two institutions would not operate at cross purposes because the Central Bank would implement policy and design policy instruments, whereas the superintendency would investigate the financial soundness of the banking system, including capital adequacy and the quality of loan portfolios. Although it might be desirable for technical reasons to establish the superintendency within the framework of the Central Bank, the Bolivian Constitution required that it be established independently of the Central Bank. Nonetheless, the location of the superintendency was still under debate.

The Deputy Director of the Exchange and Trade Relations Department noted that the issue of the number of performance criteria had been discussed extensively by the Executive Directors recently, with some Directors expressing the view that the criteria were excessive and restricted the authorities' freedom of action unduly. The staff agreed that performance criteria should be limited but also considered that they should be sufficient to ensure that the programs could be monitored and that their objectives could be attained. The call for an appropriate number of criteria, as established in the guidelines on conditionality, had been followed in the case of Bolivia, in which, in his opinion the number was not excessively large.

Turning to questions on specific criteria, the Deputy Director said that fiscal policy was a key element of the program. Therefore, the performance criterion that called for the submission of the budget to Congress was important to establish the timeliness of the fiscal adjustment and to provide a clear indication of the authorities' commitment to undertake the actions required on the fiscal front under the program. The structural benchmarks in the structural adjustment arrangement focused on the major areas of fiscal and public sector policies on which the authorities would concentrate. By ensuring policy continuity, those benchmarks--which, it should be noted, were not performance criteria--would be instrumental in building confidence in the economy, a necessary condition for the effectiveness of the adjustment program. In that sense, they complemented performance under the stand-by arrangement in providing appropriate signals regarding the direction of the authorities' policies.

The appropriateness of a strategy involving a wage-price freeze, or more broadly, wage-price controls, relative to that of an approach based on a general liberalization of prices and costs was debatable, the Deputy Director remarked. An important determinant of the effectiveness of a strategy based on wage and price controls--the so called heterodox shock approach--was the appropriateness of the structure of relative prices and costs prevailing at the time that the controls had been instituted. In that context, it should be noted that in the cases where such an approach had been adopted, relative price and cost adjustments had been effected in advance in order to start the process with an appropriate relative cost-price structure. A further key requirement of that strategy was the need for prompt domestic policy action to correct remaining or emerging relative price distortions. Determined and adept implementation of supporting domestic policies was, therefore, required in the heterodox shock approach. Under those circumstances, the strategy could be effective in influencing expectations in the economy promptly and in the right direction. Of course, its ability to continue such influence would depend on the appropriateness of day-to-day implementation of the required policy actions. Indeed, the controls themselves, which were typically placed on a transitory basis, would soon become an indication of the adequacy of policy implementation, depending on how temporary they turned out to be.

There was an important element in common between a cost-price control strategy and the alternative one based on general liberalization of prices, costs, and exchange rates--the "orthodox" shock approach--the Deputy Director continued. That element was the need for the prompt restoration of fiscal balance in the economy. There were differences, too, one of which was that in the absence of controls, the possibility of price and cost adjustments provided an escape valve for policy deviations from the program path. That would be an advantage, but at the expense of the potentially adverse impact of such deviations on confidence in the economy. In the final analysis, the relative merits of those two approaches was an empirical issue that would depend on the determination and ability of the member to hold to the fundamental policy requirements of each strategy.

Finally, there were questions concerning dollar deposits and the introduction of a new currency, the Deputy Director noted. A good indication of the extent of price liberalization in an economy was the freedom of residents to hold deposits in either domestic or foreign currency. In all probability, the existence of that freedom had been a contributing factor to confidence in the Bolivian economy. The introduction of a new currency had been openly announced because it entailed merely a change in unit; no cash balance taxation had been envisaged in the process and, thus, no secrecy was required.

The staff representative from the Research Department pointed out that the shortfall in Bolivia's exports had been caused largely by price changes. The unit value of exports had declined by one third in the shortfall year compared with the average for the two preshortfall years, whereas the volume of exports had declined by only 4 percent. The decline in volume had perhaps been related more to the adjustment and restructuring of the economy that had been necessitated by the collapse in the prices of certain key materials than to exchange rate variations. It should also be noted that the volume of other nontraditional exports had increased by 25 percent in the shortfall year, subsequent to the doubling of those exports in the previous year, 1985. The forthcoming review of the compensatory financing facility would address the issues related to access, phasing, and the use of the facility in situations in which exports were declining.

The staff representative from the World Bank said that future levels of support for Bolivia would be primarily dependent on the available level of financing by IDA because Bolivia would not be sufficiently creditworthy for at least the next few years. At the moment, the Bank was using a figure of US$60 million a year for planning purposes, and any further increase would depend on the availability of IDA resources and the demands of other countries on Bank resources.

The disbursement level would also depend on the application of quick disbursing operations and more traditional project support, the staff representative continued. In the next few years, a high proportion of policy-based operations was expected, but because virtually no older portfolio existed, the Bank would need to develop project loans, and the pace of disbursements was likely to be slower under those loans. Thus, although US$70 million was the level of disbursement that the Bank could probably have for one year, it was unlikely that the level could be sustained over the medium term.

