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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 90/82

3:00 p.m., May 25, 1990

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

Executive Directors	Alternate Executive Directors
	L. E. N. Fernando
	C. Enoch
F. Cassell	
C. S. Clark	
	Wang J., Temporary
T. C. Dawson	B. S. Newman, Temporary
J. de Groote	
	J. A. K. Munthali, Temporary
E. A. Evans	
E. V. Feldman	
L. Filardo	A. Napky, Temporary
R. Filosa	A. Fanna, Temporary
M. Finaish	T. S. Allouba, Temporary
	I. H. Thorláksson
	O. Kabbaj
	B. Goos
	H.-J. Scheid, Temporary
J. E. Ismael	T. Sirivedhin
	A. Hashim, Temporary
A. Kafka	L. M. Piantini
	L. I. Jácome, Temporary
	J.-F. Cirelli
	G. Serre, Temporary
Mawakani Samba	C. V. Santos
	A. R. Ismael, Temporary
	M. Al-Jasser
G. A. Posthumus	
	S. Yoshikuni
	K. Ichikawa, Temporary

L. Van Houtven, Secretary and Counsellor
K. S. Friedman, Assistant

Also Present

IBRD: P. Bottelier, Latin America and the Caribbean Regional Office. African Department: E. A. Calamitsis, Deputy Director; N. Krichene, R. S. Rothman, G. B. Taplin, S. Thiam, P. A. Youm. Central Banking Department: A. M. Leone. Exchange and Trade Relations Department: J. T. Boorman, Deputy Director; T. Leddy, Deputy Director; C. Atkinson, C. V. A. Collyns. External Relations Department: R. R. Brauning, H. P. Puentes. Fiscal Affairs Department: A. Tanzi, Director; G. A. MacKenzie. Legal Department: E. Aguirre-Carrillos, J. K. Oh. Research Department: G. Calvo. Secretary's Department: C. Brachet, Deputy Secretary; A. Tahari. Western Hemisphere Department: S. T. Beza, Counsellor and Director; L. R. Kenward, A. S. Linde, C. M. Loser, P. Neuhaus, A. M. Wolfe. Personal Assistant to the Managing Director: B. P. A. Andrews. Advisors to Executive Directors: F. E. R. Alfiler, M. Eran, A. Gronn, Z. Iqbal, J.-L. Menda, M. J. Mojarrad, P. O. Montórfano, F. A. Quirós, B. A. Sarr. Assistants to Executive Directors: H. S. Binay, C. Björklund, H. E. Codrington, E. C. Demaestri, S. Gurumurthi, M. E. Hansen, L. Hubloue, A. Iljas, M. E. F. Jones, P. Kapetanovic, R. Marino, Yang J.

1. ARGENTINA - STAND-BY ARRANGEMENT - REVIEW AND MODIFICATION; AND EXCHANGE SYSTEM

The Executive Directors considered a staff paper on the review under the stand-by arrangement for Argentina for the period November 10, 1989 through March 31, 1991 (EBS/90/90, 5/14/90; and Cors. 1 and 2, 5/24/90). They also had before them copies of recent communications from the Vice President of the Central Bank of Argentina to the Managing Director and from the commercial banks' Working Committee for Argentina to the Argentine authorities concerning a forthcoming meeting of the Banks' Advisory Committee for Argentina. 1/

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

> A mission returned from Buenos Aires on May 23, after having reviewed Argentina's economic performance through mid-May and discussed three key areas with the authorities: tax revenue and administration, public enterprise control, and wage policy.
>
> With respect to economic developments through mid-May, consumer inflation in May is expected to be a little higher than the 11 1/2 percent recorded in April, but still below the projection developed in March. Real wage awards in April, as noted below, may have contributed to this slight rise in inflation. The Central Bank has continued to make sizable purchases of foreign exchange; following purchases of $590 million in March, the Central Bank has bought significant amounts in April and thus far in May, approaching the target of $1 billion for the second quarter as a whole. These purchases have contributed to limiting the real appreciation of the austral. The economy remains in deep recession, but there have been some indications of a recovery in industrial production in the past month or so, and a bumper harvest appears to be in the offing.
>
> The fiscal outturn for April was much better than expected, mainly because of a sharp decline in investment expenditure and an unexpectedly large surplus recorded by the Social Security System. Partial information for May suggests that the programmed improvement for that month may not materialize; however, for the two months taken together, the primary surplus of the nonfinancial public sector appears to be approximately in line with the program. The authorities' expectation is that they will achieve the target for the primary surplus of 5 1/2 percent of GDP for the second quarter of 1990, up from 1 1/4 percent in the first quarter.

1/ Reproduced in Attachments I and II.

Legislation to extend the value-added tax to services is expected to be approved by the Lower House by the end of May and then to pass quickly through the Upper House. The measure, which probably would be effective from July 1, extends the base of the value-added tax to cover the majority of services provided by the private sector, although there may still be some exemptions in the final version of the law; for example, most nonbank financial services, publicity, and, perhaps, the media. Separate legislation, which is also expected to clear the Congress quickly, takes the important step of placing the authority to close the business premises of tax evaders under the authority of the Administrative Office of the Director General of Taxation (DGI). This step, which was an important recommendation of technical assistance missions from the Fiscal Affairs Department, would strengthen the hand of the authorities in dealing with tax evasion.

To make up for time that has been lost in extending the value-added tax to services, two taxes that are expected to be temporary--one on foreign exchange transactions and the other on foreign exchange houses--are to be introduced shortly. To reinforce these measures, the authorities are also considering raising indirect taxes on certain alcoholic and nonalcoholic beverages.

On May 3, steps were taken (Decree 850) to delegate to the provinces authority to regulate certain industrial promotion programs. This decision risks weakening the Central Government's control over these tax expenditures. The authorities have stated their intention to work with the provinces to ensure firms' compliance with terms of the programs.

The authorities have been making timely adjustments to public enterprise tariffs. A further increase of about 32 percent in electricity prices is to go into effect next week, including sharp increases in minimum tariffs which had previously contained a large element of subsidy. Also, port fees are to be raised substantially. With regard to the question of improving control over the state enterprises, the new Undersecretary for Public Enterprises in the Ministry of Economy is preparing to assign financial overseers to all enterprises. Budgetary guidelines are being issued to the enterprises for the remainder of the year. It should be noted that sales of the national airline and state telephone company appear to be proceeding apace and several prospective buyers are currently in Buenos Aires to examine the telephone company's books. Bids for the telephone company are to be opened on June 25.

On the wage front, there were slippages in April, mainly because of wage awards in the private sector and to military personnel and certain civil servants. Despite these increases in

April, real wages remain low by historical standards and public and private sector unions have been staging work stoppages, slowdowns, and protests this week. The Government's intention is to hold the increase in the overall public sector to the range of 6-8 percent in May.

The authorities have been making progress in implementing structural reforms in the official financial system. The portfolio of the National Mortgage Bank has been transferred to Banco de la Nación, as planned. Also, on May 4 the authorities announced closure of the retail operations of the National Development Bank (BANADE). The remaining functions of that institution are to be restructured. Furthermore, the effort to reform the charter of the Central Bank has regained momentum; responsibility for activities not strictly related to monetary management--for example, financing external trade--are to be transferred to other agencies, which will be expected to operate on a commercial basis. The office of a Superintendent of Financial Institutions is being created with strengthened powers of banking supervision, and an agency is being established to provide deposit insurance to the financial system, which, up to now, has been provided by the Central Bank.

Mr. Feldman made the following statement:

My authorities are very grateful to management and the staff for the invaluable collaboration and support given during the recent critical months when Argentina's economy was under severe strain. The Fund mission that stayed in Buenos Aires during long and difficult weeks provided the permanent encouragement and technical assistance to Argentine officials faced with the need to adopt painful, albeit unavoidable, measures. These decisions were required to move the country once again away from the dangers of hyperinflation and from the potential social instability it might entail.

Since the last meeting, in November, Argentina reached a very critical political and economic juncture, including two hyperinflationary bouts, in late December and late February. Economic events of recent months are well described in the staff report, and I do not need to repeat them. My authorities are also in broad agreement with the staff appraisal, so I will concentrate my remarks on the thrust of the modified program and on relations with external creditors.

It should be recognized that even in the most critical moments and despite serious difficulties in consolidating the stabilization efforts, the Government never gave up its aim of seeking a more market-oriented economy, liberalizing different economic sectors and activities, and redefining the role of the State through privatization and deregulation. As regards the challenges faced in the short run, the authorities have not ceased to acknowledge, and are acting on the basis, that stabilization and macroeconomic discipline are prerequisites for the effective implementation of structural reforms and the return to a path of sustainable economic growth in the context of external viability.

Despite some deviations experienced some months ago, my authorities believe that the adjustment effort has been a "continuum" that started last July when the new Administration launched its economic program. Thus, the objectives of the original program remain today basically the same, namely, to reduce inflation to very low rates toward the end of 1990, to lay the basis for sustained growth while attaining external viability, and to re-establish relations with external creditors. To achieve these objectives the Government is prepared to deepen the fiscal adjustment and to continue with very strict monetary and public sector wage policies. Moreover, the Government is making every effort to accelerate the pace of structural reforms.

Fiscal policy continues to be the centerpiece of the current economic strategy. The primary fiscal balance is projected to shift from a small deficit in 1989 to a substantial surplus, of about 5.6 percent of GDP, for 1990. This target is indeed very ambitious, but the results that have been obtained so far are encouraging. When compared with the original program projections, the improvement in the fiscal accounts, while still stemming mostly from an increase in revenues, can now also be explained by a significant reduction in expenditures. In fact, real wages in some areas of the public sector are so compressed that there is concern about their sustainability. That is an important reason why my authorities are tackling with strong determination the problem of overstaffing in the public sector. They are tackling this problem with a view to both increasing efficiency and generating some budgetary margin for a recovery in real wages.

There has been an impressive turnaround in the economic situation since early March; the rate of inflation has decelerated more quickly than had been expected when the program was reinforced, and the Central Bank has been able to start replenishing the stock of international reserves. The Central Bank has been purchasing reserves by injecting liquidity--as economic agents seem to be willing to rebuild somewhat their holdings of australes from very low levels--and with the backing of a growing primary fiscal surplus. The reasons for this change in market sentiment cannot and should not be traced to any single measure or government decision. Rather, the early March turnaround can be seen as the positive response of the markets to the buildup of a kind of "critical mass" of measures, mainly in the fiscal area, but also complemented by the restrictive credit policy implemented since the beginning of February. This critical mass, which includes the Economic Emergency Law and the Law of Reform of the State implemented at the outset of the program, and the more recent tax reform legislation of last December, was reached by the enactment of omnibus Decree 435 of March 6. This decree, together with some subsequent decisions adopted in March and April, helped significantly to contain public sector expenditures, to increase tax revenues to improve management control of public enterprises, and to accelerate the implementation of structural reforms. This set of measures has been of fundamental importance for a change in market expectations and for the consolidation of the fiscal effort.

Although the revised program is strong and some very positive results have already been achieved, there are several critical areas where considerable uncertainties and risks still remain. My authorities are well aware of these difficult aspects of the program, which include the management of public enterprises, the implementation of tax administration reforms, and the financial relationship between the provincial governments and the central Administration. My authorities are seriously tackling and making a response to these issues and are firmly committed to take all the necessary steps to safeguard the objectives of the program.

Apart from the bold determination of the authorities to carry out the program and the growing support to the program from the population, which has undergone once again the traumatic experience of hyperinflation, there are other strong reasons to believe that the adjustment effort will not be frustrated. First, the primary fiscal surplus is steadily growing over time, and the Treasury has not resorted to central bank financing for many months. Second, after the forced conversion of time deposits and public domestic debt, the domestic component of the quasi-fiscal deficit no longer exists, eliminating in this way a large source of money creation and of financial instability. Third, the present economic adjustment is being carried out in the context of a unified floating exchange rate, wages in the private sector determined by free collective bargaining, and market-determined interest rates and prices; hence, the risks related to the "day after" lifting of price and exchange rate controls do not exist this time. Finally, there have been unquestionable advances in the implementation of structural reforms, reflected, for instance, in the timely fulfillment of the schedule for privatization and in the dismantling of trade restrictions.

Obviously, many of the achievements mentioned above are not without costs. Just to mention a few of them: the absence of nominal anchors--which could not credibly be applied in these circumstances--has entailed large costs in terms of output loss and low real wages and might involve, until the fiscal adjustment is fully consolidated, short periods of price and financial instability. Second, the forced conversion of financial liabilities implies that the Government has lost, perhaps for a rather long period, its ability to borrow from domestic sources; it also implies that remonetization can be expected to proceed very slowly. Finally, the forced conversion and the fall in the demand for financial assets denominated in australes have implied that "banking output" has shrunk, making the restructuring of the public and private financial institutions more urgent than ever. Steps already taken with the National Mortgage Bank and the National Development Bank point in that direction.

Finally, my authorities attach utmost importance to the objective of regularizing the relations with external creditors. As is described in the staff report, Argentina has made considerable progress in re-establishing relations with official creditors and multilateral institutions, including an agreement under the aegis of the Paris Club and the elimination of arrears with the IBRD and the IADB. Now, the authorities have restarted discussions with commercial bank representatives--which were initiated in late 1989--with the intention of seeking understandings about financing and phased market-based debt and debt-service reduction. Given the very heavy debt burden that the country faces and the urgent need to create conditions for investment, capital reflows, and sustained growth over the medium term, the Government has considered it necessary to incorporate at this stage debt and debt-service reduction in its negotiations with banks. As evidence of the importance that my authorities attach to achieving the earliest possible regularization with commercial banks, a request has been made to include set-asides from the Fund in the present stand-by arrangement, and waivers from the banks to allow for debt and debt-service reduction operations will be also requested. In addition, they have already requested the waivers needed for privatization, and they have expressed their intention to seek, in the framework of the negotiations, understandings on the resumption of partial payments of interest on the medium- and long-term bank debt.

The Chairman said that there was clearly some concern about Argentina's track record, to which management and staff had given considerable attention. In addition, the staff had addressed the matter with the authorities in the preparatory stage of the current arrangement for Argentina. The proposed program was indeed a forceful one, and many major measures were already in place. Despite the serious pressures on them, the authorities had continued their efforts to expand the scope of market forces and to provide the basis for stabilization. Moreover, provision had been made for a three-month period of testing before the proposed program was brought to the Executive Board's agenda.

Of course, a program as ambitious as the proposed one was not without some risk, especially as it sought to solve many long-standing and deep-seated problems, the Chairman went on. Also, much remained to be done to ensure that the objectives of the program could be achieved. However, the staff had developed a good and close working relationship with the authorities that offered considerable promise for the future.

He was aware that some Executive Directors would have preferred an even longer testing period, the Chairman remarked, and staff and management had given considerable thought to that possibility. It was important to recognize that extending the testing period would place considerable strain on the authorities, as tangible signs of external support for their adjustment efforts were not yet evident; how and when the Fund acted would affect the support provided by other creditors.

The contents of the letter from the Vice President of the Central Bank and of the telex from the commercial banks' Working Committee for Argentina, as well as recent discussions with those involved in the preparation of those communications, led him to feel satisfied that a spirit of cooperation had been developing, the Chairman continued. However, the communications also revealed the strains in relations and the difficult problems that still had to be solved. The situation clearly would have to be monitored very closely, and the degree of cooperation shown by the authorities would have to be assessed at the time of the next review under the stand-by arrangement.

