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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 85/24

10:00 a.m., February 15, 1985

J. de Larosière, Chairman

Executive Directors	Alternate Executive Directors
	J.-C. Obame, Temporary
	M. K. Bush
J. de Groote	S. Kolb, Temporary
B. de Maulde	
	M. B. Chatah, Temporary
H. Fujino	
G. Grosche	
	Jaafar A.
R. K. Joyce	L. Leonard
A. Kafka	C. Robalino
	A. Lindø
E. I. M. Mtei	A. Abdallah
	M. A. Weitz, Temporary
Y. A. Nimatallah	J. E. Suraisry
P. Pérez	
J. J. Polak	
	A. V. Romuáldez
G. Salehkhou	O. Kabbaj
A. K. Sengupta	
N. Wicks	
	T. A. Clark
	L. Tornetta, Temporary
Zhang Z.	

J. W. Lang, Jr. Acting Secretary
K. S. Friedman, Assistant

Also Present

L. Robinson, Minister and Deputy Chief, Embassy of Guyana, Washington. Asian Department: L. Mendras. Central Banking Department: H. Mehran. European Department: L. A. Whittome, Counsellor and Director; P. Dhonte, A. Leipold, J. S. Van't dack. Exchange and Trade Relations Department: W. A. Beverdige, Deputy Director; E. H. Brau, H. W. Gerhard. External Relations Department: H. O. Hartmann. Fiscal Affairs Department: G. Blöndal. Legal Department: G. P. Nicoletopoulos, Director; Ph. Lachman. Secretary's Department: A. P. Bhagwat. Treasurer's Department: D. Berthet, J. C. Corr, D. Gupta, W. E. Hermann, A. W. Lake, T. B. C. Leddy. Western Hemisphere Department: E. Wiesner, Director; S. T. Beza, Associate Director; M. Caiola, T. Gudac, A. M. Jul, T. M. Reichmann, F. van Beek. Bureau of Statistics: V. Marie. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: H. A. Arias, G. R. Castellanos, D. Hammann, S. M. Hassan, G. E. L. Nguyen, P. Péterfalvy, T. Sirivedhin, A. Steinberg, E. M. Taha, A. Vasudevan. Assistants to Executive Directors: E. M. Ainley, J. R. N. Almeida, I. Angeloni, J. Bulloch, Chen J., J. de la Herrán, J. J. Dreizzen, G. D. Hodgson, Z. b. Ismail, A. K. Juusela, H. Kobayashi, M. Lundsager, K. Murakami, J. E. Rodríguez, C. A. Salinas, A. A. Scholten, A. H. van Ee, P. Verly, E. L. Walker, B. D. White

1. KINGDOM OF THE NETHERLANDS - NETHERLANDS ANTILLES - 1984 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1984 Article IV consultation with the Netherlands Antilles (SM/85/21, 1/22/85; and Sup. 1, 2/13/85). They also had before them a report on recent economic developments in the Netherlands Antilles (SM/85/24, 1/25/85).

Mr. Polak made the following statement:

The Netherlands Antilles, a small, high-income area in the Caribbean, has an economy almost entirely dependent on the sale of services abroad. Agriculture and manufacturing production (other than oil refining) are of minor importance, and consumption is predominantly served by imported commodities.

All three of the main service industries for export--tourism, oil refining, and offshore banking--have received severe blows in the recent past. The reduction in incomes in Venezuela cut tourism from that country, a loss only partially offset by larger tourist receipts from the United States; the oil refinery on Aruba will close by the end of March and the continued functioning of the one on Curaçao is in doubt; and the abolition of withholding tax on investment income in the United States cuts most of the ground from under the offshore banking industry. In addition, other commercial services, including those provided by a large dry dock, have declined, due partly to changes in shipping conditions and partly to the island's loss of competitiveness.

The Antilles thus face a massive task of adjusting to the effects of the declines in foreign exchange receipts, in employment, and in tax revenue. Some of these effects are already being felt, while others may be spread over a number of years due to various transitional provisions.

The problem of adjustment is made more arduous by the appreciation of the U.S. dollar to which the N.A. guilder has been pegged since the end of World War II. A further complicating factor is that Aruba (the second largest island in terms of population) is slated to achieve a separate status in the Kingdom of the Netherlands from January 1, 1986 (involving an increase in the cost of running the Government) and to become an independent state ten years later. In the financial area, preparations are going on for the Aruba branch of the Bank of the Netherlands Antilles to be split off to become an independent central bank.

The staff paper presents the difficulties of the Antilles in a clear and persuasive manner. The report is recognized by the authorities as being of great value to them in positing the policy choices that need to be made--and, as the report notes, to be made without delay. The adjustment measures must include

restoration of competitiveness, which the authorities aim to achieve by collective reduction in money wage rates rather than by devaluation of the currency. As the supplement notes, steps in that direction are being taken in Aruba; but this has not yet happened for the Antilles as a whole. It will also be necessary to cut government wage and nonwage expenditure and to adopt a conservative credit policy. Both are needed to avoid using up the country's comfortable foreign assets by delayed adjustment and to maintain confidence in the currency. Finally, to restore vigor to the economies of Aruba and Curaçao, an innovative entrepreneurial action will be required to draw new sources of employment to the islands on the basis of restored competitiveness.

Mr. de Groote said that as the staff had noted on page 5, "the islands are endowed with an enviable human and financial heritage." The relatively small population--230,000 persons--had succeeded in maintaining two of the world's largest oil refineries, a world-class dry dock, a sophisticated offshore financial sector, and an attractive tourist sector. The islands had no external public debt, could rely on regular financing from the Netherlands, and had sufficient foreign assets and a very low rate of inflation. Moreover, imaginative political formulas, reflecting the particular circumstances of each island, were being worked out.

The advantages enjoyed by the Netherlands Antilles were closely linked to the open character of the economy, Mr. de Groote continued. Indeed, exports were the equivalent of more than three quarters of GNP. At the same time, the openness of the economy was the main cause of the problems facing the islands; tourist arrivals from Venezuela had declined steadily because of recent adjustments in the bolivar; in July 1984 the United States had canceled the favorable provisions of the tax treaty between that country and the Netherlands Antilles, an action that would sharply curtail financial activity in Curaçao; the anticipated closing of the Lago Oil Refinery on Aruba would reduce that island's GNP by one third; and changes in shipping activity could idle the dry dock at Curaçao.

The effects of the reduction in foreign exchange earnings on the budgets of the three governments of the islands and on the competitiveness of the productive sectors were the main subjects of the staff's analysis, Mr. de Groote noted. However, he wondered whether the staff's concerns were correctly focused. The staff had made three main proposals: reduce government expenditure by cutting wages in the public and private sectors by about 20 percent; encourage a higher level of investment to create new activities in the tourist and industrial sectors; and increase control of domestic credit, perhaps by setting limits on credit to the private sector. Those measures would partly counter--but would also partly reinforce--the expected increase in unemployment owing to the reduction in economic activity.

In making its recommendations, the staff had assumed that the authorities would continue to peg the Netherlands Antilles guilder to the U.S.

dollar, Mr. de Groote continued. That arrangement had helped to keep the rate of inflation remarkably low, but the real effective exchange rate had appreciated by some 25 percent in 1981-84, and he wondered whether the authorities should continue that artificial link. The staff report had provided no justification for continuing the link. A more flexible use of the exchange rate intrument, if only to a relatively limited extent, could be of considerable help in correcting the erosion of competitiveness of the productive sector, particularly industry, trade, and government services. Of course, use of the exchange rate instrument should be accompanied and reinforced by other policies, such as wage restraint. Such a policy mix could ensure the restoration of the economy's competitiveness.

The staff should provide more detailed information on the precise investments it had in mind for the tourist and industrial export sectors, Mr. de Groote continued. He wondered how it would be possible to increase tourism, given the sharply devalued bolivar and the upward pressure on the guilder owing to its link to the U.S. dollar. A widespread sectoral reorganization of the economy was needed, and new investments should be directed not only at modernizing the main sectors, such as industry, construction, and transport but also at creating new sectors, such as agriculture, and new services. The staff should comment on the prospects for such a reorganization in light of the exchange rate problem and the need to allocate resources effectively.