The public sector investment and expenditure review would be critical to the Bank's operating program, the staff representative remarked. Boosting sound public investments would be essential for resuming growth, and the issue of accelerating implementation was of great concern in the Bank's current dialogue with the authorities; that issue had been a focus of discussion in the Consultative Group meeting held in Paris on December 3 and 4. The Government had established a special task force to speed up the implementation of ongoing programs.

Mr. Donoso thanked the Executive Board for its full recognition of the remarkable degree of adjustment in Bolivia's economy. The country had been experiencing a decrease in GDP for several years, and there had been a collapse in external prices at the time that it had attempted to increase production. The authorities had brought hyperinflation under control, and with the existence of relatively stable prices, they had generally managed to bring down the level of expenditures in line with the availability of resources for the economy.

Many Executive Directors had noted the numerous weaknesses still affecting the economy, particularly the managerial capacity of the public sector, the unemployment problem, and the need to increase investments in the economy, Mr. Donoso continued. The Directors had also mentioned weaknesses in the financial sector and the need to develop alternative or nontraditional exports to address the balance of payments problem that Bolivia would face for some time. In the circumstances, it was very difficult to define a balance of payments outlook for the coming year. In that connection, it was important to recognize the authorities' continuing effort to address the issue of external financial resources from commercial banks. He hoped that in their negotiations with donors, the authorities would bring up the issue of debt relief. Thus, it was clear that not only the efforts of the authorities in managing the economy, but also the availability of external resources, particularly concessional financing, was very important. Although there had been significant improvements, it was easy to understand the great difficulties that the authorities were facing in implementing adjustment measures. For example, the social emergency program had been devised mainly to create jobs for the 10,000 workers that had been laid off from COMIBOL, the state mining enterprise, as a result of its restructuring. In view of the sensitivity of the sector and the degree of human suffering, it was important to have assurances that external financing would be available to make improvements in the situation. His authorities had been very optimistic after the Consultative Group meeting in Paris, because the multilateral agencies had cooperated strongly, particularly the World Bank, and potential donors had taken a very supportive attitude. The organizations supporting the adjustment program should recognize, just as much as the authorities, the need to make greater improvement.

The Chairman then made the following summing up:

Directors were in broad agreement with the thrust of the appraisal contained in the staff report for the 1986 Article IV consultation with Bolivia; they also expressed their support for Bolivia's requests for access to Fund resources under the compensatory financing facility and the structural adjustment facility.

Directors warmly commended the Bolivian authorities on the prompt response of the economy to their bold and courageous policies initiated in August 1985 to deal with the critical economic and financial situation of the country. The elimination of hyperinflation, the liberalization of prices and of the exchange and trade regimes, the relative stabilization of the exchange rate in a flexible market-oriented framework, and the rapid decline in the public sector borrowing requirement were singled out as being very important by a number of Directors. They welcomed the

Government's determination to adhere firmly to their economic policies despite adverse exogenous developments. They noted in particular the severe deterioration of the terms of trade, which resulted from the sharp decline of prices for Bolivia's two most important exports, and the real income loss occasioned by action to suppress the production and processing of coca leaf.

While Directors underscored the substantial progress that had been achieved in reducing existing imbalances, particularly with regard to inflation and the balance of payments, they expressed concern about the continuing economic recession and the rise in unemployment. However, they recognized that the decline in activity was largely due to the adverse impact of exogenous events on the external sector of the economy and to lags in the development of projects to utilize international aid flows.

Directors stressed the importance for Bolivia over the next several years of creating conditions for sustained economic growth in a framework of price stability and overall balance of payments equilibrium. Those were the principal aims of the three-year program of the Bolivian authorities incorporated in the policy framework paper. Directors noted that the achievement of those objectives would be arduous because the program continued to be subject to many risks and the balance of payments outlook in the 1990s remained very difficult. In this connection, Directors stressed that the success of Bolivia's economic program would depend to a large extent on a prompt response from the international financial community with respect to the availability of concessional financing in the form of grants and long-term loans at low interest rates, and the terms of rescheduling and debt relief obtained from official and private creditors. Directors underlined the importance of Fund and World Bank support for Bolivia to ensure the efficient use of concessional foreign resources; in this connection, it was noted that Bolivia's investment planning and implementation capacity needed to be strengthened and that scarce resources needed to be directed to high priority projects.

Directors commended the authorities for introducing policies that had reduced the overall public sector deficit from 28 percent of GDP in 1984 to 4 percent in 1986. They urged the authorities to continue their efforts to limit the deficit of the nonfinancial public sector to a level that could be financed on a sustained basis with concessional loans from abroad. Several Directors emphasized that it would be advisable for the authorities to aim for an improvement in public sector savings beyond the level in prospect in the next several years with a view to channeling more resources to the rest of the economy for purposes of capital formation. To this end, it was important to implement the tax reform; to strengthen tax administration; to exercise firm control over current expenditures; to maintain realistic prices for goods and services provided by the public sector; and to reorganize and rationalize the large state enterprises.