Mr. Feldman said that he agreed with the Chairman's opening comments. His authorities were fully aware of the need to re-establish a sound track record and to persevere with their present adjustment efforts. Their program had been reinforced and had been monitored closely and continuously. His authorities believed that, in the circumstances, it would be appropriate for the Fund to support their program.

Mr. Jácome made the following statement:

> A few months ago, this Board approved a stand-by arrangement in support of the economic program adopted by the new Government at the beginning of its term of office to cope with a severe inherited economic crisis. After three months of successful results in terms of inflation and exchange rate stabilization, the program started to fail owing to the delay in the adoption of certain policies--mainly fiscal measures--and to the premature rise in wages both in the public and private sectors. The

uncertainty created and the excess demand generated undermined the credibility of the program, leading to exchange rate instability and, hence, to a dramatic increase in the inflation rate. In this context, most performance criteria for end-December 1989 were not observed in spite of some adjustments carried out in December, mainly in the external and public sector price areas.

During the first part of 1990, the economic authorities persevered in their efforts to stop inflation and put the program back on track to recover credibility. In our opinion, most of the economic developments in this period were driven by the decision to transform the austral-denominated bonds and term deposits in the banking system into ten-year U.S. dollar-denominated government bonds (BONEX) at LIBOR.

This decision was adopted to eliminate the inflexibility of monetary policy. Until that decision, an initial monetary contraction leading to high interest rates determined in the end an expansion in net domestic assets owing to the need to finance high real interest rates on compulsory deposits of the banking system in the Central Bank. As an immediate result, this decision led to the reduction of the domestic monetary base to sustain a tighter financial policy. However, this decision also implied economic costs. The private sector lost even more confidence in austral-denominated assets and, hence, shifted its demand to foreign exchange, provoking a fast depreciation of the domestic currency and, therefore, an increase in the inflation rate.

It is only after three months of persistent financial restraint, and after the fiscal package adopted at the beginning of March, that the program has recovered the confidence of the public. The rate of price increase slowed down and the austral appreciated in nominal terms. This allowed the Central Bank to make net purchases of foreign exchange and recover a higher level of international reserves. In these circumstances, the Argentine authorities are asking again for the support of this Board, with the aim of consolidating a positive domestic environment in favor of the economic program, and normalizing their relationship with external commercial creditors after two years of interest payment suspension.

In this connection, performance criteria for 1990 have been reviewed, although macroeconomic objectives remain the same, with the exception of output growth, which is expected to be less than 1 percent, and not 5 percent as originally planned. Structural changes are also expected to continue to be implemented, to stimulate better use of economic resources and--eventually--a faster rate of economic growth. We are in broad agreement with the program objectives and with the analysis developed by the staff in the paper before us. However, we would like to stress some issues that we consider crucial for the success of the program.

It is clear that a key element in the stabilization of the Argentine economy is achieving fiscal equilibrium. The present situation, although it has improved, is still precarious, so further slippages again could develop negative expectations leading to foreign exchange demand, depreciation of the domestic currency, and, hence, to a revitalization of inflation. In fact, the link between the exchange rate and the fiscal position is today even stronger, since the service of the BONEX in terms of domestic currency will be greater, the higher the austral depreciation. In this regard, we welcome the strong commitment shown by the Argentine authorities to proceed with the fiscal adjustment, including a more efficient management of public enterprises and their possible privatization.

In addition, the success of the economic program requires that a safe level of international reserves be rebuilt to reduce the vulnerability of the program. This objective places the Argentine authorities in a difficult dilemma, since, at the same time, they intend to normalize their relationship with commercial creditors to favor debt-equity conversion plans--in association with the privatization of some state enterprises--and a program of phased debt and debt-service reduction. We are of the view that the level of reserves is vital to the success of the program and any interest payments must take this into account. It is to the benefit of all parties first to consolidate the stabilization of the Argentine economy.

Consequently, we are convinced that this Board must support the Argentine program. The authorities have signaled that they are seriously committed to adjusting the economy and implementing a far-reaching program of structural change, in spite of political obstacles. We support the proposed decision.

Mr. Dawson made the following statement:

Today's discussion of the proposed modification of Argentina's stand-by arrangement naturally calls to mind the Fund's experience with the original, very short-lived program we approved last November. Notwithstanding some promising signs of economic stabilization at the time of the program's approval, important policy slippages--and the authorities' failure to take sufficiently strong measures to correct them--contributed to an immediate derailment of the program. In retrospect, that experience illustrates all too clearly the consequences of doing "too little, too late."

I believe that everyone wants to avoid a repetition of last year's unfortunate experience, but all parties will need to do their part. Clearly, responsibility begins with the Argentine authorities to put effective stabilization and structural adjustment policies in place and to stand ready to take additional measures, as needed, to keep the program on track. In this regard, it is encouraging to see that in recent months the authorities have begun to build a track record of policy performance. The March 6 package, followed by a number of reinforcing revenue measures, has inspired some renewed confidence in economic management, as seen in the strengthened exchange rate since March. Inflation has declined dramatically from its February level, and a modest primary surplus appears to be emerging. These developments have, in turn, permitted a significant reserve buildup and repayment of arrears to other multilateral institutions. This is a promising, but nevertheless fragile, beginning, which the authorities will need to work hard to preserve and enhance.

We recognize that this will not be an easy task. The revised program relies predominately on fiscal adjustment, which in many respects was an Achilles heel of the original stand-by arrangement. Moreover, the degree of adjustment required under the revised program to meet the primary surplus target is greater than that sought under the original stand-by arrangement, suggesting that the targeted adjustment will be all the more difficult to achieve.

Strict policy implementation will be crucial, and difficult issues will have to be tackled head on. We see various risks to the fiscal program, which, if they materialize, would probably require additional action to meet the ambitious fiscal target. Among these risks I would include the following: the possibility that the extension of the value-added tax to services could be further delayed; the chance that, for other reasons, revenues will fall short of expectations; the possibility that reductions in government staffing levels will be insufficient to accommodate future salary adjustments. I hope that the authorities will press ahead in all these areas. But if the results fall short of expectations, then they must be prepared to take additional corrective actions promptly, including raising the value-added tax rate, if necessary.

Tough decisions also need to be made with regard to the public sector enterprises. As is noted in the staff report, there is no room in the program for further delays in the privatization and divestiture programs, and more strenuous efforts are needed to streamline and improve the financial management of those entities remaining in the public sector. All of these actions will require a large measure of political will, without which the program risks going the way of its predecessor.

The exercise of monetary policy has been severely hampered by the forced conversion of financial assets into BONEX and the public's current reluctance to hold austral assets. If the program is successful, we would expect this reluctance to diminish and the effectiveness of traditional policy instruments to increase. The key to a long-term improvement in monetary policy implementation, however, lies in the independence of the Central Bank. We understand that legislation to this effect drafted last year has yet to be acted upon; perhaps the staff or Mr. Feldman could comment on where this stands.

In addition to ensuring appropriate policy implementation, we believe that Argentina also has a responsibility to begin making regular payments to commercial banks. The program provides for a substantial increase in gross reserves, which can accommodate significant payments to banks. We welcome Argentina's commitment to make a first such payment prior to the June 7 meeting with banks, and we expect a schedule of future payments to be worked out promptly.

The Fund also has an important role to play if this latest attempt at economic stabilization is to succeed. Although we would all be happier, under the circumstances, if there had been more time to establish a track record, it is difficult to see how Argentina could sustain its adjustment effort without the international support that a Fund program can catalyze. In this connection, I understand the reservations of a number of Directors concerning financing assurance. We agree that it would be preferable if the banks and the Argentine authorities were farther along in their negotiations. However, we are encouraged by their initial progress. Important groundwork for negotiations is being laid in talks at the technical level in Buenos Aires. Moreover, the agreement between Argentina and the banks to resume negotiations on June 7, and Argentina's commitment to a significant payment prior to that date, are evidence of goodwill on both sides to work toward a comprehensive package. I think that this is the essence of our policy on financing assurances. It goes without saying, however, that we will want to examine the progress of negotiations thoroughly in the next Board reviews of the program.

Given Argentina's pressing need for debt-service reduction, it is appropriate, in our view, that the program include set-asides in the three final drawings, so that Argentina can begin accumulating enhancements for this purpose. Although our approval of these set-asides today would come at an earlier stage for

Argentina than for some other countries we have considered, I do not see any risk to Fund resources in our doing so. The first effect is to reduce Argentina's immediate access to Fund resources under the program pending conclusion of a commercial bank package. Moreover, it should be recognized that there are a number of conditions that Argentina will have to satisfy before it will have access to these resources. First, conclusion of a commercial bank package is likely to depend on Argentina's commitment to a strong, medium-term reform program. In addition, we understand that Argentina would need to be in compliance with a Fund program and to return to the Board for final approval to use these set-asides. I think that these safeguards provide more than adequate protection for Fund resources.

In conclusion, we recognize that there are a number of risks involved in this program, but there is also much to be gained if, with Fund assistance, Argentina can consolidate the recent signs of economic stabilization and begin to make the necessary structural adjustments in its economy. I hope that when we look back on this revised program, we will not see another case of "too little, too late," but an example of "enough" and "in time." With strenuous efforts on the part of authorities, and the support of the Fund, important progress can be made. We can support the proposed decisions.

Mr. Goos made the following statement:

I can endorse what Mr. Dawson said in his intervention on the derailment of the existing adjustment program. This derailment is all the more regrettable considering that the program was widely, and rightly so, acclaimed as a bold and promising departure from the history of more modest and unsuccessful adjustment efforts in Argentina. I am very concerned now that the renewed program failure might have eroded much of the credit the new Administration has enjoyed among market participants in regard to its ability to bring about a fundamental and lasting improvement in Argentina's economic and financial situation. This concern is highlighted by the vigorous adverse reaction of capital flows, inflation, and interest rates to the recent weaknesses in program implementation, suggesting that patience is already wearing very thin, and that the Government's performance has come under severe scrutiny by the markets.

Therefore, the Government would be well advised to do everything possible to nurture the signs of confidence that have re-emerged in response to its revised adjustment program. I firmly believe that the authorities cannot afford to allow confidence to be frustrated again. Too much is at stake: the manageability of

Argentina's economic and social system; the prospect for eventual normalization of Argentina's creditor relationships in an orderly process; and last, but not least, the credibility of the Fund and its ability to effectively assist the country in its future adjustment efforts. Hence, I fully endorse the staff's advice in its appraisal that "it is important that the authorities implement their strategy fully and in a timely fashion, and that they respond quickly to any signs of departure from the program."

However, this sort of advice has, of course, quite a familiar ring in the Argentine context, and so far it has not been terribly efficient in ensuring the success of Argentina's adjustment efforts. Therefore, I found it a regrettable and, indeed, worrisome shortcoming of the modified arrangement that the progress envisaged has not been secured to a larger extent than is actually the case through the implementation of prior actions. There can be little doubt--and here I agree with the Chairman's assessment--that the measures envisaged under the modified program constitute a bold and ambitious adjustment effort, but it is equally obvious that, in a number of respects, those measures will place extraordinary demands on the authorities' implementation and monitoring capacity. The resulting risks and uncertainties in crucial policy areas have also been clearly acknowledged by Mr. Feldman, and it is a cause for serious concern that, according to press reports and other information available to us, the Government's wage policy has already run into stiff opposition by several trade unions, with work stoppages and slowdowns by approximately 1 million private and public workers. Moreover, as I understand it, the assumption of control over public enterprises by the central Administration is proceeding at a slower pace than envisaged under the program. All this serves to underline further the staff's call for a flexible implementation of the program and the crucial importance of the authorities' intention to take any additional measures that might be required to deal with adverse developments.

Such a flexible approach would also appear to be highly advisable when it comes to exchange rate policy and the desirability of maintaining stable exchange rate developments. While it is regrettable that the authorities had to abandon the fixed exchange rate regime as a monetary anchor--particularly as the program does not provide for effective substitutes--I have some difficulty with the stated undifferentiated intention that exchange rate market intervention under the floating regime should be guided by the balance of payments objectives, including the need to meet public external obligations and the programmed increase in official reserves. This policy prescription needs some qualification, as, at least as I understand it, it would allow such interventions to take place even in situations when the austral is under downward pressure. In such circumstances, the prescription would tend to be destabilizing, particularly as the Central Bank lacks effective instruments of open market operations to control the domestic liquidity created by the purchase of foreign exchange. Therefore, the success of exchange rate and balance of payments management will critically depend on a strong and credible orientation of financial policies, including, notably, an interest rate policy with a view toward maintaining exchange rate stability. In this context, and for well-known reasons, I should also advise against the envisaged gradual depreciation of the austral. Shortcomings in the external competitive position should be corrected by one-time-only devaluations.

I should like to note in passing that the recent large-scale redemption of austral-denominated government paper seems to vindicate our reservations about the concepts of the operational and primary budgets as useful guides for the formulation of fiscal policy. Since there is no reference in the paper to what we believe is the more relevant concept, namely, the public sector borrowing requirement, I would appreciate hearing some information from the staff on recent and prospective developments with respect to that requirement. In this context, I, like Mr. Dawson, recall plans of the authorities, mentioned in the previous staff paper, to make the Central Bank independent from the Executive Branch, and I wonder whether those plans are still under consideration. Early adoption of the necessary legislation could make a most important contribution toward a lasting improvement in domestic and external confidence.

Turning now to the difficult subject of the financing of the program, our concerns about the proposed strategy toward commercial bank financing are well known, and I wish to reiterate briefly the main issues that we already mentioned during the previous discussion. First, the explicit provision for the accumulation of arrears to the banks over the whole program period, and possibly beyond, is inconsistent without existing guidelines on financing assurances. Second, the guidelines continue to make outright Board approval of Fund arrangements contingent on the requirement that negotiations with banks have begun. The intention of this prenegotiation requirement, so to speak, was of course that the meetings prior to the Board approval should provide the basis for a well-considered assessment of the financing prospects.

Now, looking at the traditional negotiations ritual between debtor countries and the banks, it is, at least to me, quite obvious that the results of the first exchange of communications a few hours or days before the Board meeting cannot provide much insight into the banks' financing plans. Generally speaking, in most, if not all, cases, it should be possible to provide for a sufficiently long interval between the initiation of bank negotiations and actual Board consideration, and I fail to see why this should not have been possible in the case before us with a more appropriate timing of this Board meeting and perhaps greater efforts on the part of Argentina to enter into a timely dialogue with its creditor banks.

Taken all together, it appears to me that outright approval of the request before us would at least stretch the existing guidelines on financing assurances to the limits and would also be difficult to reconcile with the spirit of our arrears strategy. At the same time, we acknowledge the potentially serious effects that nonapproval might entail for Argentina. So we are apparently being confronted, and I feel to a large extent unnecessarily so, with the awkward dilemma of having to choose between the interest of a member country and the interest of this institution.