He wondered whether the staff recommendations concerning stimulation of the private sector and financing of new investments were compatible with new restrictions on credit to the private sector, Mr. de Groote said. He recognized that a tighter monetary policy could help reduce government spending, but he wondered whether a selective expansion of credit to the private sector would not encourage that sector to increase its activities. Given the very low rate of inflation and the need for structural change, there seemed little risk in promoting the expansion of the private sector while containing government expenditure.

Mr. Leonard commented that during the previous year the Netherlands Antilles had suffered a number of external blows that would have caused problems even for a much larger and more diversified economy; they had been particularly severe for the Netherlands Antilles' narrowly-based economy. The decline in tourism, the loss of preferential tax treatment by the United States, and the expected closure of the Aruba oil refinery were likely to have a substantial and lasting negative effect on employment and incomes.

Unfortunately, those adverse effects had been felt during a period in which the economy had not been functioning smoothly, Mr. Leonard continued. Table 1 of SM/85/24 showed that economic activity in the Netherlands Antilles had been, at best, uneven since 1978. Although the rate of inflation had been steadily falling because of the peg of the guilder to the U.S. dollar, economic growth across the main sectors had been erratic. No single sector had shown stable or consistent growth, and many had experienced sizable declines in output or earnings. The

authorities might have delayed taking action in the hope that those trends would be reversed, but the events of the previous year had confirmed that an automatic turnaround was unlikely. The present situation was the result of a permanent change in the islands' environment; accordingly, the adoption of strong and comprehensive adjustment measures was imperative.

He generally agreed with the staff appraisal of the economic situation in the islands and with the staff's policy recommendations, Mr. Leonard said. The fact that the decline in foreign exchange earnings was expected to be spread over a number of years gave the authorities some room for maneuver, but that did not mean that they could afford to delay making needed adjustments. Indeed, early action was needed; the sooner it was taken, the less costly it was likely to be. Furthermore, the burden of adjustment would have to be distributed among the islands, as the loss of foreign exchange and increasing unemployment were likely to affect Aruba more acutely than the other islands. An early commitment to strong adjustment measures would give the authorities a better opportunity to distribute the burden of adjustment equitably and to arrange for the strong intergovernmental coordination advocated by the staff.

He sympathized with the authorities, who were worried that a devaluation of the exchange rate could intensify inflationary pressures, thereby disrupting the impressive efforts to contain inflation of recent years, Mr. Leonard remarked. However, given their reluctance to devalue, the authorities must increase their reliance on other measures--particularly a reduction in nominal wages--to restore competitiveness and to encourage new employment-creating opportunities. It was therefore regrettable that, although the authorities had stated that they wished to improve competitiveness by containing wages, the Central Government and the Government of Curaçao had concluded that a 15 percent reduction in wages in coming months would not be possible. It was difficult to know for certain whether the 20 percent cut in nominal wages recommended by the staff, or the more moderate reduction--15 percent--proposed by the authorities, would be the more appropriate, but, given the high and rising rate of unemployment, it was preferable to exceed the 15 percent figure rather than fall short of it. In the circumstances, a review of the present exchange rate arrangements was called for.

Firmer control over budgetary expenditure was required, and serious consideration should be given to sharp cuts in subsidies, Mr. Leonard considered. He was pleased that moves in that direction were being examined, and he hoped that the specific actions the authorities intended to take would be made known soon and would be significant. If they were not brought under control quickly, the emerging fiscal deficits could cause the authorities to resort to heavy external borrowing or to a rapid expansion of domestic credit, both unattractive alternatives. In addition, the authorities should find some means of redistributing fiscal revenues among the islands as a part of both the fiscal adjustment and the effort to share the burden of that adjustment. He wondered whether such an approach was possible in the present political conditions.

The staff's recommendations concerning monetary policy were appropriate, Mr. Leonard said. Tight control over domestic credit would place a useful constraint on fiscal expenditure and strengthen the external sector.

The authorities unfortunately faced a series of difficult decisions that would inevitably impose a burden on all the inhabitants of the islands, Mr. Leonard commented. There seemed to be no way of avoiding the costs of the necessary adjustment, and he hoped that the authorities would succeed in sharing the burden as equitably as possible and in introducing measures to attract new investments while restoring the economy's competitiveness.

Mr. Pérez stated that he agreed with the staff appraisal. During the 1970s and early 1980s the Netherlands Antilles had enjoyed an enviable degree of economic stability and sustained growth. Since 1983, however, the islands had been suffering from a structural economic crisis. The three dominant sectors of the economy had been hit hard: the tourist sector had experienced a sharp decline in real revenues owing to a drastic decline in the number of tourists from Venezuela following the economic recession and the devaluation of the bolivar in 1983 and 1984, offshore financial activities had declined following the repeal by the United States of the withholding tax on investment income accruing to nonresidents; and the planned closure of the Lago Oil Refinery on Aruba would significantly affect GNP, employment, foreign exchange receipts, and public revenues.

To deal with the serious economic situation, the authorities must take two kinds of actions, Mr. Pérez remarked. They should implement a comprehensive adjustment program to avoid a deterioration of the sound external position, and they should adopt a medium-term strategy designed to promote new economic activities, mainly on Aruba.

In making adjustments, particular attention should be paid to the need to reduce nominal wages in order to restore competitiveness and to maintain confidence in the currency, thereby making the islands more attractive to foreign investors, Mr. Pérez continued. In that connection, the positive attitude of the labor force should be helpful. The recent agreements in several sectors to reduce the wage bill, partly through cuts in hourly wage costs, were welcome. However, the authorities' conclusion that a further reduction in wages could not be undertaken in coming months was a cause for concern; any doubt about the authorities' willingness to maintain an appropriate wage policy would certainly slow the momentum of adjustment in that area. Given the recent strong external shocks to the economy, the standard of living would have to be reduced through either deliberate cuts in nominal wages or an increase in the rate of inflation and a depreciation of the exchange rate that would cut the value of real wages in terms of their ability to buy tradable goods. A deliberate decision to cut nominal wages was preferable, since it would not involve an increase in the rate of inflation.

The substantial gap between public expenditure and revenue was a cause for concern, Mr. Pérez said. Despite the Government's cuts in current expenditure, the growth of such expenditure during 1984 had been positive in real terms while revenues had decreased in nominal terms and were expected to decline sharply in 1985. If the authorities were to succeed in encouraging new economic activities, they must adopt strong measures to prevent a large public sector deficit. The staff should comment further on the Government's plans to reduce expenditure.

The authorities' intention to introduce a ceiling on central bank advances to the Central Government and to freeze the growth of consumer credit in order to make room for financing of private investment was appropriate, Mr. Pérez commented.

The staff report did not discuss the medium-term outlook for the economy, Mr. Pérez noted. Medium-term scenarios were an important part of the complete picture of an economy's performance; they were a particularly convenient framework within which to assess economic policy. He wondered whether the staff had made any medium-term projections. It would be helpful to know more about the authorities' views on the islands' medium-term prospects as a result of the recent major shocks to the economy.

Mr. Clark remarked that the economy had suffered a series of shocks, the multiplier effect of which might have been even larger than the staff had indicated, given the central role in the economy of the oil refining, financial, and tourist sectors. If deterioration in the overall economy and in the external sector in particular were to be avoided, expectations in the Netherlands Antilles would have to be adjusted rapidly, the upward trend in real personal incomes would have to be contained, competitiveness would have to be increased, and public sector spending--particularly current expenditure--would have to be tightly constrained. It was true that the Netherlands Antilles would start the necessary adjustment process in a relatively favorable financial position that should provide a modest cushion, but the authorities must react swiftly to the new situation if they were not to lose that initial advantage. In that connection, the information contained in SM/85/21, Supplement 1, was worrying.

In coming years, the authorities should promote to the extent possible the development of new industries, and, in that context, they enjoyed the advantage of an experienced and well-trained work force, Mr. Clark commented. The staff paper could have usefully explored more fully the opportunities for attracting new industries, and that subject could be the focus of the report for the next Article IV consultation. The staff should comment on the prospects for attracting foreign direct investment to the Netherlands Antilles.