Directors expressed support for the present exchange arrangements, which had permitted the functioning of a flexible exchange rate policy with free access to the market by both the private and public sectors. They urged the authorities to keep exchange rate policy under close review to avoid an erosion of competitiveness and to promote export diversification. They commended the authorities for initiating the implementation of a uniform customs tariff.

Directors observed that the authorities' decision to leave the determination of interest rates to market forces had led to substantial capital inflows and rapid growth of domestic financial savings, as well as to some reduction in real interest rates. Directors commended the authorities for tightening their credit program in the light of the better than expected inflation performance during recent months. They urged the authorities to proceed quickly with the reform of the domestic financial system, giving priority to measures that would strengthen the financial position of commercial banks and improve bank supervision. The reorganization of the Central Bank to limit its functions to those of a monetary authority and government fiscal agent was welcomed by Directors.

Directors recognized that the authorities had made considerable progress in normalizing relations with foreign creditors, and expressed the view that the achievements in this area should facilitate the arrangement of the financing flows required under the program. They urged the authorities to move expeditiously to finalize the bilateral agreements under the terms of the Paris Club agreement, and to make every effort to reach agreement with foreign commercial banks at an early date.

Indeed, Directors stressed that the program could succeed only if the international financial community would lend its support to the authorities. The multilateral development banks have already stepped up their commitments, and negotiations with foreign commercial banks are at an advanced stage; official bilateral creditors have agreed to give debt relief on favorable terms within the framework of the Paris Club, and bilateral negotiations to implement this agreement are in progress. However, as Directors realize from the very difficult medium-term balance of payments outlook, debt relief, although indispensable, is not enough. Thus, I would like to underscore the point made today by Directors--namely, the need for additional concessional resources for Bolivia. For the authorities' program to succeed, it is important that such assistance become available on a timely basis, with the recently revived Consultative Group mechanism being used to improve aid coordination.

In sum, Executive Directors expressed their firm support for the authorities' determination in implementing the adjustment program. At the same time, they recognized that the consolidation of the progress made to date, while laying the foundations for sustained growth, was subject to many risks and uncertainties. Therefore, they stressed the need for sustained implementation of the program and the timely adoption of measures to ensure that performance remains on track.

It is understood that the Article IV consultation with Bolivia remains on the standard 12-month cycle.

The Executive Board then took the following decisions:

Exchange Measures Subject to Article VIII

1. The Fund takes this decision relating to Bolivia's exchange measures subject to Article VIII, Sections 2 and 3, in the light of the 1986 Article IV consultation with Bolivia conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. Bolivia maintains an exchange restriction evidenced by external payments arrears. In addition, a multiple currency practice may arise from the operation of Bolivia's exchange markets, as described in EBS/86/263. The Fund approves the exchange restriction until March 31, 1987, and the multiple currency practice until December 15, 1987 or the next Article IV consultation with Bolivia, whichever is earlier.

Decision No. 8472-(86/197), adopted
December 15, 1986

Review Under Stand-By Arrangement

1. Bolivia has consulted with the Fund in accordance with paragraph 4(d) of the stand-by arrangement for Bolivia (EBS/86/120, Sup. 1) and paragraph 4 of the letter of the Minister of Planning and Coordination, the Minister of Finance, and the President of the Central Bank of Bolivia dated May 29, 1986, annexed thereto, in order to review policies and establish performance criteria for the remaining period of the stand-by arrangement.

2. The letter dated October 30, 1986 from the Minister of Planning and Coordination, the Minister of Finance, and the President of the Central Bank of Bolivia (Attachment I to EBS/86/263) and the annexed Memorandum of Understanding on Economic Policy Through the End of 1987 (Attachment II to EBS/86/263) shall be attached to the stand-by arrangement for Bolivia, and the letter dated May 29, 1986 shall be read as supplemented by the letter of October 30, 1986 and its annexed Memorandum of Understanding.

3. Accordingly, Bolivia will not make purchases under this stand-by arrangement that would increase the Fund's holdings of Bolivia's currency in the credit tranches beyond 25 percent of quota:

a. During any period in which

(i) The ceiling on the changes in net domestic assets of the Central Bank of Bolivia, as set forth in paragraph 11 and Table 2 of Attachment II to EBS/86/263; or

(ii) The ceiling on changes in the net position of the nonfinancial public sector with the Central Bank of Bolivia, as set forth in paragraph 11 and Table 2 of Attachment II to EBS/86/263, is not being observed; or

b. During any period in which the data at the end of the preceding period indicate that

(i) The borrowing requirement of the nonfinancial public sector, as set forth in paragraph 10 and Table 1 of Attachment II to EBS/86/263; or

(ii) The limit on minimum gain or maximum loss of net international reserves of the Central Bank of Bolivia, as set forth in paragraph 16(b) and Table 3 of Attachment II to EBS/86/263; or

(iii) The limit on payments arrears on public and publicly guaranteed external debt, as set forth in paragraph 18(a) and Table 4 of Attachment II to EBS/86/263; or

(iv) The limit on increase in public and publicly guaranteed external debt, as set forth in paragraph 18(b) and Table 5 of Attachment II to EBS/86/263, has not been observed; or

c. During any period after February 15, 1987 in which the intention relating to the 1987 budget expressed in paragraph 10 of Attachment II to EBS/86/263 is not carried out.