On balance, we are prepared to support the proposed decisions, although with great hesitation. In doing so we place particular emphasis on the commendable payments performance vis-à-vis the Fund of the Argentine authorities during the recent crisis of confidence, and we are willing to follow--for want of a more satisfactory alternative--the Chairman's favorable interpretation of the exchange of communications, and the readiness of the banks to seek a solution to Argentina's financial problems. Our support is also based on the expectation that, should it become apparent that adequate financing is unlikely to be forthcoming, the possible need for offsetting measures would be discussed with the authorities and the results reported to the Board as necessary. Here I welcome the Chairman's assurances given at the beginning of the meeting.

With these observations, I can endorse the staff appraisal and the proposed decisions.

Mrs. Filardo made the following statement:

In assessing the recent economic history of Argentina one realizes that for many years, and especially during the past decade, there have been multiple attempts by the authorities to stabilize the economy, return to a path of sustainable economic growth, and reach external viability. For at least the past six years, various plans have been put into effect, including the "Plan Austral," the "Plan Primavera," and the Menen Plan. Although all of them have started out on the right foot, they were hardly able to reach the goals envisaged in the different programs. On the contrary, inflation, one of the fundamental problems in the country, rebounded vigorously, economic growth declined, the external sector deteriorated, and external arrears accumulated. These failures in the implementation of economic policies would seem to be the result of long-term embedded structural problems and probably excessively ambitious economic programs.

The economy has faced a number of structural problems. There has been a long history of a very large nonfinancial public sector deficit, financed mainly through money creation when external financing has failed, probably as a result of overambitious fiscal targets when rigidities have existed in the execution of expenditure restraint or when increases in revenue and structural policies were required. In addition, there has been a long history of wage indexation and structural problems in trade, the financial sector, and the implementation of exchange and monetary policies, and they have not been adequately addressed in the context of the different programs. Another structural problem has been the lack of synchronization of policy implementation, probably because the needed reforms, which are of a deep-seated and comprehensive structural nature, require more time than a year in order to complete the whole process of assessment, passing of legislation by Congress, and, finally, implementation. There is also a considerable debt overhang, which urgently needs to be reduced.

In relation to the different economic programs that have been implemented in recent years, probably President Menen's program has been and continues to be one of the most ambitious ones. For the first time, there seems to be a strong determination on the part of the Government to make every effort to implement a comprehensive adjustment program to stabilize the economy, return to a steady economic growth, and re-establish external viability and make the necessary corrections when problems emerge in the implementation of policies. So far, all relative prices have been liberalized: the exchange rate, domestic prices, and interest rates; the primary fiscal balance would seem to have entered into surplus; and real wages are compressed. The question is how to maintain momentum in the process of adjustment and ultimately stabilize the economy. As Mr. Feldman has indicated in his very frank statement, "there are several areas where considerable uncertainty and risk still remain." In this connection, I will make some comments and pose some questions, especially to the staff.

With regard to fiscal policy, which remains one of the greatest risks in the program, we wonder whether the fiscal correction will be reached, as it depends mainly on the increase in revenues and all these measures require legislation. Other measures, like the improvement of tax collection and of financial performance of state enterprises, privatization, and the reduction of transfers to the provinces, probably require a long time to be addressed properly. Similarly, reduction in expenditure implies a restraint in salaries and the reduction in the size of the public sector through staff cuts and public sector restructuring. These two measures are costly and also demand time. Then, as Mr. Feldman has indicated, probably the primary fiscal balance target is too ambitious. The question remains whether what the authorities expect to accomplish under a one-year program is realistic. We would like the staff to comment on how it envisages that this process will unfold. It will also be important to obtain information regarding the results of the technical assistance mission on the fiscal area.

In the area of monetary policy, while it is commendable that the authorities have eliminated the quasi-fiscal operation of the Central Bank, we have various questions relating to the mechanism employed. It would seem that the unilateral conversion of domestic debt into a medium-term external debt raises doubts about the viability of this procedure, especially when one is looking for strengthening in the implementation of monetary policy and the strongest instrument is precisely open market operations. If the potential of this instrument is lost, the Central Bank's capability to implement monetary policy could weaken, as was previously the case. Then the question is, what would be the best way to eliminate the quasi-fiscal losses of the Central Bank without impairing its main role of implementing a sound monetary policy. Another issue is that while the authorities eliminate quasi-fiscal operations in the Central Bank, the fiscal deficit has probably increased, because, in general, these operations are hidden and not properly registered and, if converted into dollars, the ultimate amount will depend on how the domestic currency evolves in relation to the dollar.

The other problem is that, although the Government cannot issue domestic debt, that does not mean that the deficit cannot be financed domestically. It could probably be financed through the accumulation of arrears within the Government itself and within the public enterprises. Another alternative will be an increase in the accumulation of arrears with the international banking community. I would like the staff to comment on the pros and cons of this mechanism. It would also be useful to evaluate whether, at this juncture, when the economy has not yet been stabilized, initiation of a financial reform would be appropriate.

The stabilization of the Argentine economy is of fundamental importance, but the reduction of the debt overhang is crucial for re-establishing confidence in the country and placing the economy on a reasonable path of growth. We wonder how long it might take to re-establish economic growth, when the kind of measures to be implemented imply restraint in domestic aggregate demand and a reduction of staff in the public sector, and when privatizing or restructuring state-owned enterprises would take place. I wonder whether, in the program of November 1989, the staff was not too optimistic in projecting economic growth of nearly 5 percent for 1990. Then, if unemployment is to proliferate, given the social and political unrest the country has been facing, which measures are contemplated in the context of the program to dampen the impact of adjustment?

In spite of all the risks the program faces, my authorities would like to reiterate to the Argentine Government our full support and to encourage that Government to continue with the implementation of the economic program. We also urge the international community to support Argentina in its request of debt and debt-service reduction consistent with the program. It is encouraging that the Chairman of the Bank Advisory Committee has scheduled a meeting with the Argentine authorities. I only would like to ask for further comment on the procedure utilized for debt-equity conversion as one of the main sources of finance during the program period. Finally, we support the proposed decisions.

Mr. Cirelli made the following statement:

We are facing today a very difficult situation. Let me say, at the outset, that in view of the present circumstances and the courageous measures which have been implemented in Argentina, this chair supports the proposed decisions.

We must acknowledge that the authorities have taken important and bold measures in reaction to the crisis situation which emerged at the end of last year, and this in particularly difficult circumstances. In particular, a far-reaching monetary reform has been implemented and a new fiscal package has been adopted in recent months.

However, as Mr. Feldman himself noted, "there are several critical areas where considerable uncertainties and risks still remain." Indeed, some issues are a source of concern to my authorities. I will comment first on the content of the program before turning to the overall financing package and the use of Fund resources.

As to monetary policy, the authorities have launched a monetary reform of great importance in order to regain control over inflation. The compulsory conversion of all austral-denominated bonds and term deposits in the banking system eliminated a large source of money creation and thus broke the hyperinflation mechanism. Moreover, the conversion operation led to a consolidation of the public debt, which was mostly of a short-term nature.

However, this operation has many other consequences. First, it totally changes the behavior of the demand for money, since private agents do not now hold significant amounts of australes but only working balances of strictly limited amounts. As a direct consequence, the buildup of reserves cannot result from the spontaneous conversion of dollars by private agents, which would come back to the austral, but can only depend on fiscal policy. Indeed, when private agents have to pay their taxes, they must draw down their balances in foreign currencies. The net tax levied on the private sector, which results from the primary surplus, must then lead to a compulsory conversion of foreign currencies. This underscores how indispensable it is to reach a fiscal surplus in order to allow the reserve to be replenished.

But as a result also of these changes monetary policy instruments have now a limited effectiveness, and the authorities have lost, for a certain period, the possibility to borrow from domestic sources and have no further access to noninflationary sources of financing.

All these elements underscore that fiscal policy is more than ever the centerpiece of the adjustment process. When we examined the program last November, this chair insisted on the ambitious target as well as the heavy reliance on the revenue side, which was expected to generate an amount equivalent to 8 percent of GDP. I note that the objective of a primary surplus of the public sector, while revised somewhat downward, is still very ambitious, and that in order to attain this target more effort should come from the expenditure side. The measures adopted since the beginning of March are certainly encouraging; nevertheless, to attain the ambitions of the program, a forceful implementation of recent measures is all the more appropriate, particularly the tax reform. In adopting a reform that allowed the broadening of the base of the value-added tax to virtually all goods, the authorities have made a valuable step. I note, however, that expanding the services sector is still pending parliamentary approval, and I would appreciate some information from the staff on the prospects in this area. In the same vein, the Executive Branch should use its margin of maneuver to change the value-added tax rate it has obtained.

On the expenditure side, the authorities are aiming at a reduction equivalent to 1.2 percent of GDP. I particularly welcome the measures undertaken to address the problem of overstaffing in the Argentine public sector and, more generally, the overall performance of the public enterprise sector, which will have far-reaching consequences in the medium term. However, in the short term, expenditure reduction will rely heavily on a restrictive wage policy, which could prove to be especially difficult, as wages are at a historically low level. I would appreciate some comments from the staff on this issue, as this is certainly a major source of uncertainty in the program.

Regarding the program of privatization, I approve the authorities' intention. However, a very ambitious target for 1990 has been set, and I would appreciate comments from the staff on how it can be realized. First, on the legal side, what is the time frame contemplated to obtain from the banks the necessary waivers to undertake the privatization process? Second, in the present circumstances, what are the prospects of finding enough buyers to fulfill this objective?

I would like to briefly raise the question of exchange rate policy. In the very special situation of the almost complete dollarization of the economy, I wonder what are the determining forces behind the exchange rate, particularly given the recent swings in the value of the austral. Does the exchange rate still have a real meaning for the conduct of economic policy? I would also appreciate the thoughts of the staff on its possible link with monetary policy.

I will now turn to the overall financing package and the use of Fund resources. First, on the question of financing assurances, we face, once again, a very difficult situation. Our guidelines provide for granting approval when negotiations between the member and its bank creditors have begun, and a financing package consistent with the external viability is to be agreed upon within a reasonable period. One must recognize that we are somewhat far from that, even if the communications that have been circulated prior to the meeting clearly show a new spirit of cooperation. I do not question the attitude of the banks or the authorities, but it is clear that we do not have precise prospects.

As to the financing package, I will make three comments. First, I note that the arrears to commercial banks have now attained a very high level, and that the prospect of eliminating them is very dim. Furthermore, since partial payments will be made this year to the banks, one must consider, which is not at all clear when reading Table 10, that the arrears will still grow. I would appreciate comments on the prospects for eliminating these arrears.

Second, I would like to raise some technical questions, again on Table 10, particularly on the significant changes in the balance of payments projection for 1990. In this table, the contribution of direct investment and export financing has been reassessed and would yield $1.2 billion more, of which an improvement of $1 billion is in trade financing. I would appreciate some comments from the staff on these figures.

Third, in the present circumstances, we welcome the authorities' intention to resume regular payments to banks. Given the fiscal and balance of payments constraints, and the utmost necessity to bring back a normal situation of reserves, I believe that we cannot but accept the fact that Argentina should make partial payments to commercial banks and thus further increase its arrears during the negotiation period. We hope that the negotiations will proceed as expeditiously as possible, and that substantial progress will have been completed at the time of the next review, even if a "phased approach" could be contemplated.

With these comments, and given the fact that Argentina has so far successfully managed to remain current with the Fund, we could approve the proposed decisions in spite of the risks it entails.

Mr. J. E. Ismael made the following statement:

I regret to observe that the new Government's far-reaching macroeconomic and structural adjustment program, which was supported by the present stand-by arrangement, had to face the plight of policy slippages, similar to all the other previous adjustment efforts. It is, in particular, regrettable that most performance criteria under the stand-by arrangement for end-December 1989 and end-March 1990 were missed by wide margins. In this context, I fully agree with the staff that, once again, the recent slippages encompassing fiscal, monetary, and incomes policies cast considerable doubt on the durability of the authorities' adjustment program.

It is quite clear that more and stronger efforts would now be needed if credibility and public confidence in the authorities' adjustment program are to be re-established. I welcome Mr. Feldman's assurance that his authorities will continue to act on the basis that stabilization and macroeconomic discipline are prerequisites for effective implementation of structural reforms and for a return to sustainable growth and external position. I also welcome the authorities' most recent efforts to strengthen their economic policies, which have been followed by an impressive turnaround in the economic situation, including, in particular, the deceleration of inflation and the buildup of international reserves.

Nevertheless, progress has only been under way for a very short period, and there is, of course, no guarantee that it can be sustained over a longer time frame. In the meantime, I note with concern from Mr. Feldman's statement that considerable uncertainties and risks still remain in several critical areas, including in the implementation of tax administration reforms, the management of public enterprises, and the financial relationship between the central and provincial governments. As these are some of the areas where progress has been quite slow, I am pleased that the authorities are prepared to take all the necessary steps to ensure the attainment of these objectives.

Having said this, I would only like to make a few brief comments regarding the proposed modification of the stand-by arrangement. In light of the significant divergence between the prevailing situation and the one envisaged under the original program, one might suggest that an introduction of a totally new program--a stand-by arrangement or an extended arrangement--might be more appropriate compared to a modification of the present stand-by arrangement.

Let me elaborate somewhat on this matter. First, I generally agree with the authorities and the staff that the objectives of the proposed revised program are basically the same as those of the original one--namely, to reduce inflation significantly and to lay the basis for sustained growth with external viability. However, the economic situation now is much worse than was expected when the original program was designed and approved. Output growth for the current year is now expected to be minus 1 percent, compared with positive growth of 4.5 percent projected under the original program. On the inflation front, despite a sharp decline expected for the second half of the year, the annual average of inflation for 1990 is expected to remain about 2,000 percent, compared with 125 percent expected in the original program. Although 1990 is expected to be generally better than the previous year, the present program, nevertheless, represents a "postponement" of the original program for about a year.

Second, there might be an important need to reconsider the stance as well as the mix of fiscal, monetary, and exchange rate policies, as a result of the forced conversion of financial liabilities at the beginning of this year. As rightly stated by Mr. Feldman, this policy implies that the Government has lost its ability to borrow domestically, and that monetary policy might need to take fully into account the fall in the demand for financial assets as well as the expected slow process of remonetization. A totally new program, in my view, is more likely to be able to incorporate all these developments, compared with a modified program, which is now presented before us.

Finally, I agree with the authorities that, given Argentina's heavy debt burden, it is important to incorporate debt and debt-service reduction in their ongoing negotiations with the commercial banks. All outstanding disputes, including one on interest payments, standing in the way of such an agreement should therefore be resolved soon.

I can go along with the proposed decisions.

Mr. de Groote made the following statement:

We all seem to agree this program is one of the most difficult ones we have before us, difficult for management and the staff because of the difficulty in negotiating it, and difficult for the Board because if we looked at it in isolation and on purely technical terms, we might probably all be tempted not to accept it. But we somehow have to look at it on a judgmental basis, taking into account the fact that it represents something quite different from its technical content on different grounds: first, given the general political evolution in this country and in neighboring countries; second, because we have to look at it as a step in the continuous process of the rehabilitation of the Argentine economy; and, third, because it is an absolutely necessary precondition for external financing from other sources.