He wondered whether the present stage was the best one at which to reorganize the internal administrative arrangements in the Netherlands Antilles, especially if the effort was bound to involve some disruption,

Mr. Clark said. Finally, the absence of data in Appendix III was striking; improvements in data collection must be made if the implementation of the required adjustment policies were to be monitored effectively.

Ms. Bush remarked that the Netherlands Antilles had suffered serious external shocks in recent years that had harmed virtually every sector of the economy. While some of the problems facing the economy were due to the growing lack of competitiveness because of the peg of the currency to the U.S. dollar, economic developments in other countries had obviously significantly affected the Netherlands Antilles' relatively open economy. The prospects for offsetting the adverse effects of the external shocks were not promising, and the burden of the effort to generate new employment and to promote exports of goods and services must fall on the domestic economy. However, as the staff had noted in SM/85/21, Supplement 1, making needed adjustments in the domestic economy would not be easy; Aruba was the only island in the Netherlands Antilles where a cut in nominal wages had been accepted. In any event, it would take time for new sectors to evolve, and she agreed with Mr. Polak that innovative entrepreneurial action was needed to spark investor interest in the islands. The staff should comment on the authorities' views on the particular economic activities that could be successfully promoted. The authorities seemed to be relying on nominal wage reductions to make local labor more attractive to outside investors, thereby suggesting that the authorities intended to concentrate their promotion efforts on labor-intensive activities. It was true that tourism might be revived if local costs were to decline, but there was considerable competition from other Caribbean countries, and the decreases in nominal wages to restore the competitiveness of tourism in the Netherlands Antilles would therefore have to be relatively sizable.

She took Table 9 in SM/85/24 to suggest that the minimum wage in the Netherlands Antilles' trade-related sectors, including tourism, exceeded that of all the other countries mentioned in the table, Ms. Bush went on. Substantial cuts in nominal wages might be needed to make the Netherlands Antilles' labor competitive with that of neighboring countries, but such cuts might be difficult to make. Accordingly, the authorities should pay particular attention to the possibility of increasing competitiveness through an adjustment of the exchange rate. Given the islands' greatly reduced role in the international financial arena, an exchange rate adjustment might be more effective than wage cuts in increasing competitiveness. An exchange rate adjustment was likely to result in increases in the domestic prices of consumer goods in the Netherlands Antilles, but if the authorities were to hold the line on nominal wages and maintain restrained budgetary and credit policies, the price effect was likely to be minimized while the impact on investment and employment would be maximized. In setting credit policy, the distinction between the public and private sectors must be clear and private sector credit demand should be given preference.

Wage reductions, together with potential price increases, were understandably unattractive to both the authorities and the people of the Netherlands Antilles, Ms. Bush concluded, but if those steps were not

taken immediately, the competitiveness of the economy would weaken further, thereby causing a contractionary spiral of disinvestment and unemployment. The authorities should be encouraged to adjust to the series of shocks forthwith, before further erosion of the economy occurred.

The staff representative from the European Department said that the multiplier effect of the various external shocks had been fairly limited because of the very openness of the economy. Nevertheless, the shocks had been substantial, and strong adjustment to them was needed.

The staff report did not contain a medium-term scenario because the authorities did not yet have a clear view on the appropriate policy response to recent economic developments, the staff representative explained. The authorities were assessing the effects of the external shocks to the economy.

While it was too soon to formulate a medium-term debt scenario, the staff felt strongly that foreign debt should remain at the present low level, the staff representative said. The various sources of foreign exchange earnings had been seriously undermined, and the authorities had no alternative but to develop new sources while trying to maintain the present ones. To that end, the authorities could expand the duty-free zone, further develop the transshipment facilities--which had been relatively successful--and encourage very light manufacturing operations under the umbrella of the ACP Convention, although the opportunities for such operations were limited. The conditions--particularly the lack of water--for the development of agriculture were unfavorable. The main potential source of additional employment and foreign exchange was tourism, but developing that sector was expensive; the cost of constructing a single hotel room was roughly $100,000. Accordingly, investments in hotels were beyond the financing capacity of the local economy and would have to be covered by foreign sources. The authorities were therefore understandably reluctant to undermine any of the advantages they enjoyed in attracting substantial foreign direct investment, including the political and price stability, and the strong currency resulting from the peg to the U.S. dollar.

At the same time, the authorities did not wish to lose existing industries, the staff representative went on. The remaining large oil refinery and sizable dry dock were uncompetitive, and their competitiveness must be restored. The competitiveness of the islands as a whole could be increased either by reducing nominal wages or by freezing wages and devaluing the currency. The authorities apparently appreciated the crucial importance of adjusting the real effective exchange rate, and the staff was confident that adjustment would in fact be made. However, the authorities had made a strong case in favor of an adjustment of the real effective exchange rate that would be noninflationary. They had argued that the comfortable foreign reserves, the payments that were still due the Netherlands Antilles for the Lago Refinery, and the backlog in taxes that they were determined to collect gave them some time to adjust the exchange rate in a noninflationary manner.

If an external imbalance were to be avoided, the exchange rate adjustment would have to be complemented by measures designed to reduce domestic absorption, the staff representative said. A cut in real wages would of course have a dampening effect on domestic absorption, but the authorities would also have to take steps to improve government finances. The size of the Government was relatively large, and personnel costs accounted for approximately half of total expenditure. Accordingly, the authorities should reduce personnel expenditures and other current expenditures. At the same time, there had been relatively little capital investment that would increase the islands' capacity to generate foreign exchange revenues in the future.

The staff agreed that in implementing credit ceilings, the authorities should distinguish between public and private sector credit demand, and that crowding out of the private sector should be avoided, the staff representative remarked. However, the overriding need was to maintain control over the external position, which was fairly comfortable at present but could be subjected to severe pressure in coming months. The need to distinguish between government and private sector credit demand should be seen in the light of that basic constraint, which underscored the desirability of cutting government expenditure as quickly as possible.

Discussions on Aruba's constitutional position vis-à-vis the other islands had not yet been concluded, the staff representative said. However, the authorities in Aruba were still determined to gain a separate status for that island, and medium-term analysis would not be feasible until the constitutional issues were resolved, as the burden of adjustment to the recent shocks would be much greater for Aruba than for the other islands; the shocks had cut Aruba's foreign exchange earnings by some 50 percent while the comparable earnings of the other islands had been reduced by about 10 percent. Therefore, the adjustment measures for two distinct economic entities in the Netherlands Antilles might be somewhat different from measures for a single entity.

Despite the very low rate of inflation in the Netherlands Antilles, the peg to the U.S. dollar had resulted in a real effective appreciation of the exchange rate in recent months, the staff representative noted. In that connection, it was useful to compare exchange rate developments in the Netherlands Antilles with those in the Netherlands and other Western European countries, whose currencies were not pegged to the dollar. Both the Netherlands Antilles and the Netherlands had large shipyard facilities. The shipyard business was very competitive, and the appreciation of the Netherlands Antilles guilder had hurt the shipyards of that country. The staff used a set of indicators in assessing the real effective exchange rate for the Netherlands Antilles, including the conclusions of various large companies on the islands about recent changes in their international competitiveness.

The price competitiveness of the oil refineries was difficult to assess, the staff representative said. A number of factors in addition to immediate price competitiveness determined the volume of the Netherlands

Antilles' oil exports. The management of the refineries had stated that the oil refineries would only invest to the extent that they could generate the financing locally. If the refineries did not make money, the level of investment would have to be cut, thereby making it unlikely that the refineries could remain competitive. The degree of price elasticity of tourism in the Netherlands Antilles was also difficult to judge.

The Venezuelan tourist market was virtually closed to the Netherlands Antilles, the staff representative from the European Department commented. The authorities intended to exploit the U.S. tourist market to the extent possible. That market was huge in relation to the size of the Netherlands Antilles' tourist sector, but price conditions in the Netherlands Antilles would be crucial in determining the volume of tourists from the United States, particularly as U.S. tourists often made their vacation arrangements through tour operators, who tended to seek more favorable prices than individual tourists.