4. The Fund decides that the review contemplated in paragraph 4(d) of the stand-by arrangement is completed and that Bolivia may proceed to make purchases under the arrangement.

Decision No. 8473-(86/197), adopted
December 15, 1986

Structural Adjustment Arrangement

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

2. The Fund approves the arrangements set forth in EBS/86/263, Supplement 2.

Decision No. 8474-(86/197), adopted
December 15, 1986

Purchase Transaction - Compensatory Financing Facility

1. The Fund has received a request from the Government of Bolivia for a purchase of SDR 64.1 million under the Decision on Compensatory Financing of Export Fluctuations (Executive Board Decision No. 6224-(79/135), adopted August 2, 1979, as amended).

2. The Fund notes the representations of Bolivia and approves the purchase in accordance with the request.

3. The Fund waives the limitation in Article V, Section 3(b)(iii).

Decision No. 8475-(86/197), adopted
December 15, 1986

2. CAMEROON - 1986 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1986 Article IV consultation with Cameroon (SM/86/283, 11/24/86). They also had before them a background paper on recent economic developments in Cameroon (SM/86/288, 12/3/86).

Mr. Mawakani made the following statement:

> Notwithstanding the adverse effects of developments in the oil market, the economic performance of Cameroon remained broadly satisfactory in 1985/86. According to available information, total output expanded by 7 percent in real terms, a rate that compares favorably with the average rate of growth of 6.5 percent achieved under the Fifth Development Plan, 1981/82-1985/86. The overall fiscal deficit of the Central Government was reduced slightly, and domestic credit expansion abated significantly. Moreover, the external current account balance recorded a small surplus. However, despite favorable developments in the supply side of the economy and in the monetary sector, inflationary pressures remained high.

It should be noted that the economic expansion recorded in 1985/86 took place against the backdrop of a sharp slowdown in oil sector activities. Economic growth stemmed primarily from the agricultural sector where, as a result of the implementation of agricultural productivity programs and the return of good weather conditions, the production of virtually all food and export crops increased. The steady upward adjustments in producer prices and the provision of adequate extension services to farmers also played a central role in the performance of the agricultural sector. In addition, in order to cope with bottlenecks in transportation and improve the marketing network, the development of infrastructure was given particular attention. In an attempt to develop the country's potential for animal husbandry, the authorities have stepped up their efforts to provide adequate veterinary facilities to eradicate livestock diseases that have impeded the development of this industry. In this connection, a veterinary laboratory will be built with World Bank assistance.

In the industrial sector, production slowed considerably in 1985/86, compared with the strong growth recorded in the previous two years. This slowdown is largely attributable to the serious financial and structural problems facing this sector. The authorities are well aware of the fact that financial and structural problems have impeded the development of the sector. Consequently, they have taken a series of measures to cope with them, which include decentralization of the system of determination of industrial prices, the introduction of a new investment code to promote export-oriented enterprises, and the promotion of greater utilization of local raw material. Furthermore, the agencies responsible for providing technical and financial assistance to small businesses have been reorganized with a view to improving their efficiency.

In the fiscal sector, the authorities have maintained a cautious policy stance and have sought to avoid dependence on temporary oil revenue. Steps have been taken to improve the buoyancy of taxes on the non-oil sector. Thus, taxes on imported alcoholic beverages and luxury goods have been increased. The system for valuing imports and assessing customs duties has been computerized and has contributed to an improvement in tax collection. Moreover, the tax administration has been strengthened. The authorities are of the view that there is room for maneuver in the taxation of business enterprises and will therefore take additional steps in that direction in the near future. On the expenditure side, total expenditure and lending increased by about 8 percent in 1985/86, a much lower pace than in previous years--19.5 percent on average during the two previous fiscal years. As a result, the overall fiscal deficit was reduced slightly. Well aware of the decline in oil revenue and its adverse effects on the budget, the authorities have adopted a more restrictive fiscal stance for 1986/87. In this connection, there will be no general salary increase, and tighter control will be exercised over recruitment, retirement, and other nonwage benefits.

The financial position of the public enterprise sector is a source of major concern to my authorities. They are fully aware that adequate actions are necessary to cope with the financial and structural difficulties confronting this sector. Thus, measures have been taken to alleviate the financial difficulties of some enterprises; unpaid tax liabilities have been converted into shares to improve their capital base. Furthermore, the parastatals will benefit from the decentralization of the system of determination of industrial prices. In addition, two nonviable units were closed down and a tannery plant was sold to private interests. Finally, a national commission vested with the task of making recommendations to the Government for solving the financial and structural problems of the sector has been set up with the assistance of the World Bank. In the meantime, they are implementing programs for the rehabilitation of key enterprises.

The authorities have followed an accommodating policy in the monetary sector, in which the aim has been to encourage investment so as to ensure economic growth. This policy, while it can have unwanted consequences, has been successful in achieving its aim. The authorities are also concerned about the nonperforming loans in the portfolios of the commercial banks, and they have taken measures--as described on page 16 of the staff report--to address this issue.