In agreeing with the request, I have been especially impressed by a number of elements. First, there was a period of testing, and the testing was on the whole successful during that period. Second, Mr. Feldman has made it clear that the authorities recognize the great weaknesses of the program and thereby admit that much still has to be done. And I do not detect in the presentation some of the self-justification that was present sometimes at previous stages in the program, and I was especially impressed by the fact that I could understand from Mr. Feldman's statement that the authorities recognize that stabilization and macroeconomic discipline are the necessary preconditions for growth, and that the financial relationships between provincial governments and the central Administration have to be drastically improved. Third, it is necessary to introduce additional reforms in the financial sector to be able to protect the exchange rate against possible pressures.

Argentina's experience in implementing the program certainly shows that the ability to implement short-term measures greatly depends on the speed of action in the structural area, and a number of examples made this quite clear. First, it is quite clear that without incurring the cost of correcting the financial sector, there is very little possibility of success in the fight against inflation. Second, unless tax reform is implemented quickly, there is also little possibility to be successful in increasing tax collection.

Another area where the link between the possibility to implement a demand-management program and structural adjustment is very obvious is reserve reconstitution. This is one of the main objectives of the Government, and it is strongly supported at the center of this program, and I agree with that. But this aim cannot be achieved unless the authorities reorganize the financial sector and tie in monetary policy to credit restraint through measures that should be a little more thorough than the ones that the authorities have proposed. How will the market operate to sell those reserves to the Central Bank? And in the absence of appropriate offsetting mechanisms, how can the effect of that be offset in terms of foreign exchange and possible inflationary pressures?

Two areas certainly require quick action in the field of public finances. One, of course, is the public enterprises, and the other is the relation between provinces and the State. The action on public enterprises is not yet fully convincing. One has the impression that there is no clear underlying model for action in this area. For instance, it is rather worrying, to say the least, that instead of tackling the very challenging issue of reorganizing public enterprises by changing the management or reducing the overstaffing in many of those public enterprises, the authorities have introduced a tax of 5 percent of gross sales on parastatals to reduce the costs. That is not much of an incentive to reduce the costs if tariff adjustments continue to cover the costs of those enterprises. There is a serious inconsistency in these actions. It is also striking that, while about 60 percent of revenues are absorbed by local or provincial authorities, all the measures considered in the field of public finances relate to the central Government. I am confident that, on the occasion of the next review, we will hear better news on those two major topics.

On the financing of the program, questions have already been asked, and I think that we should probably in a more general way have another look at our strategies in this respect. Are we sufficiently certain that financing will be made available to make the implementation of the program possible? If not, are we sufficiently certain that additional measures will be adopted to compensate for the absence of sufficient financing? There is a large area of shadows in the program, and it would probably be better if in the future we could have somewhat more certainty on those points.

A very positive fact is that the negotiations with the banks are to start again. Personally, I doubt, however, that they will lead to a successful result to the extent of providing all the financing needed for a certain period, unless the hope is given to the financial community that strong additional measures can be envisaged. It is in this hope that I can support the proposed decisions.

Mr. Clark made the following statement:

With hindsight, it would now appear that last November, as we were reviewing the Argentine program, economic conditions were changing so rapidly that, for all intent and purposes, the program was already at risk. Nevertheless, I believe that it was the hope of this Board that the authorities would quickly respond with the required policy measures that would rapidly address the source of the problem. It is now clear that the authorities' policy response was not sufficiently convincing to establish the credibility that was essential to keep the program on track.

The staff paper does not point to any one single event that led to the derailing of the program. Rather, the fault lies in a variety of minor, and not so minor, slippages, including the delay in the passage of the tax reform legislation, the stalling of the privatization program, the inconsistent implementation of credit policy, and the inadequate implementation of wage policy. Each of these slippages in policy implementation may have occurred for good reasons. However, Argentina, with its poor policy implementation record, cannot afford any signal of less than full commitment of the authorities. The key lesson from Argentina's experience is that the policy response must leave no doubt of the authorities' intentions.

With these general remarks, I wish to turn to the proposed modified stand-by arrangement. We welcome the revival of the Fund program and the recent policy actions, and we note the success that the authorities have had in stabilizing the economic situation in the past two to three months. Nonetheless, we have some concerns about the program in a number of areas, including the most recent deterioration in the economic indicators, the lack of concrete policy plans in specific areas, the composition of the fiscal plan, the limitations of monetary policy, and, finally, the lack of financing assurances.

First, we are concerned about the recent economic data, which seem to suggest that the recent short period of relative stability may be at risk. For example, inflation for the first week of May accelerated sharply to almost 6 percent from a monthly rate of

12 percent in April; also, the austral has come under some downward pressure and is currently trading at about A 5,200 to the U.S. dollar, compared with A 4,750 in April and early May. Could the staff comment on what it believes underlies these developments?

Second, I note that considerable progress has been made in stipulating specific measures and enacting the necessary laws. Nonetheless, we are concerned that, in a number of important areas, the paper presents only the authorities' good intentions, rather than concrete measures. This includes policies on salaries and wages, where the authorities indicate that they are committed to a policy consistent with a sharp decline of inflation. Further details on what this actually implies and how it will be implemented would be very helpful. Similarly, with regard to provincial transfers, the authorities intend to seek ways to reduce these transfers. Again, more concrete plans would provide reassurance that the reduction in transfers could be implemented this year. I note the reassurance provided in Mr. Feldman's statement that the authorities are addressing these and other areas of the program.

Third, with regard to fiscal policy, we had considerable concerns last November. Although there has been considerable progress since then, particularly in implementing major tax changes, we are still concerned that this part of the program is very vulnerable. We note with satisfaction that there is a substantial increase in reliance on expenditure reduction. However, reaching the fiscal target continues to be heavily dependent on increasing revenues. An increase in revenues of about 4 percent of GDP in one year seems to us a very ambitious target at a time when economic activity is expected to remain quite weak. Similarly, in our view, the projection that privatization of public enterprises will yield cash proceeds of 1.2 percent of GDP appears to be somewhat optimistic. Experience in other countries suggests that progress in this area can be very slow. Moreover, the delay in the meeting with the commercial banks has meant that there is already some delay in obtaining the necessary waivers for proceeding with the privatization of certain enterprises. We would urge the authorities to put in place firm contingency plans. They cannot afford to once again miss their targets.

Fourth, the role of monetary policy in this arrangement is very constrained. As noted in Mr. Feldman's statement, the forced conversion of liabilities virtually closed the Government's access to sources of financing in domestic currency. We concur with staff that the resulting constraint on the ability of the Central Bank to conduct open market operations underscores the importance of achieving the program's fiscal objectives.

Finally, with regard to the lack of financing assurances, I, like other speakers, would note that this is an area where we had considerable concern during our last discussion. At that time, we were willing to go along with the program, despite the lack of any tangible contact with the banks, because the alternative of not going along with the program seemed considerably more inferior. To our regret, there has been no progress in this regard since November, and we are now faced with an even more difficult decision. We are therefore pleased to hear that the authorities will meet with the Bank Advisory Committee on June 7, and that Argentina will resume payment on its debt to commercial banks no later than June 6. It is absolutely essential that rapid progress be made now in putting together a financing package with the commercial banks. As the Chairman indicated at the beginning of our discussion, we will have to monitor the situation carefully and evaluate the extent of "cooperation" at the time of the next review.

The modified stand-by arrangement includes provisions for set-asides to date from future drawings. Given the minimal contact with the commercial banks, it seems somewhat early to make such a request. Nonetheless, we could go along with this decision, as the set-asides do not increase Argentina's access to Fund resources and will be disbursed only after an agreement on a financing package with the commercial banks has been reached and has been reviewed by this Board.

In conclusion, like some other Directors, we have considerable reservations about this program. Nonetheless, we can support the proposed decisions, because we believe that the authorities are firmly committed to addressing the major problems facing the Argentine economy. In addition, we are reassured by the major strides that have been made in the past few months, although difficult policy decisions still have to be taken. Above all, the authorities should be prepared to respond quickly to any program failures that may arise and not let disequilibria compound to the point where critical performance goals are missed and confidence in long-term prospects are further undermined.

Mr. Evans made the following statement:

In the course of a recent conference in Europe, the Managing Director in addressing the Fund's support of East European members, made the important statement that "having encouraged them to cross by the ford, we must not leave them stranded in midstream." That statement, of course, is applicable to the Fund's support of all of its members and is, I believe, central to our consideration of the case of Argentina.

It is applicable, however, only if we have actually found "the ford" by which they are to cross--by which I am sure the Managing Director was referring to the appropriate adjustment policies. With the benefit of hindsight, it is clear that we had not found that ford when we approved Argentina's stand-by arrangement last November--so that we have since found ourselves, together with Argentina, in rather deep water.

Many Directors anticipated this last November, and all expressed considerable reservations at that time. There was, moreover, one important signpost available at the time which indicated that we should not, then, have even put our feet in the water--namely, the spread that had opened up between the official and parallel exchange rates in late October/early November. At that time, the staff had no convincing explanation of that occurrence, but we were all prepared to accept its judgment that it was likely to be temporary. Yet we read in the staff report before us today that the re-emergence of that spread in late October reflected earlier policy slippages across a wide front. The first question I would put to the staff, therefore, is why it was that the markets were aware, in November, of those policy slippages as, presumably, were the authorities, but the Fund was not. Had we been so aware, we may have heeded Mr. Posthumus's judgment that approval of a stand-by arrangement at that time was premature; more importantly, we would have been better placed to advise the authorities on timely policy responses that could have averted the turmoil of the ensuing months. For the problem in November was not just with policy slippages but, as subsequent events have shown, with the adequacy of the policy package.

Have we now found the appropriate policy package? In many respects, the revised package looks much like its predecessor. Indeed, in many respects the staff paper reads much like its predecessor, notwithstanding that the economic landscape has changed dramatically. One might note, by way of example, that the value of the austral is now approximately one tenth of what it was last November, when the staff assured us that the rate then was broadly appropriate; and the system now appears to be completely without a nominal anchor.

The policy package has changed in one important respect, however, in that fiscal policy has been decidedly strengthened and, most importantly, a much higher proportion of the necessary fiscal adjustments have now been implemented. I believe that we can be reasonably comfortable regarding the adequacy of the fiscal package, and we should welcome the attention now being given to restraining outlays. But it must be emphasized that, while tax policies are now more appropriate, there remains the daunting task of actually collecting the revenue. The staff is right to be urging the authorities to improve tax administration, and to be assisting the authorities in doing so, including through the pursuit of effective penalties.

On other elements of the policy package, however, the situation does not appear to be much clearer than it was last November. This applies particularly to those elements which must bear primary responsibility for ensuring that the key objective of the program--a substantial reduction in inflation--is realized.

In particular, on the question of wages, both the staff paper and the Memorandum on Economic Policy do not venture beyond generalizations, although this has been one of the important areas of slippages in the past and remains one of the most contentious issues for the future. As with the spread in exchange rates last year, the staff report contains none of the worrying signposts on wages that are now appearing regularly in the media. Does the staff have any information on how the authorities will contain nominal wage increases while dealing with the growing social unrest that real wage declines have engendered? What advice has the staff given the authorities on this point?

Similarly, the scope for utilizing monetary policy is clouded in uncertainty. The decision in January this year to replace austral-denominated bonds and time deposits with U.S. dollar-denominated bonds has both stored up a substantial debt problem for the future and, for the short term, has enormously complicated the task of monetary management. The Government will need to give the Central Bank full rein to make the best of the situation but will also need to assist the Bank by accelerating financial reforms.

Added to those difficulties are others of external financing, arrears, and debt, on which previous speakers have commented at some length. I share their concerns.

In all these fields, the authorities have been very active since the Board last considered this case, in November, and they are to be commended for their perseverance. But there has been a worrying lack of consistency in their approach: the fiscal policy measures, while welcome in the aggregate, have involved a lot of chopping and changing and resort to temporary expedients. The application of monetary policy has been haphazard, and incomes policy has been, perhaps unavoidably, a month-to-month affair. Mr. de Groote provided some further examples.

For the new policy package to have any chance of success, it will be important that consistency become a central feature of the policy approach. Without such consistency, it may not prove possible to sustain credibility in the program, and without credibility, the costs of adjustment will be that much higher.

Even so, and to borrow again the Managing Director's words, there will be "inevitable reversals and disappointments." Such developments are as inevitable in cases like Argentina as they will be with the East European transitions. While we must urge and assist the authorities to avoid such outcomes, to pretend or insist that they should not occur is simply departing from the real world--and, in doing so, putting at risk the progress that has been made. It is in that spirit that I can support the proposed amendment to the stand-by arrangement and the associated decisions.

Mr. Yoshikuni made the following statement:

When we discussed the stand-by arrangement for Argentina last November, this chair expressed strong concern about the country's poor track record and the lack of financing assurances in the program, and we approved the arrangement only on an exceptional basis. In the event, the program went off track just after the Board approved it, and all the performance criteria were missed by a large margin. Furthermore, no progress had been made regarding the negotiations between the Argentine authorities and commercial bank creditors until yesterday. It is disappointing that Argentina has once again failed to implement the program. Such repeated failures would seriously undermine the confidence of the international financial community in the ability of the Argentine authorities to adjust the economy. Under these circumstances, we welcome the authorities' intention to get the program back on track with a minor modification. Nonetheless, we have a number of reservations about the review and modification of the stand-by arrangement before us. Most important, in view of the poor track record of the past, there must be a strong assurance that the revised program will be implemented without any slippages. In this connection, while we recognize that some progress has been made in the fiscal area, such as the new legislation pertaining to tax reform, we are not fully convinced that sufficient prior actions have been taken to ensure the full implementation of the program. With this in mind, let me briefly touch upon the program before us.

First, on the fiscal front, many legislative actions pertaining to revenue enhancement, such as the extension of the value-added tax to service transactions and measures to strengthen the tax administration, are needed in order to achieve the new target, even though it was revised downward. Furthermore, on the expenditure side, while I welcome the authorities' intention to address the overstaffing of the public sector, I am disappointed that there was a significant slippage in wage policy in April, and there are indications that further increases will be awarded in May because of protests by the labor unions. Like Mr. Evans, I am concerned about the lack of policy specifications in the report.

Second, on monetary policy, following the adoption of the drastic debt conversion scheme, there is much uncertainty about the demand for domestic currency, as is evidenced by the very volatile movement in the monetary aggregates. In the circumstances, it is very difficult to evaluate at this time the strength of monetary policy unless we have additional data on money and credit. More fundamentally, we have some doubts about the validity of the conversion scheme itself. Even if it helped to contain the money supply, it was made possible at the expense of public confidence in the domestic currency. That, in my view, does not seem to be consistent with the aim of anti-inflation policy, which is to restore public confidence in domestic currency.

Third, as regards structural policies, much remains to be done in order to consolidate the adjustment process toward medium-term external viability. Again, a number of measures must be implemented before we can be assured of the full implementation of the program. In particular, substantial delays in privatization and divestiture of public enterprises, and their lax financial management, despite some minor progress in recent months, cast doubts about the attainability of a strong fiscal position, which is an essential prerequisite of the adjustment program. On the external side, while we appreciate the unification of the exchange rate, it remains to be seen how the abolition of the nominal anchor as a result of floating would bring about stability in the macroeconomy, given the uncertainty surrounding monetary policy. I share Mr. Goos's concern on this point.

On the medium-term balance of payments outlook, we are concerned about the deterioration of the external debt profile compared with the original program. As this chair stressed in November, the medium-term scenario is quite sensitive to external shocks. Accordingly, the program needs to be strengthened considerably, particularly in a sufficient medium-term policy framework, in order to achieve external viability. All in all, while we are in broad agreement with the revised program targets, we still have strong reservations about their attainability, given the very poor track record of program implementation.