Mr. Polak remarked that the discussion had underscored the benefits the Netherlands Antilles derived from Article IV consultations separate from the consultations for the rest of the Kingdom of the Netherlands. The authorities had particularly benefited from the staff's analysis of the problems facing the economy.

The economy was very open, and in making needed adjustments the authorities could choose between adjusting wages and devaluing the currency while freezing wages, Mr. Polak continued. The authorities clearly preferred the latter alternative, and one of the main issues at hand was whether they had taken sufficient steps in that direction. In that connection, it was important to bear in mind the importance of both offsetting the appreciation of the Netherlands Antilles guilder due to the peg to the U.S. dollar and the need to increase competitiveness in response to the serious problems with respect to the basic external position. Merely offsetting the appreciation of the exchange rate by exchange rate action would not be sufficient; reducing nominal wages also was necessary. That alternative was most unattractive in itself, particularly in the light of the apparent reluctance in the Netherlands Antilles to permit nominal wages to decline. Moreover, it would be difficult for the Netherlands Antilles to become competitive in manufacturing even if nominal wages were considerably reduced, as many other Caribbean countries already had much lower wages; that was probably one of the reasons why manufacturing had never succeeded in the Netherlands Antilles.

The present period was probably not the best one in which to make important constitutional changes, Mr. Polak remarked. However, there was still a good deal to be done before Aruba could become a virtually independent constitutional entity. Before the recent shocks to the economy, Aruba had clearly been the most advanced of the islands and had wished to maintain its own foreign exchange holdings and pursue its own set of economic policies. However, some persons who had favored independence apparently now had reservations about that goal, or a least had

concluded that independence should not take effect as early as the end of 1985, as had originally been planned. Moreover, there was some question about the extent to which an independent Aruba should separate itself from the Central Bank and the currency of the other islands. Supporters of Aruba's separate status had argued that given the island's relative economic strength, it should have its own currency, thereby enabling it to protect itself from the adverse effects of movements in the currency of the other islands. However, in the immediate future, at least, Aruba's economy would not be much stronger than that of the other islands. Accordingly, the issue of a separate currency would have to be carefully reconsidered.

The prospects for an organized redistribution of the burden of adjustment among the various islands were not promising, Mr. Polak said. One option was to redistribute the significant aid from the Netherlands. The authorities had limited leeway in distributing that aid, as most of it was used to finance long-run infrastructure developments. Another burden-sharing option could be based on the Solidarity Fund of the islands, which was to be established for the benefit of the smaller and poorer islands. The Netherlands was to contribute to the fund, and the various islands also would make contributions, although the amounts for each one had not yet been agreed. Indeed, the whole structure of the Solidarity Fund was still in doubt. Aruba had been expected to be a major contributor to the fund but had indicated that instead it intended to make claims on the fund. In assessing the possibilities for sharing the adjustment burden, it was important to bear in mind that half the islands of the Netherlands Antilles were 500 miles away from the other half.

The Chairman made the following summing up:

> Directors noted the large, traumatic external shocks which have affected the entire economy of the Netherlands Antilles, sharply reducing foreign exchange resources and government revenues. Directors considered that the current and prospective decline in foreign exchange resources reflected a lasting change in the islands' economic base, and that a fundamental adjustment effort was therefore necessary to ensure a commensurate drop in domestic absorption. They expressed grave concern that, unless promptly addressed, these problems would lead to severe domestic and external imbalances.
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> Directors observed that in facing these difficulties the islands enjoyed a number of advantages, including a strong external asset position and a low rate of domestic inflation. They stressed that these advantages, which had been built up over previous years, needed to be used to develop new opportunities for employment and foreign exchange earnings and did not, in any case, justify an attempt to delay adjustment.

Directors warned that, in view of the recent loss of competitiveness, nominal wages had to be significantly reduced. The delay in adjusting wages in the island of Curaçao was considered worrisome. In addition, nonwage public expenditures needed to be sharply trimmed.

Directors welcomed the moves already made in these directions but emphasized that the adjustment so far fell short of what was required. If not controlled quickly, the emerging fiscal deficit could lead to dangerous foreign borrowing or domestic inflation. Strong and evenhanded financial actions should be implemented in a way that would preserve investment opportunities and concentrate cuts on current spending. To attract foreign capital and to promote investment and export opportunities, competitiveness must be increased.

Given the recent difficulties in reducing nominal wages, Directors felt that the time has come for the authorities to reassess the policy of maintaining a fixed rate for the U.S. dollar against the alternative of greater exchange rate flexibility. The latter policy would of course have to be backed by appropriate financial and wage restraint.

It was also pointed out that an improvement in the statistical base would assist in the analysis of the economy.

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

2. GUYANA - OVERDUE FINANCIAL OBLIGATIONS - REVIEW OF DECISION ON COMPLAINT UNDER RULE K-1

The Executive Directors considered the staff paper on the third review of the decision taken on June 6, 1984 (EBM/84/88) to limit Guyana's right to use the Fund's general resources (EBS/85/36, 2/13/85).

Mr. Leslie Robinson, Minister and Deputy Chief of the Embassy of Guyana in Washington, was also present.

The staff representative from the Treasurer's Department noted that the staff paper indicated that the authorities had intended to make a further payment on February 14, 1985. In fact, the authorities had paid SDR 600,000 on that date, thereby fully discharging the overdue payments to the SDR Department of SDR 297,517. The balance--SDR 302,483--of the payment of SDR 600,000 had been applied to the overdue obligations in the General Department, thereby reducing those obligations to SDR 18,664,672.

Mr. Kafka said that his authorities had carefully examined EBS/85/36 and were still deeply concerned about their inability to discharge promptly all their obligations to the Fund. However, they suspected that the full

extent of the difficulties facing them might not have been fully appreciated. They had devoted to repayments to the Fund all hard currency receipts except those needed to maintain their export capacity and to prevent a breakdown in the most basic operations of the economy. Accordingly, imports of production inputs had been limited to items needed to maintain exporting capacity. Total imports of consumer goods had amounted to less than $1.3 million in 1984, and most of them had been milk that had been distributed to children. Hard-currency reserves had also been used to make interest payments on loans by the World Bank, OPEC, and the Inter-American Development Bank, to ensure the continued disbursement of the remaining credit under the loans. Interest payments had also been made to commercial banks and on nationalization payments to prevent defaults that would have led to the seizure of export receipts. The authorities believed that further cuts in payments in hard currency would be counterproductive, in the sense that they would reduce the country's future capacity to repay the Fund.

Except for a relatively small amount of semiannual and quarterly charges, Guyana was current in all charges to the General Department and in all its obligations to the SDR Department, Mr. Kafka remarked. If the authorities had elected to make repurchases, rather than to pay the charges, Guyana would be in a better position because less charges would have accrued; however, the Fund's income position would be worse.

In his recent budget speech, the Minister of Finance had referred specifically to the need to repay Guyana's debt to the Fund and had underscored the authorities' decision to devote every available cent to that purpose, Mr. Kafka continued. In fact, payments to the Fund had consumed one third of receipts outside the bauxite and rice sectors in 1984 and would continue to absorb the same proportion in 1985. The bauxite sector used its export receipts to maintain its export capacity. Official rice exports were directed to Trinidad as a condition for obtaining enough oil from Trinidad to maintain basic services in Guyana; the value of those oil imports exceeded the value of the rice exports.

The Guyanese authorities had already taken advantage of the Fund's offer of technical assistance and looked forward to using the additional assistance that had been offered, Mr. Kafka said. They were prepared to adopt all necessary measures to enable them to improve the functioning of the economy in general, and to maximize their capacity to make repayments in particular. Considerable steps in that direction had already been taken, although, as the authorities themselves recognized, those measures would have to be reinforced. The authorities had already changed their stance on subsidies, particularly those relating to sugar and electricity charges, and they intended to adopt additional measures in that area in the immediate future. The authorities continued to seek credit to supplement their export receipts in order to enable them to speed up their payments to the Fund.

Mr. Tornetta commented that the authorities were making a serious effort to eliminate their overdue financial obligations to the Fund. Their

strong commitment in that area was reflected in the important share of the country's export receipts that had been used to make repayments to the Fund. However, the results of those efforts had not been fully satisfactory, and strong corrective measures were still needed. Despite the recent payments to the Fund, Guyana's overdue obligations had increased as new payments had fallen due. Moreover, Guyana had been continuously in arrears to the Fund for more than 20 months and, according to the timetable presented by the authorities, would be unable to become current in its obligations to the Fund before 1986, an outcome that was clearly unacceptable.