With regard to the external sector, relevant indicators showed satisfactory improvements over the period 1981/82-1984/85. However, in 1985/86, due to the sharp decline in oil prices, the current account surplus which was equivalent to 9.3 percent of GDP in 1984/85 shrunk to only 0.1 percent of GDP. Since the medium-term prospects for oil prices remain bleak, the authorities are taking steps to boost non-oil exports in order to diversify export earnings. An autonomous amortization fund has been created to strengthen external debt management.

In conclusion, the economy has achieved significant progress over the past few years. While oil revenue has played a crucial role, the authorities' cautious economic and financial policy stances have been important toward this achievement. However, with a sharp decline in oil prices, external and internal imbalances have emerged and will require appropriate adjustment measures in the short and medium term. My authorities are confident that, given the country's economic potential, the international community will support their development efforts to meet those new challenges.

Mrs. Ploix made the following statement:

Like many other countries, Cameroon is facing difficulties resulting from the recent sharp fall in world oil prices. However, there are three reasons why the situation is more manageable for Cameroon.

First, the authorities have always considered petroleum resources to be temporary; therefore, they have been very cautious about not allowing this resource to play too dominant a role in the economy, because it could have been detrimental to the diversified nature of Cameroon's productive base. They have channeled a substantial part of the resources stemming from petroleum production into investments aimed at supporting other essential productive sectors. Hence, a substantial part of the public investment program in the past few years has been devoted to industrial and agricultural projects, as well as infrastructure development.

Second, financial policies have remained prudent, as demonstrated by fiscal and debt statistics. The Government's secrecy about the operations of the oil sector and the handling of foreign reserves--the amount of which has not been revealed--is evidence of the authorities' caution. I understand that this practice is unorthodox, but it has proven to be fully effective in saving petroleum resources from being wasted under inevitable internal pressures. Thus, Cameroon has been able to accumulate substantial reserves for use in case of hardship, thereby implementing in its own noteworthy way one of the recommendations of the Bank and Fund that is often made but seldom put into effect, which is particularly welcome because it eases the burden of the present adjustment program.

Third, since 1981, the authorities have demonstrated their ability to implement limited adjustment while maintaining a steady rate of growth. The domestic savings rate registered during this period has been quite remarkable. Therefore, I have faith in Cameroon's adaptability in the face of unfavorable external developments.

However, the current sharp fall in petroleum prices is a very serious development and the authorities will have to consider the implementation of a comprehensive set of adjustment and structural measures. Furthermore, the timing of those decisions will be crucial. According to the scenarios in the staff report, which take into account the uncertain statistical base, it is clear that adjustment rates that are too slow would result in substantial deficits, the financing of which appears problematic.

The staff report shows that the authorities agree on the need to control strictly the growth of budgetary expenditures. The measures recently taken should be sufficient to contain the fiscal deficit for 1986/87 within financeable limits. This tight fiscal stance will have to be pursued in the years to come, and additional measures will probably have to be considered. The authorities will also have to tackle a number of structural weaknesses, as correctly stressed by the staff report.

Regarding the agricultural sector on which longer-term growth will depend, it is worrisome to see that food and export crop production has shown little sustained growth in the past, despite input subsidization and the large share of investment that has been allocated to agriculture. Therefore, it would be fully justifiable to look more closely at pricing and subsidization policies and the best way to provide the incentives that would induce the producers to increase their production. Some figures are given in the staff report about the share of export prices that is currently passed on to the farmers. It would be interesting to compare those figures with the farmer's share of export prices in neighboring countries. Does the staff have such comparative figures? I would encourage the authorities to pursue their dialogue with the Fund and the World Bank in order to design a strong and efficient incentives policy.

As to the industrial sector, I note that the introduction in 1984 of a new investment code is beginning to yield positive results in terms of promoting small and medium-sized manufacturing enterprises. However, most of the growth in this sector in the short run is more likely to come from large industry. I was glad to note that the authorities will largely focus their industrial policy on the rehabilitation of ailing industries. In addition, in order to improve the overall economic climate, they are well advised to focus their attention on the rehabilitation of the large parastatal sector, as mentioned in Mr. Mawakani's opening statement. Considering the prime importance of a sound financial sector, the authorities should also consider measures to achieve a lasting strengthening of the financial situation of the commercial banking system.

I believe that the authorities are broadly in agreement with the staff on all these issues. The problem lies more with the speed and strict implementation of the reforms than with their substance.

There is a large discrepancy between the GDP growth rate targeted under Cameroon's Sixth Devlopment Plan--6 percent--and the growth rate of 3.5 percent considered viable by the second scenario presented in the staff report. This represents an important difference, and I would encourage the authorities to actively pursue their dialogue with the Fund and the World Bank to clarify the issue and to accurately design the required policies.

I am confident that the authorities will tackle their current difficulties with the same pragmatism and wisdom they have shown in the past.

Mrs. Walker made the following statement:

Cameroon's economy has performed well over the past few years, largely on account of expanding oil production and exports, but also owing to prudent financial policies pursued by the authorities. With the current status of oil prices and the prospects for a continuation of low prices in the future, the authorities have adopted more stringent fiscal policies for the next year and are stepping up actions designed to help bring about needed growth in the agricultural and industrial sectors.