Now let me move on to the issue of financing assurances. As we have stressed on many occasions, we have serious concerns about the adverse consequences of setting an inappropriate precedent by approving the outright disbursement of Fund resources with no financing assurances. The case before us is particularly worrisome in that we had not been informed of any developments pertaining to the negotiation between the banks and the Argentine authorities until today. In this connection, the new information provided by the Managing Director is encouraging; however, like other Directors, I see much uncertainty in the agreement, the details of which, particularly the exact amount of the "significant" payment, are not known at this stage. Furthermore, we are not very happy about the fact that this information was provided on the day of the Board discussion, giving us no time to consult our authorities. That being said, I associate myself with the view of Mr. Rhodes that this is a first step in the right direction and every effort should be made to further improve the relationship with commercial banks.

In conclusion, like some other Directors, I am inclined to think that the timing of this review is premature, given the poor track record of the country and the insufficient financing assurances. At the same time, we do not intend to discount the progress made by the Argentine authorities since the onset of the program, thereby discouraging their efforts toward further adjustment. Also, we recognize that Argentina has little room for maneuver in getting its program back on track. All told, given the very unusual circumstances facing the country, and with the understanding that the new development concerning the external debt negotiation would pave the way toward significant improvement in the relationship between Argentina and the commercial banks, I will go along with the proposed decisions, if the majority supports them.

Mr. Filosa made the following statement:

On the occasion of the approval of the stand-by arrangement in November, this chair took the view that the ultimate success of the Argentine program would be determined by the prompt adoption of the measures envisaged in the fiscal adjustment program. We also manifested our concerns about the financial viability of the program. I would also like to recall that the support given by this chair to the November stand-by arrangement came after lengthy and laborious consideration of the case on the part of my authorities. My authorities supported the Argentine request to show tangibly that they strongly encouraged the undertaking of what they sincerely hoped would have been the decisive adjustment effort on the part of the country.

We therefore strongly regret that various policy slippages, in the fiscal as well as in other areas, have led to the collapse of the program at the time of the Board approval of the stand-by arrangement. The collapse of the program has further damaged public confidence and will certainly complicate the implementation of the modified program we are discussing today. The modified program appears less ambitious than the original program, as the authorities have decided not to rely on nominal anchors to fight inflationary expectations for reasons that are not entirely evident, particularly as far as wage policy is concerned. But the new program envisages a fiscal policy broadly similar to the one prescribed by the old program. Therefore, the modified program, if implemented in a timely manner, offers comparable adjustment opportunities to the country. Nevertheless, the financial viability of the new program remains as precarious as the viability of the old program. I will therefore concentrate my comments on these two basic issues. I will first discuss the issue of fiscal policy, then deal with the issue of the financial viability of the program.

Regarding fiscal policy, I generally agree with the staff that the program is capable of addressing the fiscal imbalances in Argentina. But it will be the timely implementation of fiscal measures envisaged by the program which will determine its final success. In this regard, I note that a number of decisive actions have yet to be taken to improve the financial position and control of public enterprise, to enlarge the scope of privatization, and to expedite the transfer to the provinces. Mr. Feldman himself is aware that, in these areas, much still remains to be done.

I also agree with the staff's prescription that every effort should be undertaken to raise revenues substantially. In this regard, the introduction of a value-added tax on goods represents an important step in the right direction, a step which should be promptly followed by the introduction of the value-added tax on private sector services. Prompt introduction of the value-added tax on services has two main advantages to offer. First, it would signal the authorities' commitment to fiscal adjustment, on which the whole program is based. Second, the introduction of the value-added tax on services would broaden the effective basis of both indirect and direct taxes, since it would make income tax evasion much more difficult on the part of those income earners who provide the services subject to value-added taxation. This important positive effect of the value-added tax depends upon the ability of the tax administration to cross-check individually income and value-added tax returns. The cross-checking, in turn, requires a fully efficient tax administration. Therefore, I urge the authorities not only to introduce promptly the value-added tax on services, but also to implement in a timely manner all the measures recommended by our recent technical assistance mission to improve tax administration.

The objective of achieving a prompt and durable increase in tax revenues should be regarded as an absolute necessity. In fact, the new program envisages a limited expenditure compression. I wonder, however, whether it is realistic to assume that the present level of expenditure restraint can be maintained in the medium term on important items of public expenditure, such as public wages, given their present low real level. In this regard, I would like to stress that it is rather illusory to assume that all the improvement in public sector wages can come from the solution to the overstaffing problem. Therefore, the Argentine authorities should stand ready to take additional measures if needed.

Regarding the financial viability of the program, I share the staff's view that it remains precarious. It is clear that in the short term only partial payments can be made to the banks, and that in the medium term debt and debt-service reduction operations must be undertaken. In this regard, I welcome the exchange of communications between Argentina and the banks' working committee. However, it is difficult to consider this a satisfactory solution to the financial assurance problem. In this respect, I agree with Mr. Goos's views. Therefore, I think that the Argentine authorities and the commercial banks have to start negotiations as scheduled and make every effort to reach an agreement on a financial package consistent with the basic requirement of the program.

The policy slippages that occurred in Argentina at the beginning of the year have certainly contributed to complicating the task which now lies ahead. The Argentine authorities are aware that a decisive adjustment effort must be undertaken in the very short term if they want to revert the trend of economic and social deterioration of the country. Certainly, another crisis would have incalculable costs for the country and for the authorities' credibility. The fact that since March some slight improvement has been recorded only indicates that the country is still able to respond to good policies, but that does not mean that another serious crisis might not loom in the next few months if the adjustment efforts are once again delayed.

The lack of Fund support for the program would make it impossible for the Argentine authorities to achieve their goal. With this in mind, and despite many reservations, I can support the proposed decisions.

Mr. Posthumus made the following statement:

When the Board approved Argentina's stand-by arrangement on November 10, 1989, we thought that it was premature, as we felt that some prior actions should have been taken. Furthermore, we suspected that the program was already off track even before we approved it, with baseline indicators exceeding the program's assumptions by wide margins. As it turned out, the December criteria were not observed and the review scheduled for February did not take place.

I believe that it was not in Argentina's or the Fund's best interest to push for the program in November. The program's immediate--foreseeable--failure was detrimental to the authorities'--as well as to the Fund's--credibility and probably caused more harm than good.

In November, I thought that the program in itself was good, but that there were too many intentions. In this respect, there has been some progress since then. In particular, the legal framework for the tax reform is in place; and there is progress in the negotiations concerning privatization of some public enterprises. On the other hand, the discussions with the banks have not even started.

Since the monetary base in Argentina is very small and no monetary instruments exist, the main burden of adjustment is on the budget. The situation is complicated by the fact that virtually all the external debt repayments are to be made by the Government, which needs to finance them through a fiscal surplus if it is to contain monetary expansion. The fiscal program is therefore absolutely vital.

I think that it is only fair to acknowledge the continuous efforts that the Argentine authorities have been making since the new Government came into office in July 1989. Admittedly, it is very hard to judge from the outside the enormous difficulties which have to be faced by a government trying to get a hyperinflationary economy under control. The Argentine authorities, in spite of repeated failures, persisted in their attempts to fight inflation by implementing additional measures. They were perhaps even overzealous, as with the compulsory conversion of short-term financial assets--a strong, desperate step, which may well have negative repercussions for a long time to come. Nevertheless, the authorities have proved their serious intentions and have established a track record of determination and persistence, although not always of results. I would therefore feel uneasy about not supporting the program at this time. Giving my support is made a bit easier now that total access has been scaled down somewhat.

Finally, I would like to ask two questions. The first has to do with the financial assurances. I agree, of course, that, in the context of the program, we should be concerned with Argentina's capacity to repay loans in general, and to the Fund in particular. The success of this program--and of the ones to follow--depends heavily on agreement with the banks. On the other hand, the banks demand at least partial payment of interest at the outset. Would this demand on scant reserves not threaten the timely repayment to the Fund and to the World Bank, and would this not undermine the very financial assurances we seek?

My second question has to do with "equal treatment," or at least "comparable treatment." It is not clear to me in what circumstances a program is abandoned and in what circumstances it is just interrupted, to be picked up sometime later. I recall the recent case of Costa Rica, where the program went off track and had to be discontinued. Costa Rica was in an advanced stage of discussions with commercial banks, which is more than can be said of Argentina, and it therefore urgently needed a Fund program. Why could we then not help the Costa Rican authorities return to the adjustment program without the need to start the whole process afresh, and why can we do this in the case of Argentina?

Mr. Al-Jasser made the following statement:

The Argentine authorities showed considerable boldness and determination when they initiated the broad-based program last year to come to grips with years of structural distortions. The runaway inflation was contained, the privatization process was initiated, a degree of credibility was accorded to the exchange rate, and the real sector exhibited a sharp recovery. In addition, the external trade regime was liberalized, arrears to multilateral institutions were eliminated, and official debt was rescheduled.

However, despite these important early successes, the Argentine program quickly went widely off track, primarily because the public sector failed to adjust adequately. Delays in tax reforms, an inadequate reduction in public sector expenditures, and a failure to speedily divest or reform ailing state enterprises led to a loss of credibility of the program. Monetary and credit restraints could not be maintained, the incomes policy became largely inoperative, real interest rates remained unattractive, the exchange rate viability came into question, and inflation started to gallop again. The subsequent measures taken in December 1989 and in early 1990 were too little to fully restore confidence.

Given this background, the Argentine authorities have to show greater resolve in implementing the revised adjustment program, if the objectives of reducing inflation and a buildup of official international reserves are to be realized. The success of the program will therefore depend upon the ability of the authorities, which remains to be tested. It is to be hoped that the renewed efforts toward a durable recovery of the economy will facilitate progress for a normalization of relations with international creditors, including commercial banks. Without a substantial alleviation of the debt burden, Argentina's external position will remain unstable.

As was emphasized in Mr. Feldman's statement, the success of the renewed effort will critically depend upon the success of the underlying fiscal program. I agree with Mr. Dawson that the lack of fiscal discipline has been Argentina's Achilles' heel. However, once again the program calls for an inordinately large burden of fiscal adjustment on the revenue effort. Its success hinges heavily on an early and full implementation of the value-added tax and on a major strengthening of the tax administration. While improvement in tax administration will inevitably take time, I am not sure that the threat of punitive steps alone against delinquent taxpayers would suffice.

Raising revenues is only part of the solution. I feel strongly that the strengthened fiscal effort should focus more aggressively on reduction in expenditures and a shift in their composition. While I note that the revised program stresses expenditure restraint somewhat more than the original program, it does not seem to be enough to address the present level of economic disequilibrium. This is especially true given the uncertainties with respect to revenues. Consideration should, in particular, be given to autonomizing provinces' finances so as to contain overall public sector expenditures and to reduce the burden on the Central Administration.

Expenditure reductions need to go hand in hand with far-reaching structural reforms. Not only should legal impediments to the privatization of the telephone company and the state airlines be removed without delay, but also the divestiture of other state enterprises should be pursued more vigorously. In this context, the financial improvement of state enterprises calls for timely corrections in tariffs and charges while efficiency is being enhanced.

I also support the staff assessment that the maintenance of a tight policy in respect of wages and salaries is essential, and that any recovery in the purchasing power of wages should be a function of improvement in the efficiency and productivity of state enterprises. However, there are obvious risks in letting real wages decline substantially. Undoubtedly, enhanced efficiency will lead to an elimination of overstaffing and create unemployment. Hence, there may be a need to consider some form of a safety net to cushion the social impact of this necessary economic correction. It is not clear from the staff paper whether such an approach was under consideration.

As to the monetary and credit program, it is to be hoped that the strengthened fiscal performance will stabilize the exchange rate, reverse flight from the austral, and facilitate management of liquidity. Any slippage in the fiscal program, if financed by credit expansion, could seriously damage exchange rate credibility and worsen the problem of de-australization; hence the need for a tight credit program. Moreover, a central element in the success of the credit program will be the effective recovery of state enterprises' debts to the Central Bank. Could the staff indicate how effective the banking system's loan recovery program has been? Also, what additional steps are being contemplated to restructure the banking system?

In the final analysis, the Argentine economy continues to be deep in the woods. Its recovery will crucially depend upon the success of the fiscal program and reform of the state enterprises. Debt reduction will also be essential for long-term external viability, and, therefore, the authorities have sought external assistance to support their efforts. Such support would be easier if the authorities reinforce the steps taken so far to attract Argentine capital back to the country. In view of the considerable risks inherent in the implementation of the program, it will be necessary to strengthen the social contract with the various groups in the economy so that difficult measures can be fully achieved.

With these observations, I support the proposed decisions with reservations. I hope that the authorities will have greater success this time in implementing the program.

Mr. Thorláksson made the following statement:

It seems particularly difficult to transform an economy such as that of Argentina, which has for a long time been subjected to both internal and external imbalances, into a sound economic system. On several occasions, Argentina has undertaken economic programs which in themselves were strong, but they were not satisfactorily implemented.

In assessing the new modified economic program for 1990, we find that no major changes have been made in the basic program. Instead, the implementation of the policies has been strengthened by the closing of loopholes where slippages have occurred, and the authorities are adhering to the overall goal of bringing down the inflation rate, mainly by bringing about a relatively large primary surplus in the fiscal budget.

The success of the fiscal policy is heavily dependent on the implementation of the tax reform, the strengthening of the tax administration, and on sustaining the program's expenditures level even though the real wage level in the public sector is low.

The Nordic countries commend the Argentine authorities for the reform measures instituted under the exchange and payments system. Like the staff, we emphasize that the remaining import restrictions must be abolished and the customs duties further liberalized to demonstrate the authorities' long-term commitment to pursuing market-oriented policies.

The debt/GDP ratio of Argentina is high and servicing the debt inflicts strong pressure on the economy. The Nordic countries believe that the country would benefit from a reduction in debt and debt service, provided that this is combined with sound adjustment policies. The creditors need clear evidence that the authorities are making progress in stabilizing the economy. However, the stop-go policies conducted so far have had negative repercussions. If indications of sound policies and effective implementation exist, financing will certainly be more easily obtainable.

Argentina's modified stand-by arrangement is a renewed effort to direct the country's economy toward a sustainable growth path. As there is no room for slippages, it is important that the development of the program is followed up carefully and that deviations are immediately corrected. The Argentine authorities must realize that it is the credibility of the country that is at stake. The stop-go policies conducted so far have worn creditors' patience very thin, and another unsuccessful attempt would not be tolerable.

Reflecting the strong doubts expressed by my countries as regards the implementation of the program, the well-known track record, and the lack of financing assurances, we would have preferred it if a change in the proposed disbursement could have been considered so that the first purchase would have been reduced, for example, by 50 percent. The remaining part would, of course, in that case have been added to the next purchase. However, as a majority of the Board members have expressed opinions that favor the staff's proposal, we can--very reluctantly--support the staff's proposal.