In dealing with cases of overdue obligations, the Executive Board had given high priority to treating member countries in an evenhanded manner, Mr. Tornetta noted. To that end, the Board should carefully consider all the relevant circumstances--such as the period in which a country had been in arrears and the severity of its adjustment effort--and compare them with previous cases. The present case was similar to the recent case of Nicaragua: both had been brought to the attention of the Executive Directors at about the same time and had been discussed by the Executive Board on June 6, 1984 (EBM/84/88); and both countries were making efforts to reduce their overdue obligations to the Fund, although Guyana had perhaps shown more perseverance in that respect. Hence, in order to adhere to the principle of equal treatment of member countries, the decision on Guyana should be similar to the recent one on Nicaragua. The proposed decision was therefore acceptable; the date for the next review should be May 15, 1985, and strong and comprehensive adjustment measures were clearly required. Presumably the foreign exchange receipts from sugar sales would enable Guyana to make substantial payments to the Fund in the near future, ahead of the schedule the authorities had mentioned.

Ms. Bush remarked that the Executive Board had already undertaken two reviews of the decision adopted in June 1984 on Guyana's overdue payments to the Fund. Although Guyana had paid the Fund SDR 2.6 million since the previous review, another SDR 5.8 million had fallen due and the total overdue payments exceeded SDR 18 million. More payments would fall due in 1985, and Guyana's total overdue obligations to the Fund could increase unless steps were taken immediately to enable Guyana to become current in its financial obligations to the Fund.

The authorities had stated their intention to make every effort to ensure that the overdue payments to the Fund would be reduced to the minimum or eliminated in 1985 or 1986, Ms. Bush noted. The Fund should not accept any repayment timetable proposed by Guyana; approving a timetable would be tantamount to a rescheduling, something that would be unacceptable. Prompt settlement of all the overdue obligations was the only acceptable action.

During each discussion on Guyana's overdue payments and during the most recent Article IV consultation discussions, Executive Directors had urged the Guyanese authorities to implement comprehensive adjustment measures that would address the serious financial imbalances in the

economy, Ms. Bush recalled. On page 5 of EBS/85/36, the staff had concluded that the measures recently announced by the authorities were inadequate to bring about adjustment of the required magnitude. Moreover, the Fund had provided technical assistance in an effort to help the authorities to address the problems facing the economy. Moving quickly on the adjustment measures suggested by the staff would be in the best interest of the Guyanese economy. Since the Fund was Guyana's largest creditor and had provided considerable technical assistance, the authorities should be more responsive to the Fund's policy recommendations.

While it was important for the Fund to urge the authorities to adopt adjustment measures, that issue was distinctly different from the question of Guyana's overdue obligations to the Fund, Ms. Bush said. Draft paragraph 3, which called on the authorities to adopt adjustment measures, should be seen in that light. However, the text could be interpreted as implying that the Fund was willing to wait until those measures were adopted before it was repaid. The authorities should be made to clearly understand the importance the Fund attached to the adoption by Guyana of adjustment measures, but that point need not be included in the formal decision on Guyana's overdue payments to the Fund. That point could be more appropriately communicated to the authorities by the Managing Director in his letter to the authorities following the adoption of a decision on Guyana's overdue payments to the Fund. Recent experience with Nicaragua underscored the need to avoid any misinterpretation of the Executive Board's decisions on overdue payments and communications with member countries in arrears to the Fund. Accordingly, the Guyanese authorities must clearly understand that prompt repayment to the Fund was of the utmost importance. She preferred to eliminate paragraph 3 of the proposed decision, or at the least, to amend it to end with the word "adjustment" in the third line. For the sake of consistency, the words "including actions taken by Guyana in accordance with paragraph 3 above" in paragraph 4 should also be eliminated. The amendments she had proposed would avoid any misunderstanding of the meaning of the decision.

She wondered whether the staff had any information on Guyana's request to the World Bank for a supplementary loan of $9 million to cover cost overruns on a forestry project, Ms. Bush remarked.

Mr. de Groote stated that the proposed decision, with the amendment suggested by Ms. Bush, was acceptable. There were a number of positive elements in Guyana's case: the authorities had made some payments; the latest payments and the authorities' attitude toward the remaining overdue obligations were particularly encouraging; some adjustment measures along the lines of the staff recommendations had been introduced since the previous discussion on Guyana; the authorities had accepted technical assistance from the Fund; and the dialogue between the Fund and the authorities had been constructive. However, the amount of the overdue obligations was still large and increasing, and the authorities had overstated the seasonality of Guyana's foreign exchange receipts; that point was not fully relevant to the issue of the overdue obligations to the Fund. Even more important, the adjustment measures, although in the right direction,

apparently were insufficient, as the public sector deficit was still equivalent to 50-70 percent of GDP, and the adjustment of the exchange rate since the adoption of the currency basket had not clearly offset the effective depreciation of the Guyanese dollar. Moreover, the authorities seemed to favor bureaucratic--and, therefore, ineffective--approaches to wage and price policies. Accordingly, the first sentence in paragraph 3 of the draft decision, which stressed the urgent need for a strong and comprehensive adjustment program, should be retained, and the point it made should be reinforced in the Managing Director's communication to the authorities. With the amendment suggested by Ms. Bush, the proposed decision would be consistent with the recently adopted decision on Nicaragua's overdue payments.

Mr. Lindå recalled that on previous occasions his chair had expressed its concern about member countries' overdue financial obligations to the Fund. Guyana had been in arrears to the Fund for nearly two years, and while its payment of February 14, 1985 was welcome, he hoped that it was an indication of the authorities' intention to expedite the remaining payments. The proposed decision was acceptable, provided that it was clearly understood that the thrust of the text, and particularly of paragraph 3, was that the handling of Guyana's case in the future would be based on the country's payment record and not on anticipated adjustment measures. For that reason, the amendments proposed by Ms. Bush should be approved.

Mr. Joyce recalled that during the previous discussion on Nicaragua, he and other Executive Directors had argued that the Fund's approach to overdue payments--and particularly the steps to be followed and the timing of decisions on eligibility--must be systematic. There had also been broad support for evenhanded treatment of the various member countries in roughly comparable situations. Meeting those conditions would be essential if the Fund were to maintain its credibility and integrity, and the conditions should certainly be applied to Guyana.

The Executive Board had discussed Guyana's arrears to the Fund no less than five times, Mr. Joyce noted. It was true that the authorities had paid some SDR 2 million prior to the Executive Board's discussion on December 1984 and SDR 600,000 on February 14, 1985, as promised, and that all the overdue payments to the SDR Department had been eliminated and all but a small portion of the charges in the General Department had been paid. Nevertheless, the authorities' progress in eliminating the overdue payments was disappointing. An additional SDR 5.7 million in payments had fallen due since the previous discussion on Guyana, and Guyana's total overdue obligations had increased since that meeting and now stood at SDR 18.6 million. Hence, Guyana's total arrears to the Fund had increased substantially since the Managing Director's complaint under Rule K-1 had first been considered by the Executive Board in March 1984. He would have been more reassured by recent developments if the authorities had begun to implement strong and comprehensive adjustment measures designed to strengthen the external accounts and to place them in a better position to discharge their obligations. However, the authorities had not done so. Some measures had been introduced, but they were not adequate to bring about the necessary degree of adjustment.

The main question at hand was what steps the Executive Board should take in handling Guyana's case in coming months, Mr. Joyce remarked. Given the guidelines the Executive Board had been following thus far, and particularly the need for consistent and evenhanded treatment of the member countries concerned, the general thrust of the staff's recommendations was appropriate. The Executive Board need not adopt a firm decision at the present meeting declaring Guyana ineligible to use Fund resources. However, unless the authorities acted quickly, the Fund would rapidly approach the point at which it would have no alternative but to adopt such a decision.