The staff's medium-term scenarios are helpful in pointing out the potential results of these policies and those of stronger adjustment policies than those currently being pursued. Although we agree with the staff that the authorities' proposed measures to contain the 1986/87 fiscal defict should be sufficient, and policies in the agricultural and industrial sectors are in the right direction, we believe that the medium-term scenarios suggest there is scope for even stronger actions than currently planned. There is no point in waiting until the financing gaps become unmanageable before additional fiscal and other measures are taken. In our view, the most prudent course of action would be for the authorities to step up adjustment efforts when economic conditions are more favorable in order to reduce the need for more painful adjustment at a later stage.

We welcome the steps the authorities have taken thus far in the fiscal sector, particularly regarding the civil service. In the face of declining oil prices and the need to avoid large fiscal gaps in the future, we urge the authorities to step up their current policy stance and maintain tight fiscal policies over the medium term. In our view, this will undoubtedly mean some scaling down of the investment budget. We agree that the authorities could benefit from World Bank assistance in assessing the contribution of individual investment projects to immediate productivity needs and finding room for reducing investment expenditure.

As to the practice of transferring oil earnings held abroad to finance budgetary investment expenditure, we welcome the authorities' intention to limit those outlays to the completion of ongoing projects. Such transfers, however, are troublesome, as are the related difficulties in assessing the operations of the oil sector and in presenting an accurate picture of official government finances, the balance of payments position, and international reserves. We urge the authorities to provide information on the oil sector to assist the Fund's surveillance process and to provide the authorities with accurate information to facilitate macroeconomic analysis and planning.

Clearly, with the prospective decline in oil exports, attention must be given to expanding production in other areas of the economy. In this context, we welcome the attention that the authorities have given to stimulating agricultural production. I note that improvements in the agricultural sector have been made and that producer prices have been raised, but it is doubtful that these improvements will be adequate to bring about the needed growth in agriculture. The World Bank and the Fund argue for a more active producer price policy, and we urge the authorities to take this into account.

The parastatal sector is weak and seriously in need of overall reform. We welcome the creation of a high-level commission to solve these problems, but urge that it become operational soon. The sale of a few enterprises to the private sector and the pricing measures that have been taken are positive steps, but overall structural reforms in this sector are urgently needed.

The weak financial position of the commercial banking sector is worrisome, and we hope the authorities can devise a method for strengthening it, perhaps along the lines of the World Bank study.

Cameroon's external position could deteriorate markedly in the near future. The burden of the adjustment will undoubtedly fall on the fiscal sector, which calls for additional measures to complement those already adopted. In this regard, most of the measures mentioned above should help to bring about a more viable external position over the medium term and allow the authorities to maintain a cautious debt strategy. The authorities have taken prudent steps in the past and we urge them to continue in this direction in the future.

Mr. Fox made the following statement:

As other Executive Directors have noted, recent economic performance in Cameroon has been generally good. The rapid growth of petroleum exports has allowed strong overall economic growth to be combined with sound finances. However, the staff report shows that this apparently comfortable overall economic performance has tended to hide some underlying weaknesses, especially in agriculture, the parastatal sector, and the banking system. The sharp fall in oil prices has made it more urgent to tackle those problems.

The medium-term analysis in the staff report, which presents alternative outcomes under moderate adjustment policies--more in line with those that the authorities are currently contemplating--and a rather stronger response, which would be preferable, will be invaluable to the authorities in plotting their course for the next few years. It is regrettable, however, that the staff is prevented from developing its analysis by the authorities' continuing secrecy about oil sector operations, making the consultation process less useful than it might have been. I would strongly urge the authorities to be more forthcoming about such statistics in the future--on a confidential basis, of course--in keeping with their obligations under the Fund's Articles of Agreement and in the interests of a more constructive policy dialogue.

The staff report presents a clear list of priorities for action. The most urgent need is to reduce government spending--both current and capital expenditures--more in line with the much lower level of revenues that is now envisaged. The authorities have made a good start in this area with a sharp reduction in the growth of current expenditure. The decision not to grant a general salary increase this year is an important one, as is the decision to reduce civil service staff. However, there does seem to be a need for greater cutbacks in capital investment, and I note that the authorities have not discussed their new public investment program with the World Bank, which I would strongly encourage them to do.

On page 15 of the staff report, it is noted that recent and prospective fiscal measures are adequate to keep the fiscal deficit to about 4 percent of GDP in 1986/87. However, this figure seems considerably worse than either the deficit that the authorities have budgeted for or the projections indicated in Table 2 of the staff report. I would appreciate an explanation for the different estimates presented in Table 2.

The proposed overhaul of the parastatal sector can make an important contribution to strengthening public finances in the future, and I would be interested in knowing the timetable for action that the World Bank currently envisages.

Monetary policy has tended to be accommodative in the past, and I would be interested in staff comments on whether or not that approach has been an important factor in Cameroon's rather disappointing inflation performance in recent years. An increase in nominal interest rates would appear necessary, together with action to strengthen the commercial banks as recommended by the World Bank. The tendency for prices in Cameroon to rise more rapidly than in its competitor countries is one that must be reversed, particularly in view of the constraint on changing relative prices imposed by membership of a monetary union.