Mr. A. R. Ismael made the following statement:

We welcome the renewed efforts of the authorities to strengthen their adjustment program and to pursue structural reforms after the slippages that occurred during the last quarter of 1989 in the implementation of the adjustment program, and which led to the nonobservance of the performance criteria. The authorities' revised 1990 economic program, which they had been implementing steadfastly during the past three months, appears to be a strong one and should help the Argentine authorities meet the objectives set. Important and courageous measures have already been taken with noticeable results, among which we note the significant deceleration in the inflation rate and the improvement in the country's external position. On the whole, we agree with the thrust of the revised program and with the staff appraisal and recommendations and can therefore support the proposed decisions. We would like only to make some brief comments on some aspects of the program, mainly the fiscal and external sectors.

In the fiscal area, we note the wide range of revenue-increasing and expenditure-reducing measures being implemented with a view to strengthening the financial position of the public sector and producing a primary surplus of 5.6 percent of GDP for 1990. Given developments in the first three months of the year, this seems an ambitious objective and its achievement would depend to a large extent on close adherence to the elements of the program, especially the implementation of all proposed revenue measures, decisive progress in tax administration, and strict control over expenditure. Therefore, the strong determination of the authorities to carry out the program and the growing support for the program by the population, as noted by Mr. Feldman in his statement, are encouraging.

The measures taken to improve the financial performance of the public enterprise sector also should help to meet the target set in the fiscal sector. Noteworthy are the steps already taken to divest and privatize many of the enterprises. We note that delays have occurred in the privatization process. But in such an undertaking, delays of a legal, administrative, and procedural nature are unavoidable. In the circumstances, the progress made up to now is remarkable, and we encourage the authorities to pursue vigorously their privatization efforts. Similarly, in the financial sector, we urge the authorities to proceed further with the structural reform and to strengthen the supervisory role of the Central Bank. Progress in this area will encourage confidence in the currency and contribute to the fight against inflation.

In the external sector, we note the strong commitment of the authorities to the opening of the economy to foreign trade and investment and the re-establishment of relations with foreign creditors. These measures, together with those being taken to improve production, would in the medium term help to increase exports and thus reduce the debt-service burden. But for the immediate future, the size of the external debt service, at almost 50 percent of exports, is of major concern. Despite the strong adjustment program being implemented, it is not likely that, with available financing, the present level of external debt can be fully serviced.

Moreover, the debt-service burden is certainly having an adverse effect not only on the present level of investment and growth, but also on medium-term developments as well, thus further constraining the country's ability to grow out of debt. In this context, we note the positive effects of debt and debt-service reduction operations on the medium-term prospects, as analyzed in the staff report. Therefore, we welcome the resumption of discussions with the commercial banks and we support the authorities in their efforts to seek a debt and debt-service reduction package. We also support the request of the authorities regarding the set-asides.

Mr. Cassell said that it was unfortunate that the discussion had to be held at the present stage. It had been widely felt in November 1989 that the Board was taking a chance in approving the stand-by arrangement, but the arrangement had gone off track to a greater extent even than Executive Directors had then expected, and it was important to ask why they should have more confidence now than had seemed justified in November 1989. Argentina did not have a good track record, and the outlook for growth looked no more promising now than it had during the previous discussion on Argentina; indeed, the somewhat negative growth forecast seemed like an obvious understatement. Still, there seemed to be two reasons to be slightly more confident now than in November 1989: fiscal policy looked more strongly based; and the financial markets were not sending signals that were dramatically inconsistent with the projections for the economy.

The package before the Board was an attempt to salvage something from the wreckage of the program, Mr. Cassell said. Fiscal policy remained the central element. Indeed, it was really the only active element. Monetary policy must play a more passive role. The intended nominal anchor of the fixed exchange rate had been swept away, but the authorities could not allow confidence in their policies to slip for fear of prompting a further run on the austral.

The question, then, was whether the action taken by the authorities to come to grips with the fiscal position, taken together with actions still to come, gave sufficient confidence to put to one side the lack of a track record and to go ahead with the proposed disbursement, Mr. Cassell continued. Foremost among those actions was the extension of the VAT base, with adjustment of the rate left, within certain limits, to the Executive branch. The extension had yet to be fully ratified by the Congress, and there remained much to be done to improve tax administration.

On the expenditure side, Mr. Cassell remarked, there was some evidence that the authorities were coming to grips with the need to hold down real wages. But given the extent to which they had already been compressed, success would depend on the maintenance of some form of social consensus. It was also imperative that the provinces share more of the spending burden, as they, too, benefited from the Central Government's revenue effort. Much needed to be done to regain lost ground in the reorganization and divestiture of the state enterprises; it was essential not only to restrain treasury funding of such enterprises, but also to control their budgets to ensure no financing through accrual of domestic arrears.

The task was a formidable one, but it had to be done, Mr. Cassell stated. The alternative of monetary financing and a likely downward spiral of the exchange rate that would ensue would create another bout of hyperinflation. In that sense, fiscal discipline was being forced on to the authorities, and the staff's most recent report suggested that the results were beginning to show.

He agreed with previous speakers' comments on privatization, Mr. Cassell said. As to the financing issue, even if the domestic policies were implemented successfully, there would be an external financing gap for years to come. Moreover, financing in 1990 would depend heavily on the further accumulation of arrears. It was therefore critically important that rapid progress be made in the negotiations with the banks, and he, too, found it regrettable that a full meeting between the banks and the authorities had not yet taken place. At the same time, he was pleased that a spirit of cooperation seemed to be developing; a first payment of $100 million was to be made on June 6, 1990, and monthly payments were to be made thereafter, although their precise size was not evident.

In the absence of solid progress, approval of the proposed decision on the review under the stand-by arrangement would stretch the policy on financing assurances to the limit, Mr. Cassell considered. Nonetheless, the proposal was acceptable, given the importance of sustaining confidence in continued adjustment. In approving the proposed decision, he wished to stress that it represented the last chance for Argentina to establish an acceptable track record in the context of the current adjustment program. In the absence of full adherence to the objectives of the program and evidence of genuine progress in the negotiations with the banks, it would be extremely difficult to approve any further disbursements under the stand-by arrangement.

Mr. Kabbaj made the following statement:

In dealing with the hyperinflation and the external payments difficulties and setting the economy on a durable path of sustainable growth, the Government of Argentina launched a broad-based program of macroeconomic and structural adjustment which was later strengthened through a Fund-supported program for the period through the end of 1990. It is unfortunate that deviations from most of the program's performance criteria in late 1989 and early 1990 compromised early successes. Given the protracted economic problems Argentina is facing, the authorities' determination to renew the adjustment effort for the remainder of 1990 is commendable. The substantial success in bringing down the hyperinflation of late February and in improving the external position of the country since early March is encouraging. Indeed, inflation came down from over 115 percent during February to 13 percent during April. Moreover, there has been an improvement in the balance of payments owing to a turnaround in confidence and the economic situation beginning in early March.

On the basis of the encouraging economic performance in March through May, which is documented in the staff report as well as in Mr. Feldman's comprehensive statement, we wish to support the proposed decisions. Since we are in broad agreement with the thrust of the staff appraisal, we would like to make few brief remarks.

On the fiscal side, we are pleased to note that the Government plans to improve rapidly the fiscal position in order to bring down the rate of inflation to 2 percent a month in the second half of 1990. Genuine expenditure reductions, which would result from measures to be taken to tackle the problem of overstaffing in the public sector and the weaknesses in the management of the public enterprises, are welcome. The success of revenue measures, particularly to make the tax system more broadly based, depends highly on improvements in the tax administration, which has remained weak, and on the revenue-sharing arrangements between the provincial governments and the central administration. Therefore, we hold the view that more emphasis should be put on effective implementation of the structural reforms in the public sector.

On the monetary front, it is encouraging to note that the authorities are committed to continue their policy of permitting interest to be freely determined by market forces and to eliminate subsidies on central bank credit. Although the debt conversion operation undertaken by the authorities to eliminate a large source of money creation is the right step toward achieving the macroeconomic objectives of the 1990 program, the involuntary nature of this operation casts doubt on its overall effectiveness. On the other hand, if such an operation is to lead to a major restructuring of the financial system, we share the view expressed by the staff in this connection that the Central Bank's supervisory powers should be strengthened.

On the external side, the partial recovery in imports together with a modest rise in exports is expected to reduce the overall deficit to $450 million in 1990, compared with an annual average of about $3 billion in the preceding three years. Staff projections indicate a current account deficit of about $2 billion over the medium term as a result of a rather continued export expansion. Explicit in this scenario is the assumption of annual real growth of 4.5-5 percent, for which the maintenance of sustained adjustment and structural efforts by the authorities over the medium term is a prerequisite. Furthermore, the steps taken by the authorities to liberalize the exchange and payments system to this stage are welcome, and we encourage the authorities to make further efforts toward removing the remaining trade restrictions to restore the balance of payments equilibrium. The authorities' determination to continue the adjustment process in the external accounts is commendable.

In the light of the results of the revised program thus far achieved, and the positive expectation from the continued program of adjustment, we support the proposed decisions.

Mr. Fernando made the following statement:

Although it is not unusual to deal with program deviations and modifications, the situation with respect to Argentina is at the outer limit. Deviations are so large and have come so soon after the approval of the program in November, we are apt to wonder whether the warning signals at the time of first approval were adequately heeded. Such performance criteria as have been met, such as on contracting external debt, have little practical significance, given the state of relations with commercial creditors. Incidentally, is the debt conversion operation at year-end not having any implications for public sector external debt outstanding?

Even though the previous record is one of crisis management and off-track programs, the bold approach of the new Administration that took office in July last year provided a platform on which to base our confidence and expectations. That fragile credibility has now to be built all over again.

We have noted the efforts of the authorities to arrest the slide. But, at the same time, we feel that the sustainability of adjustment is that much more difficult. For instance, we note that a growth environment can no longer be envisaged. The cutback in investment, and the obvious compression of expenditures for maintenance and upkeep, will further depress potential output. We also note that inflation performance and breakdown in confidence in the currency would have adversely affected poverty groups and undermined the tolerance level for adjustment, which should make a new start. In this context, the tax reform exercise, for example, which includes elimination of the wealth tax for whatever reason, could only serve to heighten social tensions.

Another development with social but, more importantly, economic implications is trade reform, particularly the liberalization of imports. While the importance of trade reform is not in question, we seriously wonder whether import and external payments liberalization is running unhealthily ahead of macroeconomic stabilization. At the same time, budgetary constraints are inducing the authorities to adopt arrears to commercial creditors as a source of financing. The push for trade liberalization is thus an added pressure on macroeconomic stabilization.

The setback in the fight against inflation strikes at the very core of the stabilization effort and the results so far. The vulnerability to hyperinflation continues to be very prominent. Although shock treatment has brought down hyperinflation, and would no doubt be employed again if necessary, this is well short of the primary goal of enduring stability. A further complication is the lack of sound assurances that private sector wage developments will not run counter to the public sector effort. The public effort itself is tough, and reasons which make it tougher were mentioned earlier. In this context, further clarification is necessary as to what macroeconomic policies, checks and balances, and fallback positions exist to keep wage-push inflation in check. The cancellation of the banking sector loan of the World Bank would thus seem a setback to the urgent reform required in the financial sector.

We need to be further convinced that the turnaround in the fiscal accounts during the rest of 1990 could be accomplished. The revenue effort has already been damaged by severe inflation. Too much of the burden is placed on greater efficiency in administration, and implementation of decisions on transfers to the provinces is fraught with much difficulty.

On the question of the capacity to repay the Fund, we have a comment and a question. In making the assessment of the capacity to repay the Fund there is a standard assumption that there will be no further use of Fund credit after the present arrangement. This is unrealistic not just in the present context, but seemed so even at the time the program was initially considered last November. Even then it was recognized that sufficient conditions exist in Argentina after the stabilization effort to argue for a longer period over which structural adjustments could be initiated and a time frame within which they could take hold. A type of extended arrangement has been mentioned. Besides this argument on the adjustment front, there is also ahead negotiations with commercial creditors, which the Chairman said would commence shortly. Obviously, judgmental considerations point to a lengthy period of Fund involvement, and this should be given due weight in assessing the capacity to repay the Fund. Furthermore, we have a question on the subject: should this capacity also be assessed in terms of the ability of the authorities to provide budgetary resources to finance the repurchase? If so, the capacity to repay would relate not merely to balance of payments and reserve considerations but also to conditions of public finance in the medium term. We do, however, commend the authorities for remaining current with the Fund.

Overall, in our view, the risks to the program pointed out by Mr. Feldman and the staff at the outset are even greater at this time. Evidently, it is a difficult task to make a judgment on the kind and extent of support that could be given at this stage. It is, of course, clear that there is a pressing need to help Argentina obtain some relief from the burden of external debt. Even with relief of the sort depicted in Scenario B of the medium-term balance of payments projections, debt service would remain at 40 percent of exports five years from now. We have to have a careful balance between leveraging for debt relief against the domestic effort for economic adjustment. This leveraging applies both to the quantum of debt relief sought as well as the timing. The extent and momentum of adjustment should not be held hostage to the scope and timing of creditor response. With these observations, we could agree to give another chance to the authorities by approving the continuation of the stand-by arrangement.

Mr. Wang made the following statement:

I support the proposed decisions. Despite the slippages and considerable underperformance of the Argentine economy at the end of December and again at the end of the first quarter of 1990, the authorities deserve to be commended for their remedial actions taken in March this year to correct the deviations of the economy from the program. We are encouraged by some of the initial results from the corrective measures, such as the improvement in the external position and the restoration of confidence in the economy. More important, some fundamental structural measures have been put in place, the results of which, though, will take some time to be felt. It is obvious from Mr. Feldman's statement that the Argentine authorities are fully cognizant of the vital aspects of the program; indeed, the deviation has shown how difficult it is to implement a program. The deviation from the program could be traced to many factors, including policy slippages and delays in legislative actions on the structural reforms. But, clearly, the adjustment program--complex and comprehensive as it was--left very little room for failure at the time of formulation. Now, after a period of trial and error, program targets have been modified to more realistic levels, while still maintaining the basic aims of the original ones. In our view, the Argentine economy has once again come to a critical stage and, given the uncertainties, it will be crucial for the authorities to adhere to the course of action mapped out in the modified program and to stand all the more ready to take remedial actions when necessary. But, on the other hand, the support of the Fund and other relevant parties is also indispensable for the program to remain on track.

As to the authorities' continued emphasis on fiscal policy in carrying out the program, we have little to add to the staff's comments, except to caution against the potential pitfalls lying ahead, such as the overshooting of wages and salaries of public and private employees. As so much of the program depends on the fulfillment of the fiscal objectives, the authorities cannot afford to slip in the fiscal area; the role of monetary policy is already constrained as a result of the forced conversion of debt. In addition, it is also important for the authorities to expedite the transfer of expenditure programs to the provinces, in parallel with the transfer of revenues, in order to strengthen the fiscal position of the central authorities.

On monetary policy, we see great merit in strengthening the supervisory power of the Central Bank, in addition to maintaining a tight monetary stance. The authorities are well advised to keep vigilant in credit policies, despite the seemingly easier task resulting from the expected net domestic financing surplus of the public sector and the absence of the domestic quasi-fiscal deficit.