The Executive Board must bear in mind all the factors and circumstances involved in each case of overdue payments, particularly the efforts being made by a member country to eliminate its arrears to the Fund, Mr. Joyce went on. Mr. Kafka's statement on the steps the authorities were taking and their intentions for the coming period was welcome, but it did not give the Executive Board any greater assurance about the authorities' determination to implement comprehensive adjustment measures. Such measures were needed if Guyana were to reach quickly a position in which it could discharge its obligations to the Fund. However, he agreed with Ms. Bush that the need for adjustment in Guyana should not be linked solely to the country's obligation to repay the Fund. Adjustment was required for its own sake.

He was prepared to accept the proposed decision if the date of the next review for Guyana were the same as the recently agreed date--April 29, 1985--for the next review for Nicaragua, Mr. Joyce said. After all, both cases had initially been considered by the Executive Board on the same date in December 1984 and again in March 1984, and his proposal would bring the Executive Board's consideration of the two cases back in tandem.

Mr. Pérez stated that the proposed decision was acceptable. During the previous discussion on Guyana, his chair had noted that the serious problems facing the economy had been compounded by adverse weather conditions. The economic situation was still serious, and the authorities should implement as soon as possible a strong and comprehensive package of measures designed to reduce the basic imbalances.

Guyana's recent payments to the Fund had required great effort by the authorities and were warmly welcome, Mr. Pérez continued. The recently adopted economic measures, particularly in the exchange rate and fiscal policy areas, were also welcome. However, he agreed with the staff that, given the magnitude of the economic imbalances, the progress that had been made was insufficient. The authorities should be urged to take additional steps to implement stronger economic measures that would restore balance to the economy and enable the authorities to become current in their obligations to the Fund as soon as possible.

Mr. Weitz noted that since the previous review, Guyana's overdue obligations to the Fund had risen to more than SDR 18 million. The authorities themselves had anticipated that development. They had stressed that

export proceeds were strongly seasonal and that further progress in reducing their overdue obligations to the Fund in the first quarter of 1985 would therefore be unlikely. At the same time, the authorities had repeatedly reaffirmed their intention of settling the arrears and had indicated that they expected to use one third of their net currency receipts in 1985 in repayments to the Fund. Hence, Guyana seemed to have made a reasonable effort and had given due priority to reducing its overdue financial obligations.

Guyana's level of reserves and import structure gave the authorities no room to make additional payments to the Fund at the present stage, Mr. Weitz remarked. However, the authorities should act quickly to implement a strong adjustment program to reduce the domestic imbalances and to strengthen the external position in order to encourage financial inflows, thereby enabling Guyana to reduce its arrears to the Fund. It was imperative for the authorities to avoid any further delay in adopting the corrective measures needed to achieve orderly adjustment; failure to act would compound the problems facing the economy. He was particularly worried by the imbalances in the public finances and by the negative effects of the exchange rate on the competitiveness of Guyana's exports. The Fund's technical assistance should help the authorities not only to meet their obligations to the Fund but also to establish the foundation for restoring stability and reasonable growth. The proposed decision was acceptable. It reflected the difficult economic situation in Guyana and provided for treatment of Guyana that was similar to the treatment of previous cases.

Mr. Grosche agreed with the staff's suggestion on page 8 to indicate to the authorities that unless by a certain date Guyana was current in its financial obligations to the Fund's General Department, Guyana would be declared ineligible--with effect on that date--to use the Fund's general resources. The proposed decision should stress the need for a strong and comprehensive adjustment program. Accordingly, the draft decision should be amended as Ms. Bush had suggested. The present text might wrongly give the impression that it would be appropriate for Guyana to delay eliminating its overdue obligations to the Fund until after an effective adjustment program had been implemented.

Mr. Fujino noted that Guyana had been in arrears to the Fund for 22 consecutive months. Although Guyana had made payments of SDR 14 million during that period, its overdue financial obligations had increased and now stood at SDR 18.6 million.

Each country with overdue payments to the Fund had expressed its sincere wish to repay the institution but had stressed that its economic circumstances were difficult, Mr. Fujino remarked. He certainly sympathized with all the authorities concerned, and Executive Directors had generally agreed that disciplinary measures against such members would be effective only if they were used sparingly, as a last resort. Still, the Executive Board must take the steps suggested by the general guidelines on the treatment of such cases in order to maintain the Fund's

credibility and to preserve its cooperative character. Excessively flexible treatment of individual cases would effectively negate the basic principle of equal treatment of member countries. Accordingly, the third alternative mentioned by the staff on page 7 was appropriate.

The adoption of the proposed decision was not the final step in dealing with Guyana's case, Mr. Fujino said. The Fund should help the authorities to formulate a strong and credible adjustment program, so that Guyana would be able to eliminate its overdue financial obligations as soon as possible. In that connection, paragraph 3 of the proposed decision was particularly significant. However, as Ms. Bush had suggested, the text could be misinterpreted. The Fund's willingness to work with the authorities on a viable adjustment program that would help Guyana to settle its arrears at an early date should not be taken to mean that the Fund would condone any delay in repaying the Fund. Accordingly, the text should perhaps be amended as Ms. Bush had recommended.

Mr. Wicks remarked that he had studied EBS/85/36 in the context of staff papers on similar cases recently dealt with by the Executive Board and in the light of recent developments in Guyana. The Guyanese authorities' latest payments to the Fund were most welcome, and he was pleased that the beginnings of an adjustment program had been made. However, the staff had concluded that the measures introduced thus far were inadequate to bring about adjustment of the needed magnitude.

The various cases of overdue payments to the Fund should be treated in an evenhanded manner, and option 3 on page 7 of EBS/85/36 was therefore appropriate, Mr. Wicks said. Rescheduling Guyana's payments to the Fund, or adapting the repurchase schedule to Guyana's crop cycle, would be unacceptable. While he sympathized with the authorities, he accepted the proposed decision, as amended by Ms. Bush in order to clarify the intent of the text. He looked forward to the staff's response to Ms. Bush's inquiry about Guyana's request for a supplemental loan from the World Bank.

Mr. de Maulde stated that his position was the same as that of Mr. Leonard, Ms. Bush, and Mr. Wicks. Ms. Bush's proposed amendments made the draft decision more consistent with the principle of equal treatment of member countries. In accordance with that principle, Guyana, like other member countries, should be given an additional three months in which to settle its overdue obligations. Accordingly, the date of the next review should be May 15, 1985.

Mr. Romuáldez remarked that the Executive Board had already held two reviews of its decision of June 6, 1984 to limit Guyana's use of the Fund's general resources. During those discussions, Executive Directors had repeatedly urged the authorities to implement comprehensive and fundamental adjustment measures. The inclusion of statements to that effect in the decisions adopted by the Executive Board were in response to the relatively large size of Guyana's overdue obligations in relation to the country's export earnings, the state of Guyana's economy, and, perhaps, the fact

that in the coming five years the country would have to make further repayments to the Fund amounting to approximately SDR 80 million.

The authorities apparently had not accepted the fact that, if Guyana were to become and remain current in its obligations to the Fund, a comprehensive adjustment program would have to be implemented, Mr. Romuáldez continued. The steps they had taken since the previous review clearly fell far short of what was required. In particular, the proposed reduction in the budget deficit from 66 percent of GDP to 57 percent was obviously inadequate. Moreover, the reduction was to be achieved mainly through rescheduling domestic interest payments rather than through a meaningful reduction in government outlays. In that connection, it was important to note that the authorities planned substantial increases in government capital expenditure and that their intentions with respect to exchange rate policy remained undefined even though decisive exchange rate action was clearly called for. Moreover, the commitment under the 1985 budget to apply $25 million--or about one third of projected export receipts--to discharging obligations to the Fund corresponded with earlier indications given by the authorities that the Executive Board had already concluded were inadequate.