The real exchange rate in Cameroon has been appreciating for the past four years and although that was not so much a problem when oil production was also rising rapidly, that period now seems to be over. The promotion of non-oil exports is perhaps the major structural problem facing the authorities at this time. Finding a solution to that problem will determine the success of the authorities' efforts to maintain strong economic growth. In that connection, Cameroon is better placed than many oil-dependent economies because the oil sector, even at its peak, accounts for less than one fifth of total output. Agriculture remains the biggest single sector, the stronger performance of which must be a prime objective. Moreover, the authorities are in a position to change relative prices in favor of exports, given that producer prices in many cases are at present less than half of world export prices, a differential that is large enough both to permit a significant increase in producer prices and still leave some margin to finance public investment in agriculture, which the authorities currently envisage.

The staff representative from the African Department said that, on the whole, producer prices in Cameroon were higher than in many other African countries, and were roughly comparable to prices in Cote d'Ivoire. However, with respect to coffee, the conditions were different in Cameroon. The share of export prices passed on to the producer in Cameroon was about 50 percent, a substantially larger figure than in Uganda, where the share was only 25 percent. However, unlike Cameroon, Uganda's only source of tax revenue was the coffee sector. Thus, it was very difficult to compare producer prices among the countries without taking into account their need for different levels of export taxes.

As to the target rate of growth, the staff representative pointed out that although the target under the Sixth Development Plan was 6 percent or more, the staff had estimated that it would not be feasible to reach much more than 3 or 3.5 percent. Part of the problem related to the oil sector because, under the Sixth Development Plan, the authorities had not made any specific assumptions about the volume of oil production. As information relating to the oil sector was confidential, even those preparing the Sixth Development Plan did not have any data on that sector to use in their projections. The planners had assumed more or less the same level of current oil production, but the staff had assumed a substantial decline; that difference of opinion accounted for the disparity between the growth targets of 3 and 6 percent. Nevertheless, the authorities were extremely optimistic with respect to the potential for economic growth in the agricultural sector, the rate of growth of which was projected to be an average of 8 percent a year over the next five years. Since the rate of growth in the agricultural sector over the past 10-15 years had been zero or less than 1 percent, it was difficult to understand where such substantial improvement in that sector was going to take place.

It was true that there were large differences between the authorities' budget and staff estimates, the staff representative continued. Part of the difference related to extrabudgetary revenue and extrabudgetary expenditure. The extrabudgetary revenue included transfers from the secret funds of the oil company that was located abroad, and extrabudgetary expenditures were those financed by the secret funds. There were no data in the budget on either of those items. The lack of data accounted for a large part of the difference between the surpluses estimated by the authorities and the deficit forecast by the staff. The staff also believed that the authorities were somewhat optimistic in projecting no increase in the wage bill between 1985/86 and 1986/87. Although it was true that there would be no increase in the wage rate, it was somewhat doubtful that the authorities would be able to offset the previous increase in the size of the civil service of about 10 percent in early 1986 despite their current policy of limiting any increases in the size of the civil service. Thus, the staff had projected significant increases in the wage bill for 1986/87.

As to monetary expansion and inflation, the staff representative remarked that the authorities' expansionary credit and interest rate policies had been the cause of the current inflation rate. The very large increase in effective demand resulting from the expansion of Government expenditures in the past had also been a factor causing inflationary pressure.

Mr. Mawakani said that the authorities were aware of the negative impact of decreased oil exports on the balance of payments position and the budget and were determined to diversify production in other sectors, particularly in agriculture and industry. That strategy was reflected in the Sixth Development Plan that the authorities intended to implement from 1987 to 1991. The authorities were also determined to pursue a prudent fiscal and monetary policy designed to establish stable economic growth.

The Chairman made the following summing up:

Executive Directors noted that Cameroon's overall economic and financial performance in recent years had been broadly satisfactory. In particular, the country's rate of economic growth remained high, under conditions of relative internal and external financial stability. The rapid expansion of crude petroleum production and exports had contributed to that good performance, but a further major factor had been the pursuit of generally prudent financial policies and the achievement of a high internal savings ratio. Government spending had been kept within reasonable limits, so that recourse to external borrowing could be minimized and part of the oil revenues saved.

Notwithstanding that overall good performance, Directors noted that agricultural development remained disappointingly slow. Despite generally favorable natural conditions and substantial government intervention in the form of subsidies and investment, there had been no long-term increase in agricultural production since the early 1970s. Directors were generally of the opinion that comprehensive measures, including appropriate pricing policies, needed to be taken in order to raise agricultural output. Moreover, a large number of parastatals--many in the agricultural sector--remained in a difficult financial situation, and Directors believed that the authorities would have to substantially accelerate their program of rehabilitation.