As to the external side of the program, we are encouraged by the progress of the authorities in liberalizing the exchange and payments system, in reducing the level and dispersion of import tariffs, and in removing some of the quantitative restrictions. On the issue of external indebtedness, we have noted with concern the continued huge debt and debt-service burden of Argentina, and we welcome the authorities' appropriate request to set aside 25 percent of future purchases to finance debt-reduction operations. We encourage the authorities to continue to make strenuous efforts to remain current in their debt service and wish them well in their forthcoming negotiations with the commercial banks.

In addition, I would like to touch upon a point that I believe can never be overemphasized--the credibility of economic policy and confidence at home and abroad. Repeated frustration from adjustment programs and failure to reconstruct public confidence will be detrimental to adjustment efforts. Therefore, I call the authorities' attention to this important matter and I hope that the Board will give continuing support to the Argentine authorities, who are committed to the continuation of the ambitious adjustment program and have displayed an evident spirit of cooperation.

Mr. Allouba stated that he supported the proposed decisions.

Mr. Munthali said that he, too, accepted the proposed decisions.

The staff representative from the Western Hemisphere Department recalled that several Directors had commented on the efforts that had been made to respond to the warning signals that had been evident in November 1989. A package of revenue measures had been implemented--although not until early 1990--to prevent the continued trend toward hyperinflation. A number of Directors suggested that it seemed inconsistent to aim to restore confidence in the markets while implementing the debt conversion measure of January 1, 1990. However, that measure had been forced by events. At the time, most of the financial savings of the private sector were intermediated through the Central Bank and loaned to the public sector. At that stage, the effective legal reserve requirement was in excess of 90 percent of the liabilities to the private sector. A run on deposits had occurred beginning in mid-December, and the commercial banks had been hiking interest rates to protect those deposits and had been passing on the cost to the public sector through rapidly rising losses of the Central Bank, which were covered by further monetary creation. Given the situation of rising interest rates, a depreciating currency, and increasing prices, the authorities had seen no option but to basically freeze deposits and convert them into 10-year bonds. That decision had not been made lightly, and the authorities had been well aware of the implications, which were the main reason for the need to have a stronger fiscal effort than had been envisaged earlier. The fiscal effort was in fact stronger than had been initially planned and was the key policy tool for the remainder of 1990 and beyond. Monetary policy could not play a role, in the sense that the Central Bank was in no position at the present stage to issue paper to absorb liquidity; basically, the inflation must be brought under control with a strong fiscal effort.

The move toward a free exchange rate must take into account the problem that there had been two rounds of hyperinflation in a very short period--the first in July 1989 and the second in December 1989-February 1990, the staff representative commented. To control the freely floating exchange rate, the policy emphasis had to be on adjustment of the fiscal accounts. Mr. de Groote and Mr. Goos had mentioned that the absence of a nominal anchor in the form of a fixed exchange rate could lead the Central Bank to buy foreign exchange and let the exchange rate depreciate. Of course, that clearly was not the authorities' intention. They obviously wished to reduce the rate of inflation quickly. As the trade surplus had been generated by the private sector and most of the external debt had been undertaken by the public sector, it was clear that the public sector needed to generate a primary surplus that was large enough so that the associated savings in local currency could be used to purchase the receipts from the trade surplus of the private sector without creating inflationary pressures.

As a number of speakers had stressed, the revenue effort was the main tool for reducing the fiscal deficit and generating the desired primary surplus, the staff representative said. The legislation extending the value-added tax to services had come out of the relevant committee of the Congress, been sent to the lower chamber, and was expected to be approved by the end of May 1990. Apparently there would be smoother sailing for the legislation when it was subsequently considered by the Senate. At present, the sale of public assets was expected to generate the equivalent of about 1 percent of GDP; in November 1989, privatization had still been in the planning stage. The large number of bids that had been made for the telephone company should be opened in late June, and the final sale should take place later in 1990; and the authorities expected to be able to sell the national airline as well. The cash from those sales and from the auctioning of oil fields in the secondary areas should contribute to the revenue target.

As for expenditures, it was useful to note that there was no policy of directly controlling private sector wages, the staff representative continued. In that connection, the authorities' intention was that any private sector wage increase that was in excess of the level of wages needed to contain inflation would not be validated by either fiscal or credit policy. The authorities recognized that public wages were quite low, creating considerable social tension; but they also realized that, until the level of public employment was reduced, there was little chance of improving real wages in the public sector without undermining the effort to bring the rate of inflation to a low level. It was difficult to judge in advance whether the authorities would be able to restrain wages, and that effort would need to be sustained on a month-to-month basis. The authorities hoped to reduce the monthly inflation rate from the current rate of about 10 percent to roughly 2 percent, which would make wage policy easier to implement.

Another expenditure area where there was tension was the earmarking of revenues for the provinces, the staff representative remarked. The authorities' intention was that, until the revenue sharing arrangement could be modified by congressional action, the projected revenue increases should not give rise to an increase in total public expenditure. To avoid that outcome, spending programs were to be transferred to the provinces. Beginning July 1, 1990, the secondary education expenditures were to be transferred to the provinces; and the Central Administration would retain certain resources that would otherwise be spent on road maintenance and special housing programs in the provinces.

Public enterprises was another expenditure area that was a potential problem if the authorities failed to bring the enterprises under control, the staff representative commented. A start had been made in terms of bringing the operations of the enterprises--particularly procurement practices--under control. The Ministry of Economy was putting together a team to supervise more directly the operations of the enterprises; the process was a slow one, as there were deeply entrenched practices and pressures from private groups for excessive spending. Some progress had been made in recent months in controlling wages; the Minister of Economy had become increasingly able to prevent unplanned wage increases; there had been no increases in April, and no wage awards were planned for May. Similarly, the Minister of Economy had regained control over setting public sector tariffs, a problem area in the past. Timely tariff adjustments had recently been made, and the present level of tariffs was adequate.

Given the very low level of wages, some Directors had asked about the provision of safety nets under the program, the staff representative recalled. Of course, reducing the rate of inflation would improve the situation. Beyond that, the program envisaged an important recovery of the real value of social security pensions, which was to be financed with stronger efforts to collect contributions. To that end, the social security system had been made autonomous of the Central Administration and had been given the legal means to enforce collections; in fact, collections had improved over the past three months. In addition, there had been a number of improvements in the delivery of health expenditures.

While monetary policy had to be tight, the means to achieve that was through the recovery of rediscounts, as the Central Bank was not in a position for the time being to issue paper, the staff representative commented. Over the past several months, the Central Bank had not been issuing rediscounts except for one brief period; during that period, the Central Bank had been engaged mainly in buying foreign exchange and collecting rediscounts, at the rate of about $95 million per month.

Progress in the drafting of a new central bank charter had been halted as a result of the events of late 1989 and early 1990, but work had resumed in recent weeks, the staff representative said. The Fund's Central Banking Department had been playing an advisory role in that regard; the draft legislation had been sent to the executive and should be put to the legislature in coming weeks. The aim was to complete the reform of the Central Bank as soon as possible.

The authorities strongly emphasized the primary surplus as a key fiscal target, the staff representative remarked. In fact, however, the relevant performance criterion was the public sector borrowing requirement. There were performance criteria on the deposits of the nonfinancial public sector and on the combined public sector, which included the losses of the Central Bank.

The debt conversion operation involved substantial risks, the staff representative commented. It basically foreclosed policy options in the monetary area, for example, and thus increased the emphasis on fiscal policy.

The prospects for growth depended largely on the implementation of the adjustment program, the staff representative explained. To the extent that the program was implemented forcefully and began to inspire confidence, the growth prospects would improve. The present projection was for a small contraction in output from 1989 to 1990, but from the final quarter of 1989 to the final quarter of 1990 the economy was expected to expand by 5 percent.

Debt-equity swaps were not a major component of the financing of the program, the staff representative noted. The staff was assuming that, as a result of the privatization of the telephone company and the national airline, there would be some reduction in the stock of medium- and long-term commercial bank debt. Debt-equity swaps were a feature of the menu of options to be discussed with the commercial banks.

Waivers for the privatization of the telephone company and the national airline had been requested some time ago, the staff representative said. They would likely be one of the issues to be addressed during the discussions with the authorities in early June. The prospects for eliminating the arrears to the commercial banks would also be addressed during those discussions.

The sharp increase in trade financing envisaged under the export financing for the program appeared in the balance of payments because it was reported as the authorities had presented it, the staff representative remarked. It reflected the fact that export prefinancing had been reintroduced in late December 1989, on the expectation that the exchange rate liberalization would not last long.

The 5 percent tax on the sales of the public enterprises was meant to constrain the resources available to the enterprises for spending. Those resources would be absorbed instead by the Treasury, the staff representative said. The idea was not to pass on the tax through an increase in tariffs.

Considerable progress had been made in restructuring the official banks, the staff representative from the Western Hemisphere Department noted. In addition to the changes in the Central Bank, the retail operations of the mortgage bank had been eliminated and the bank's portfolio had been transferred to another official bank. The retail operations of the National Development Company also were to be eliminated, and cuts in personnel were to be made.

The staff representative from the Exchange and Trade Relations Department recalled that a question had been asked whether partial interest payments to the commercial banks would undermine Argentina's capacity to repay the Fund. The large financing gaps, owing both to the accumulation of arrears and the prospective gaps, clearly required that Argentina undertake debt and debt-service reduction on its commercial bank debt. It also required Argentina to obtain from the commercial banks waivers to undertake the debt-equity conversions needed to proceed with the privatization sales of the telephone company, the national airline, and other enterprises. The waivers and the debt and debt-service reduction would need to be negotiated with the banks on a voluntary basis and would need to be market based. Progress in that area would depend on the resources that Argentina would be able to raise to finance the debt-reduction operations. Of course, the banks wished that the resources that Argentina would raise for those purposes would not come out of the resources that the banks felt should be used to make interest payments to them.

Hence, the progress in the negotiations between the authorities and the banks would depend on Argentina meeting its undertaking to begin a process of partial payments of interest to the banks, the staff representative from the Exchange and Trade Relations Department continued. The key was that those payments were to be in line with the country's capacity to undertake them. In that connection, the adjustment program supported by the stand-by arrangement was important. That program attached considerable importance to rebuilding and maintaining an adequate level of gross reserves, which would give the Fund the reassurance it needed that Argentina would have the capacity to make repurchases. Building up and maintaining an adequate level of reserves would be important also for the effort to encourage direct investment and repatriation of capital. Over and above the amounts of reserves for the repayments to the Fund, the program identified a margin of resources that should be available, with full implementation of the program, for payments to the banks. Hence, the resumption of partial interest payments to banks within the margins specified in the program was essential. The pace of progress in the negotiations with the banks and the undertaking of debt and debt-service reduction operations would depend in part on the accumulation of enhancements, and Argentina had requested that a beginning be made in accumulating those enhancements through the set-asides in association with the remaining purchases under the stand-by arrangement.

The question of the parallel between the cases of Argentina and Costa Rica had been raised by Mr. Posthumus, the staff representative recalled. The Costa Rican adjustment program had experienced difficulties on the fiscal side toward the end of 1989, and the authorities had not been able to make purchases. In discussions with the staff, it had become clear that important corrective action was needed. Those events had occurred as an election period was approaching, and the outgoing Administration had decided to invite members of the incoming Administration to work with the staff in diagnosing the problems facing the economy and in identifying measures in an attempt to bring a program for the Board's consideration as soon as possible. In fact, a staff team was currently in Costa Rica. At the same time, Costa Rica and the banks had made an effort to preserve the commercial bank debt package by prefinancing the package--which, as he understood it, had just been completed--in the hope that later on some of the temporary financing that had been utilized could be replaced.

Mr. Feldman commented that Directors had stressed that fiscal policy was at the center of the authorities' adjustment program. In his view, that program included abundant prior actions; some time was still needed to see the effects of all those actions. Of course, in an economy characterized for a long period by resource misallocation and mismanagement it was sometimes difficult to see where short-run macroeconomic management ended and structural adjustment began. In sum, a large number of adjustment measures had been introduced, and they were expected to yield good results.

The conversion measure had been an unavoidable response to the threat of hyperinflation; it had been a kind of financial chemotherapy, in the sense that it been a necessary treatment but had destroyed much of the country's financial tissue, Mr. Feldman remarked. It had clearly helped to reconstitute the savings that were crucial for economic growth, but Argentina obviously needed to build up a positive track record, which would take some time yet. Monetary policy had been significantly limited because the Government had been unable to use open-market operations, but that was not worrying in the very short run, given the emphasis on controlling domestic credit and on fiscal adjustment. The public sector was expected to record a negative net growth of credit in the coming period; hence, it would be absorbing liquidity in 1990. In addition, rediscounts were being collected as another important instrument of monetary control.

Private sector wages were determined on the basis of free collective bargaining, Mr. Feldman noted. Public sector wage policy had been operating as an anchor for wages, and real wages had declined strongly.

In the very short run, it was very difficult to reconcile adjustment goals with growth objectives, Mr. Feldman stated. Of course, the hope was that those goals would be compatible in the medium and long term. The sizable decline in economic activity in Argentina underscored the need for debt reduction that was stronger and quicker than had initially been planned. The authorities had originally planned to tackle the question of debt reduction at a later stage in the adjustment effort--perhaps after completing the stand-by arrangement and starting an extended arrangement. But the burden of debt was so heavy that the issue of debt reduction could no longer be postponed. The set-asides were evidence of the authorities' willingness to negotiate with the banks. The authorities recognized that they needed to accumulate enhancements to support the process of debt reduction.

The Executive Board then approved the following decisions:

Stand-By Arrangement - Review and Modification

1. Argentina has consulted with the Fund in accordance with paragraph 4 of the stand-by arrangement for Argentina (EBS/89/199, Sup. 1) and paragraph 3 of the letter of October 12, 1989, from the Minister of Economy and the President of the Central Bank of Argentina, in order to reach understandings regarding further measures to achieve the objectives of its program and the circumstances in which purchases may be resumed under the stand-by arrangement.

2. The letter, with annexed Memorandum on Economic Policy and tables attached thereto, dated May 10, 1990, from the Minister of Economy shall be annexed to the stand-by arrangement, and the letter of October 12, 1989 with the annexed Memorandum on Economic Policy and tables attached thereto shall be read as modified and supplemented by the letter of May 10, 1990 with annexed Memorandum on Economic Policy and tables attached thereto.

3. Accordingly, paragraphs 1, 2, and 4(a), (b), and (c) of the stand-by arrangement shall be amended to read as follows:

"1. For the period from November 10, 1989 to March 31, 1991 Argentina will have the right to make purchases from the Fund in an amount equivalent to SDR 920 million, subject to paragraphs 2, 3, 4, 5, and 6 below, without further review by the Fund.

2. (a) Purchases under this stand-by arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 184 million until May 15, 1990, the equivalent of SDR 368 million until August 15, 1990, the equivalent of SDR 552 million until November 15, 1990, and the equivalent of SDR 736 million until February 15, 1991.

(b) Each of the amounts that would be available in accordance with paragraphs 1 and 2(a) above, after August 14, 1990 during the remaining period of this arrangement, shall be reduced by an amount equivalent to 25 percent. The amount equivalent to corresponding reductions in the purchases made by Argentina under this stand-by arrangement shall be made available subject to the following conditions:

(i) Argentina represents that it has a need to make a purchase because of use of its reserves or impend pay ments for the discharge of liabilities under debt reduction transactions;

(ii) the Fund, after examination of the request, has determined that the requested purchase is needed for the replenishment of Argentina's reserves or for the making of payments in connection with debt reduction operation; and

(iii) the Fund, upon a review of the financing of Argentina's program supported under this stand-by arrangement, has determined that the debt reduction involved is consistent with the objectives of the program.