The proposed decision should be strengthened, Mr. Romuáldez considered. At the conclusion of the previous review, the Executive Board had decided that consideration would be given, in the light of developments, to declaring Guyana ineligible at the present review to use the Fund's general resources. There had been few encouraging developments since that review. Moreover, the proposed decision, unlike the recently adopted decision on Nicaragua, in effect gave Guyana the best possible treatment, namely, a further three-month review period and an implicit agreement on a further extension if decisive policy actions were taken before the next review. Nicaragua had been granted a further three-month review period on the basis of the unqualified expectation that Nicaragua would be declared ineligible to use the Fund's general resources if it were not current in its obligations to the Fund by the time of the next review of the decision on that country. The Executive Board's willingness to grant a further review period for Nicaragua had also been based on the significant reduction in arrears since the previous review. In contrast, Guyana's arrears to the Fund had increased since the previous review of developments in that country.

Given the principle of uniform treatment of member countries and the need to maintain the credibility of Fund decisions, the proposed decision on Guyana should be no more generous than the recently adopted decision on Nicaragua, Mr. Romuáldez continued. Accordingly, Executive Directors might wish to consider two options short of an immediate declaration of Guyana's ineligibility to use the Fund's general resources. First, the Fund could indicate to the Guyana authorities that they had made inadequate progress in discharging the country's overdue obligations and that the policy measures announced and implemented to date were inadequate to facilitate a substantial acceleration of payments to the Fund. Accordingly, the Executive Board's agreement on any further review period would be

based on the unqualified expectation that, if Guyana were not current in its obligations to the Fund by the next review, it would be declared ineligible to use the Fund's general resources. Under that approach, a further three-month review period could be accepted. In accepting that period, Executive Directors would recognize that, while Guyana had no external reserves and would have limited foreign currency receipts during the next four-six weeks, it could realistically be expected to discharge all its overdue obligations to the Fund by the end of the three-month period. Paragraph 3 of the proposed decision could be replaced by a statement expressing the Fund's regret about the inadequacy of the repayment and adjustment efforts to date; the final sentence in draft paragraph 4 could be eliminated.

Alternatively, the Executive Board could approve the proposed decision with an amendment shortening the review period to, say, four weeks, Mr. Romuáldez went on. Within that period, Guyana would be expected to take decisive policy action, and it would be the Executive Board's expectation that in the absence of such action and if Guyana were not current in its obligations to the Fund by the next review, the country would forthwith be ineligible to use the Fund's general resources.

Of the options he had proposed, the second one seemed more constructive, Mr. Romuáldez said. It would recognize Guyana's limited scope to settle its obligations promptly without considerable policy adjustments. Giving Guyana a slightly longer period, in which it might have a chance to scrape together enough foreign exchange to discharge its obligations to the Fund without implementing an adjustment program, might well cause the authorities even greater difficulties in meeting the obligations that would fall due in the future.

Mr. Zhang stated that the proposed decision was acceptable. Paragraph 3 as it stood seemed sensible. He preferred to eliminate all of the paragraph rather than part of it, as Ms. Bush had suggested.

Mr. Polak noted that a number of member countries had made great efforts to remain current in their obligations to the Fund. All member countries that had accumulated arrears to the Fund must be treated in an evenhanded manner. Accordingly, Guyana should be treated just as Nicaragua had been, as reflected in the discussion at EBM/85/16 (1/30/85), and in the decision on Nicaragua (EBS/85/22, Supplement 1, 1/31/85). To that end, paragraphs 3 and 4 should be amended as Ms. Bush had suggested. Indeed, paragraph 4 in the proposed decision could be the same as the relevant paragraph in the decision on Nicaragua. The meaning of paragraph 4 of the present draft was unclear: on the one hand, the draft provided that the Fund would declare Guyana ineligible to use its general resourses; on the other hand, it implied that the Fund could conceivably decide not to declare Guyana ineligible to use its resources if the authorities were to adopt a strong and comprehensive adjustment program even though they had not fully met their financial obligations to the Fund.

Mr. Nimatallah said that the increase in Guyana's arrears to the Fund, despite the recent payments, was disappointing. Moreover, the arrears were still substantial and had been outstanding for almost two years. That situation was unacceptable, and Guyana should settle the arrears promptly. The adjustment measures introduced since the previous review were clearly inadequate, and the need for the authorities to adopt a comprehensive adjustment program was crucial. That step would strengthen Guyana's creditworthiness, thereby enabling the country to borrow from other sources and to pay the Fund promptly. The authorities should appreciate the seriousness of the overdue payments to the Fund, and the proposed decision should reflect the Executive Board's firm position and convey its dissatisfaction with Guyana's performance thus far. In the light of the Executive Board's treatment of previous cases, and of the principle of uniformity of treatment of member countries, option 3 on page 7 was appropriate, and the draft decision, with the amendment suggested by Ms. Bush, should be approved.

Mr. Jaafar noted that Guyana's overdue payments to the Fund had been outstanding for a long period, despite the Executive Board's encouragement to the authorities to become current in their obligations. He had reluctantly concluded that the authorities had made no significant progress in eliminating their obligations to the Fund, although the serious attempts they had recently made to pay the Fund were welcome. The authorities' adjustment measures were in the right direction but were inadequate to eliminate the imbalances in the economy, and the authorities should be urged to adopt additional measures. The Fund should continue to provide Guyana with technical assistance--if the authorities requested it--in the areas identified by the technical assistance mission in January 1985, provided that the prospects for making some progress in repaying the Fund were good. The proposed decision was acceptable.

The Chairman remarked that Ms. Bush's proposed amendment of paragraph 3 was appropriate. The paragraph was intended to underscore the crucial need for a strong and comprehensive adjustment program. At the time of the adoption of the recent decision on Nicaragua, that country's overdue payments to the Fund had amounted to some SDR 6 million, compared with Guyana's present outstanding obligations of approximately SDR 18.6 million. Moreover, the adjustment policies adopted by the Guyanese authorities had obviously been inadequate to bring about the required degree of adjustment. Management and staff had assumed that the crucial need for major adjustment in Guyana could be appropriately stressed in the draft decision.

Mr. Fujino said that he attached some importance to retaining draft paragraph 3 through the word "adjustment."

Mr. Wicks remarked that a further comment on staff and management's view on the relationship between the need for strong and comprehensive adjustment and the need to make full and prompt repayment of overdue obligations would be helpful. Of course, the main purpose of the proposed decision was to address the question of Guyana's overdue financial obligations.

The Chairman responded that the proposed decision was not meant to suggest the existence of a rigid link between the adoption by Guyana of a convincing adjustment program, and a decision whether to declare the country ineligible to use the Fund's general resources. The text was meant to reflect the conclusion that the adjustment policies adopted by the authorities thus far were not adequate to deal with the substantial problems facing the economy. It was conceivable that the prompt adoption of a convincing set of adjustment measures would enable Guyana to undertake a bridging loan to repay the Fund promptly. But the draft decision was not intended to suggest that the mere adoption of such measures would in effect either exonerate Guyana from meeting its overdue obligations to the Fund or weaken the expectation that the Fund would decide to declare Guyana ineligible to use the Fund's general resources if the obligations were not met.

The staff representative from the Treasurer's Department noted that the proposed text of paragraph 4 had been drafted in the light of the recent decision on Nicaragua, which had mentioned the expectation that the Fund would decide, effective on the date of the next review, to declare Nicaragua ineligible to use the Fund's general resources unless Nicaragua were current in its financial obligations to the institution. The decision on Nicaragua had also mentioned that in arriving at its decision, the Executive Board would take account of any further relevant developments. In drafting the proposed decision on Guyana, it appeared to the staff that one particularly relevant further development could be the implementation--or absence--of strong and comprehensive adjustment measures, especially in light of the stress that the Executive Board had placed on the need for such measures during the previous reviews of its decision on Guyana adopted on June 6, 1984. The staff had certainly not intended to invite any delay by the authorities in eliminating their overdue financial obligations to the Fund.

Mr. Nimatallah remarked that there seemed to be two basic categories of member countries with overdue financial obligations to the Fund--namely, countries that had sufficient resources to repay the Fund and countries that did not. It was not sufficient for countries in the second group to inform the Fund that they simply did not have the resources to repay the institution. The reason why those countries had become delinquent in their payments had to be carefully explored, and they should be encouraged by the Fund to implement the policies needed to improve their creditworthiness and to obtain financing from other sources that would enable them to repay the Fund promptly. Those other sources would be willing to lend money to the countries in question if they believed that the strong adjustment measures would enable the countries to earn the foreign exchange needed to repay the additional loans. Those sources could afford to wait a while for full repayment of their loans, but the Fund could not.