In the light of the sharp decline in oil prices and the medium-term prospects for a marked decrease in oil production, Directors noted that Cameroon was now faced with the need to implement a rapid and major adjustment effort, and they urged the authorities to proceed without delay while the underlying financial situation was still sound and before major disequilibria would emerge. In this regard, they welcomed the authorities' efforts already under way to reduce the real growth rate of current government expenditures, including the tightening of employment policies of the Central Government as well as the reduction of extrabudgetary expenditures pari passu with shrinkages in the resources accruing from the oil sector. Directors encouraged the authorities to move ahead with their policy to reduce the size of the civil service. They also stressed the need for the authorities, with the advice of the World Bank, to reduce the investment program proposed under the Sixth Development Plan.

Moreover, Directors observed that the controlled fiscal stance would have to be stepped up and supported by measures to strengthen the domestic financial system, and by a prudent credit policy and an active interest rate policy designed to foster financial savings and improve the allocation of resources in the private sector. That approach was all the more important in a country which did not have the active use of the exchange rate instrument.

Directors indicated that it was important for the authorities to substantially improve Cameroon's economic data base in order to strengthen macroeconomic analysis and planning. While understanding the reasons behind the authorities' treatment of the oil sector, Directors encouraged the authorities to provide the staff--even on a confidential basis--with more comprehensive information on the country's oil resources.

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

The Executive Board then took the following decision:

1. The Fund takes this decision in concluding the 1986 Article XIV consultation with Cameroon, in the light of the 1986 Article IV consultation with Cameroon, conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund notes with satisfaction that Cameroon continues to maintain an exchange system that is free of restrictions on payments and transfers for current international transactions.

Decision No. 8476-(86/197), adopted
December 15, 1986

3. INCOME POSITION FOR FINANCIAL YEAR 1987 - MIDYEAR YEAR REVIEW

The Executive Directors considered a staff paper on a review of the Fund's income position for the first six months of financial year 1987, including a proposal for delaying a decision on the disposition of income in excess of the target amount until the end of the financial year (EBS/86/258, 11/21/86).

The staff representative from the Treasurer's Department observed that the charges accruing from members in arrears to the Fund for six months or more were recognized as current income only when actually paid. At the time of the drafting of EBS/86/258, charges from members on nonaccrual status had amounted to some SDR 100 million, and the maximum possible amount of deferred income by the end of the financial year had been SDR 262 million. Since that time, a number of members had settled outstanding obligations, and one member had indicated its intention to become current in the following week. As a result, the maximum of income that could be deferred during the financial year in the worst case scenario was reduced from SDR 262 million to SDR 152 million. Of the latter amount, some SDR 100 million would be deferred during the second half of FY 1987.

Mr. Schneider remarked that, having reviewed the various courses of action open to the Board for disposing of excess income projected for FY 1987, he had concluded that it would be preferable to delay taking any action until the end of the financial year when actual net income could be calculated. The staff had appropriately noted that the main reason for introducing midyear income reviews had been to protect the Fund's income position from the emergence of annual deficits. The excess that had materialized over the first half of FY 1987 should therefore only be considered as an indication that the Fund's financial position was evolving favorably. Midyear reviews had never been considered as occasions for disposing of excess income that had seemed to be emerging during the course of the year. The Fund's income targets were defined on a 12-month basis, which meant that the midyear projections of excess income could not be counted as definitely acquired. Hence, no decision should be taken at the present meeting concerning the disposition of such tentative excess. The postponement of action was particularly important since it was uncertain in what direction the SDR interest rate would move from its present relatively low level. Moreover, the immediate disposition of excess income might introduce into the rate of charge an unnecessary element of instability of the sort that the Board had been attempting to avoid in adopting some months previously the method of retroactively adjusting the rate. For the reasons he had mentioned, he could support the staff's explicit advice that the Board defer taking any action on the disposition of excess income until the end of the financial year.

Mr. Lim made the following statement:

We support the staff proposal to delay taking a decision on the disposition of income in excess of the targeted amount until after the end of the financial year. As the staff indicates, a delay now does not prevent the Board from taking, later on, any of the alternative courses of action outlined in the staff paper. At the same time, it allows the Board to base its decision as much on developments during the second half of the year as on the outcome for the first half. Waiting until the end of the financial year enables the Fund to relate the decision on disposition of the excess directly to the income actually realized for the financial year. It makes for greater stability in Fund charges as well, something we have always regarded as a worthwhile operational objective.

The staff is right in emphasizing that the Fund's net income cannot be projected with certainty, and it has pointed out two important considerations in suggesting that the prudent course is to delay action on the disposition of the excess. First, net income by comparison with total income and expenditures is small; consequently, small variations in these aggregates have a magnified impact on deviations of actual from projected income. Second, some factors affecting income in a substantial way are beyond the Fund's control, for example, the SDR interest rate and the amount of purchases. The discharge of deferred income is also fraught with uncertainty. In conclusion, nothing will be lost by a delay; in fact, there might be some advantages, given the existing major uncertainties and the fact that immediate action would not be conducive to stability in Fund charges.

The Executive Directors agree to continue their discussion at 3:00 p.m.

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/86/196 (12/12/86) and EBM/86/197 (12/15/86).

4. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/86/310 (12/11/86) and by an Assistant to Executive Director as set forth in EBAP/86/311 (12/12/86) is approved.

APPROVED: July 31, 1987

LEO VAN HOUTVEN
Secretary