The Chairman said that he would go one step further: if the Fund was repaid because a member country had adopted appropriate adjustment

measures that had enabled the country to obtain bridging financing, and if the country's adjustment policies were adequate, the Fund itself would consider providing additional support to the country.

Mr. Kafka considered that draft paragraph 3 made an important point, namely, that there was an urgent need for Guyana to adopt a strong and comprehensive adjustment program. The text seemed carefully written and had not given him the impression that the Fund would accept the implementation of an adjustment program as a substitute for prompt payment of all Guyana's overdue financial obligations. However, adjustment was clearly a precondition for Guyana's settling its arrears and remaining current in its obligations to the Fund. Hence, the need for such adjustment should be clearly and strongly expressed in the proposed text. To that end, the proposed decision as it stood was adequate.

Mr. Vasudevan noted that Guyana had made some payments since the previous review and had eliminated all the overdue charges in both the SDR and General Departments. Moreover, the recently adopted adjustment measures--and particularly the authorities' stance on subsidies--were welcome. In his opening statement Mr. Kafka had suggested that the authorities wished to make further adjustments in the economy, and the authorities should be urged to implement stronger measures to reduce the fiscal deficit. The clarification by the Chairman of the intent of draft paragraph 3 was helpful. The level of Guyana's reserves was very low, and the flow of export receipts was somewhat seasonal. Given those facts, and in the light of the time usually needed for adjustment measures to bear fruit, the Fund should give the authorities sufficient time to discharge their obligations to the institution. Hence, the third alternative on page 7 and the proposed decision were acceptable.

Mr. de Maulde said that it might be best to eliminate draft paragraph 3 in its entirety. Guyana should certainly be called upon to adopt a strong and comprehensive adjustment program, but that point could be made by the Managing Director in his communication to the authorities, rather than in the proposed decision. As to paragraph 4 of the draft decision, it should be based precisely on the relevant part of the latest decision on Nicaragua's overdue financial obligations.

Mr. Nimatallah stated that he preferred to retain the text of draft paragraph 3 up to the word "adjustment." The paragraph would then usefully stress the need to adopt a strong and comprehensive adjustment program. The full intent of the present text of paragraph 3 could be explained by the Managing Director in his communication to the authorities.

Mr. Wicks said that he preferred to eliminate all of draft paragraph 3.

Mr. Grosche remarked that draft paragraph 3 through the word "adjustment" should be retained.

Mr. Zhang said that he preferred to retain the entire paragraph.

Mr. de Maulde commented that while his first preference was to delete the paragraph, he was willing to accept Mr. Nimatallah's proposal to retain the text through the word "adjustment."

Mr. Joyce said that his position was the same as Mr. Nimatallah's.

Mr. Lindå considered that all of paragraph 3 should be deleted.

Mr. Polak said that he preferred to retain the text through the word "adjustment."

Mr. Vasudevan, Mr. Pérez, Mr. Weitz, and Mr. Kolb agreed with Mr. Polak.

Mr. Jafaar said that he preferred the draft decision as it stood. However, he could go along with the proposal to eliminate the text of draft paragraph 3 after the word "adjustment."

The staff representative from the Treasurer's Department commented that to meet the request to make paragraph 4 of the proposed decision similar to the relevant paragraph in the recent decision on Nicaragua, the proposed text could read: "The Fund shall review Decision No. 7719-(84/88) further on May 15, 1985, taking into account any further developments. Unless at that time Guyana is current in its financial obligations to the Fund in the General Department, it is expected that the Fund will decide, with effect on that date, to declare Guyana ineligible to use the general resources of the Fund pursuant to Article XXVI, Section 2."

Mr. Wicks said that he preferred to use to the extent possible the precise wording in the relevant portion of the decision on Nicaragua in paragraph 4 of the proposed decision on Guyana.

The staff representative from the Treasurer's Department responded that the text in question would then read: "The Fund shall review further Decision No. 7719-(84/88) on May 15, 1985, taking into account any further developments. It is expected that a decision to declare Guyana ineligible to use the Fund's general resources pursuant to Article XXVI, Section 2 will be taken, with effect on that date, in the absence of full settlement of Guyana's financial obligations to the Fund in the General Department by that date."

The Director of the Legal Department remarked that there was no substantive difference between the proposed text of paragraph 4 on Guyana and the relevant portion of the recent decision on Nicaragua; both texts were meant to stipulate that if the country were not current in its financial obligations to the General Department by the agreed date, it was expected that a decision declaring the country ineligible to use the Fund's general resources would be taken, effective on the date of the review concerned.

The staff representative from the Western Hemisphere Department said that the World Bank intended to lend Guyana US$9 million to finance an export-oriented forestry project. In addition, the Inter-American Development Bank had recently approved a loan of some US$20 million for industrial rehabilitation in Guyana.

The staff believed that the adjustment measures the authorities had recently introduced were in the right direction but were clearly insufficient to cope with the imbalances in the economy, the staff representative from the Western Hemisphere Department remarked. The fiscal problem was closely related to the pricing and exchange rate policies. The growth of the underground economy underscored the inappropriateness of the exchange rate, and the effects of the controlled prices had obviously added to the burden of the state enterprises. Given the political and social conditions in Guyana, efforts by the authorities to tackle those problems would be genuinely major undertakings. However, the staff had concluded--and the authorities agreed on the technical level--that Guyana had no alternative, and the major social and political implications of such measures explained why the authorities had delayed adopting them. It was true that there had been measurable improvement in the bauxite sector as a result of purely organizational changes, and that the staff hoped that similar changes would be possible in the rice sector. However, there was little hope that the adjustment measures adopted thus far would yield significant improvements in the economic situation and would help the authorities to obtain needed foreign exchange.

Mr. Kafka said that he preferred to retain all of paragraph 3. However, he was willing to go along with a consensus in favor of retaining most of the first sentence.

Mr. Chatah remarked that as a result of the discussion, the authorities would fully understand the Fund's view on the need for strong and comprehensive adjustment in Guyana. However, a sentence similar to the first one in draft paragraph 3 had been included in the previous decision on Guyana and, for the sake of consistency, it should be repeated in the proposed decision.

The Executive Board approved the following decision:

1. The Fund has reviewed further Decision No. 7719-(84/88), adopted June 6, 1984, regarding the nonobservance by Guyana of its financial obligations to the Fund in the General Department in the light of recent developments described in EBS/85/36 (2/13/85) and the communications of the Guyanese authorities dated January 3 and February 6, 1985.

2. The Fund welcomes the payments made by Guyana on December 31, 1984, January 4, 1985, and February 14, 1985. In view of its policies and practices, however, the Fund cannot accept the program of the Guyanese authorities with respect to further payments, as communicated to the Fund in connection with

the Executive Board's review of December 3, 1984, and confirmed in their communication of February 6, 1985. The Fund regrets the continuing nonobservance by Guyana of its financial obligations to the Fund. The Fund urges the Guyanese authorities to make prompt and full settlement of the remaining overdue obligations to the Fund.

3. The Fund reiterates its call upon Guyana to adopt urgently a strong and comprehensive program that would bring about a much needed economic adjustment.

4. The Fund shall review further Decision No. 7719-(84/88) on May 15, 1985, taking into account any further developments. It is expected that a decision to declare Guyana ineligible to use the Fund's general resources pursuant to Article XXVI, Section 2 will be taken, with effect on that date, in the absence of full settlement of Guyana's financial obligations to the Fund in the General Department by that date.

Decision No. 7906-(85/24), adopted
February 15, 1985

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/85/23 (2/13/85) and EBM/85/24 (2/15/85).

3. INDONESIA - TECHNICAL ASSISTANCE

In response to a request from the Governor of Bank Indonesia for technical assistance on money market management and operations, the Executive Board approves the proposal set forth in EBD/85/47 (2/7/85).

Adopted February 13, 1985

4. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors and an Advisor to an Executive Director as set forth in EBAP/85/37 (2/12/85) and EBAP/85/39 (2/13/85) is approved.

APPROVED: November 19, 1985

LEO VAN HOUTVEN
Secretary