(c) Pursuant to a review under (b)(iii) above and if requested by Argentina, the Fund may decide to make available to Argentina, notwithstanding the phasing specified under (a) above and subject to the conditions specified in (b)(i) and (ii) above, an amount equivalent to 25 percent of the total of purchases that may be made by Argentina during the remaining period of this stand-by arrangement. In that event, the right of Argentina to make purchases under this arrangement shall be subject to such phasing of purchases and designation of amounts for debt reduction as shall be determined.

(d) If requested by Argentina, the Fund may decide to discontinue the designation of amounts for debt reduction under (b) and (c) above, provided that the Fund determines that the objectives of Argentina's program supported under this stand-by arrangement can be achieved."

"4. Argentina will not make purchases under this arrangement that would increase the Fund's holdings of Argentina's currency in the credit tranches beyond 25 percent of quota or increase the Fund's holdings of that currency resulting from purchases of borrowed resources beyond 12 1/2 percent of quota:

(a) during any period in which the data at the end of the preceding calendar quarter indicate that

(i) the limit on the combined deficit of the nonfinancial public sector and the Central Bank specified in Table 1 of the Memorandum on Economic Policy annexed to the attached letter of May 10, 1990, or

(ii) the limit on the cash deficit of the nonfinancial public sector specified in Table 1 of the Memorandum on Economic Policy annexed to the attached letter of May 10, 1990, or

(iii) the limit on treasury outlays specified in Table 1 of the Memorandum on Economic Policy annexed to the attached letter of May 10, 1990, or

(iv) the targets for change in the net domestic assets of the Central Bank specified in Table 2 of the Memorandum on Economic Policy annexed to the attached letter of May 10, 1990, or

(v) the targets for change in net international reserves specified in Table 3 of the Memorandum on Economic Policy annexed to the attached letter of May 10, 1990, or

(vi) the limit on external arrears of the public sector as specified in Table 4 of the Memorandum on Economic Policy annexed to the attached letter of May 10, 1990, or

(vii) the limit on the external debt of the public sector and the limit on net disbursements of short-term debt of the public sector specified in Table 5 of the Memorandum on Economic Policy annexed to the attached letter of May 10, 1990, are not observed, or

(b) if Argentina fails to carry out the intention regarding the elimination by the end of 1990 of the remaining import prohibitions and restrictions referred to in paragraph 25 of the Memorandum on Economic Policy annexed to the attached letter of May 10, 1990; or

(c) during any period after August 14, 1990, until the review contemplated in paragraph 28 of the Memorandum on Economic Policy annexed to the attached letter of May 10, 1990 has been completed and understandings on additional measures that may be needed to attain the program's objectives had been reached, or after such understandings have been reached, while they are not being observed, or"

4. The Fund decides that the review contemplated in paragraph 4(c) of the stand-by arrangement is completed and that,

notwithstanding the nonobservance of performance criteria, Argentina may proceed to make purchases under the arrangement.

Decision No. 9439-(90/82), adopted
May 25, 1990

Exchange System

Argentina continues to retain exchange restrictions as described in Appendix IV to EBS/90/90. In the circumstances of Argentina, the Fund grants approval of the retention of the restrictions listed in Appendix IV, Section 1b-c, until August 31, 1990 or the completion of the next review pursuant to paragraph 4(c) of the stand-by arrangement, whichever is earlier.

Decision No. 9440-(90/82), adopted
May 25, 1990

2. CENTRAL AFRICAN REPUBLIC - 1990 ARTICLE IV CONSULTATION; AND STRUCTURAL ADJUSTMENT FACILITY - THIRD ANNUAL ARRANGEMENT

The Executive Directors considered the staff report for the 1990 Article IV consultation with the Central African Republic and its request for the third annual arrangement under the structural adjustment arrangement for the Central African Republic (EBS/90/88, 5/8/90; and Cor. 1, 5/22/90). They also had before them a policy framework paper for the period 1990-92 (EBD/90/139, 5/8/90) and a statistical annex (SM/90/87, 5/14/90).

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 Committee of the Whole of the Executive Directors of the Bank and IDA in their meeting on May 22, 1990.

1. The Executive Directors of the Bank and IDA discussed, in a meeting of the Committee of the Whole, the above-mentioned paper.

2. The Executive Directors expressed their general support for the adjustment program of the Government of the Central African Republic as presented in the policy framework paper. They expressed satisfaction for the efforts and continued strong commitment of the Government to the adjustment program despite unfavorable external circumstances. They noted the favorable

growth performance in 1989 after three successive years of declining per capita income. They also noted, however, that the overall economic situation remained fragile. It was generally recognized that in view of the deep-seated structural constraints, the weak administration, the ambitious strategy adopted, and the difficult external environment, progress in each of the areas of reform was satisfactory. Nonetheless Directors asked whether a more substantial reduction of the current account deficit might be sought.

3. It was also recognized that sustained growth will be possible only after the structural adjustment measures are all put in place and implemented properly. Directors expressed satisfaction that in this policy framework paper, particular attention was given to applying policies favoring the most disadvantaged segments of the population so as to alleviate the possible adverse effects of the adjustment program. However, in the planning, the Social Dimension of Adjustment project should be coordinated with the strategies that have been put in place for the development of the health and education sectors. Directors welcomed the planned higher expenditure on these sectors.

4. There was consensus that this third-year policy framework paper represented the continuation and deepening of the adjustment program undertaken by the Central African Republic since 1986. The Directors noted the significant progress made in the main areas of reform. The strengthening of public sector management was seen to be particularly important and Directors welcomed especially the putting in place of a rolling public sector investment program. The civil service reform is to be commended but Directors wondered whether further cuts could be made in the number of civil servants.

5. The Directors voiced concern over the low growth projections. Staff argued that the growth scenario was conservative. The agricultural and SME sectors appear to be promising.

6. Directors noted the weak fiscal performance and urged Government to pursue their resource mobilization efforts which are necessary to protect the minimum levels of recurrent expenditures while working toward generating budgetary saving. Efforts to contain the growth in recurrent expenditure--particularly wages--should also be sustained. Several commented that more might be done to mobilize private savings.

The staff representative from the African Department said that the staff had recently received information from the BEAC confirming that the administrative arrangements to ensure the Central African Republic's future timely payments to the Fund, as spelled out in paragraph 22 of the

Government's Memorandum on Economic and Financial Policies, had been implemented. In addition, the tax revenue and current expenditure targets for the first quarter of 1990, spelled out in paragraph 25 of the Government's memorandum, observance of which were conditions for the Board's consideration of the request for the third annual arrangement under the structural adjustment facility, had been met. Tax revenues had exceeded the target by a wide margin and were 17 percent above the level during the comparable period in 1989.

Mr. Mawakani made the following statement:

In pursuit of their adjustment efforts, the C.A.R. authorities made further progress in reforming their economy and laying the foundation for a more sustained economic growth over the medium term. The basic macroeconomic objectives set for the second annual program under the structural adjustment facility were achieved, and almost all the benchmarks relating to structural reforms and measures, as shown in Tables 5 and 6 of EBS/90/88, were observed.

I will limit my remarks to the most important economic developments during 1989 and the main elements of the third annual program under the structural adjustment facility for which the C.A.R. authorities are requesting continued financial support from the Fund.

Real GDP growth is estimated to have increased by about 3.7 percent in 1989, compared with about 1.8 percent in 1988, mainly as a result of a sharp expansion in the manufacturing and mining activities, which more than offset the decline in value added in the cash crops subsector. Inflation, as measured by the GDP deflator, at around 2 percent remained relatively low. In the fiscal area, despite the authorities' efforts to contain current expenditure, the fiscal objective of achieving a deficit of 12.2 percent of GDP could not be met, owing to a decline in fiscal revenue. As is explained in the staff report, the shortfall in budgetary revenues was mainly a reflection of weaknesses in the tax and customs administration as well as delays in implementing some of the reform measures. In the external sector, the external current account deficit, on a commitment basis and excluding grants, estimated at about 14.4 percent of GDP, was in line with the program target. However, as a consequence of the tight budgetary situation, external payments arrears were accumulated at end-1989.

With regard to structural reforms, substantial progress was made in 1989 on several fronts: in the agricultural sector, the authorities successfully implemented the cotton sector rehabilitation program aimed at reducing the operating costs of the agricultural development agency (SOCADA) and laying the foundation for the long-term viability of the whole sector. Important steps were also taken to improve the coffee sector through the strengthening and the restructuring of the coffee development agency (ADECAF) and the coffee stabilization fund (CAISTAB). Moreover, in order to restore the financial soundness of the CAISTAB, the authorities reduced the price for coffee from CFAF 380 per kilogram to CFAF 220 per kilogram following the drop in world market prices. Regarding public investment, and as mentioned in the policy framework paper, the authorities adopted a rolling three-year program for the period 1989-91, which is expected to facilitate coordination between physical and financial programming, and to improve the selection as well as the monitoring of projects. Moreover, the Government pursued actions within the framework of the first two structural adjustment programs aimed at restoring and rehabilitating the parastatal sector. To that end, three banks and seven public enterprises have already been liquidated and five other public entities have been fully privatized. With the signing of the first performance contract with the Government in 1989, the rehabilitation of one of the most important public enterprises, the Electricity Company (ENERGA), is also well advanced. Regarding the semi-public enterprises still in the Government's portfolio, several actions were also taken to improve their legal framework and the economic environment and to restore their financial discipline.

As part of the Government's structural plan to improve public finances, the authorities reinforced in 1989 a number of measures to boost revenue and reduce expenditure. In this regard, the management of tax collection and administration was strengthened, and in order to contain the wage bill, staffing plans were established in line with a voluntary departure assistance program (PDVA) supported by the World Bank which has proved to date to be successful. This redeployment of personnel outside the civil service is expected to have an important impact in the medium term not only on the budget but also on the revival of private sector activities by the creation of small and medium-size enterprises.

As is indicated in the policy framework paper, the authorities intend to maintain the thrust of their growth-oriented policies undertaken during the first two annual programs under the structural adjustment facility. Thus the medium-term macroeconomic objectives over the next three years are as follows: to achieve an average annual rate of growth of real GDP of 3.6 percent; to keep the inflation rate as measured by the GDP deflator to an annual average of 3.3 percent; and to reduce the external current account deficit (excluding official transfers) to 13.8 percent in 1992.

The strategy for achieving these objectives will continue to focus on gradually opening up the economy to market forces, widening the productive base of the economy through sectoral development plans for agriculture and industry, mobilizing external financial assistance on concessional terms, and further improving public finances.

Consistent with these objectives, the authorities have revised their policy framework paper to introduce additional measures and will implement a wide range of policies in the context of the third annual structural adjustment arrangement.

In the agricultural sector, the authorities will implement the new rural development strategy approved at the donors' conference of June 1989, which includes improving crop productivity by establishing suitable research and an extension service system covering several crops. Moreover, efforts will be made to diversify agricultural production and export of new products such as spices, medicinal plants, fruits, and vegetables. The authorities will pursue the implementation of the adjustment programs agreed with bilateral and multilateral creditors in the cotton and coffee subsectors. As to the coffee subsector, it should be mentioned that a new flexible pricing system will be introduced beginning with the 1990-91 crop year, and that a more comprehensive plan for improving the whole sector, which entails the rehabilitation and maintenance of feeder roads in the context of a transportation project financed by IDA, has already been adopted.

In the fiscal sector, the authorities' broad objective is to reduce gradually the fiscal deficit and enhance domestic savings so as to finance an increasing part of investment with internal resources. Therefore, additional revenue-raising and expenditure-containing measures will be implemented. On the revenue side, these include: a computerized tax collection system, the taxation of all imports related to newly approved investment projects externally financed, and the introduction of a tax reform as part of the regional adjustment program being discussed between the World Bank and the UDEAC countries. On the expenditure side, the authorities intend to limit strictly current expenditure, particularly by establishing ceilings on civil service hiring over the next three years. In this regard, they will, under the PDVA supported by the World Bank, implement a civil service reform program. As to capital expenditure, owing to financial constraints, and despite the efforts that will be made to improve savings, the bulk of capital investment will continue to be financed mainly by grants and concessional borrowing in the near future.

Regarding the public enterprise sector, the rehabilitation and restructuring process underway will continue with the rehabilitation of the service enterprises (SNE, ENERGA, and OCPT), while four other public enterprises will be privatized. The Government also intends to initiate rehabilitation programs for three other public entities in particular, the C.A.R. Office of Social Security (OCSS), the National Computer Services Office (ONI), and the National Diamond Board (CND), as soon as their audits and studies are available. Moreover, steps will be taken for the settlement of cross-debts and for the conclusion of the liquidation process of some public enterprises so as to assign their liabilities to the public debt management department (CAADE) and their assets to the Treasury.

On monetary policy and financial reform, the authorities will pursue policies consistent with the program's objectives relating to growth, inflation, and the balance of payments. They are putting particular emphasis on encouraging the development of the private sector through better credit allocations. At the same time, they are taking steps to enhance private savings. Moreover, the authorities are preparing, with the assistance of the World Bank, a comprehensive project aimed at strengthening the banking and financial sectors.

As to the external sector and external debt management, the projections of the balance of payments over the period 1990-94 show only a slight improvement in the current account/GDP ratio. The authorities are thus keenly aware of the need to pursue a prudent external debt management policy so as to maintain the debt-service ratio at a sustainable level. In this context, not only are they taking steps to clear the stock of external arrears and avoid the accumulation of new ones, but they are also initiating the necessary administrative procedures in conjunction with the BEAC to ensure the timely repayment of financial obligations to the Fund as they fall due.

In conclusion, my authorities wish to reiterate forcefully their commitment to the adjustment process underway in order to put the C.A.R. economy on a sustainable growth path over the medium term and reverse the decline in the living standards of the population registered over a number of years. They are hopeful that the international financial community will continue to provide adequate financial support, which is critical to achieve the objectives of their program.

Mr. Serre made the following statement:

Three years ago, the authorities embarked on an ambitious adjustment program which focused on stabilization policies and structural reforms aimed at addressing the deep-seated distortions that affected the economy. Noteworthy substantial progress led to an increase of 1.8 percent of real GDP growth in 1988 and 3.7 percent in 1989 while inflation was contained. In this respect, we are pleased that, except for the reduction in domestic payments arrears and the nonaccumulation of new external arrears, all the quantitative benchmarks under the program have been met. As regards structural reforms, despite some delays encountered at the beginning of the program, progress has been achieved in trade and price liberalization as well as in reducing the weight of the civil service and in restructuring the main public enterprises. The objectives outlined in this updated policy framework paper are consistent with the necessity to reinforce the adjustment process in various areas.

I will address the principal issues on which the authorities must focus their utmost attention in order to reach the objectives of the 1990 program. I will deal successively with macroeconomic policies, structural reforms, and the external sector.

On macroeconomic policies, we agree with the staff that recovery of public finances still remains the centerpiece of the program. Reinforcing the tax base should contribute to increasing government revenue to 12.4 percent of GDP in 1990 from 11 percent in 1989. Special attention should be paid to customs strengthening, within the framework of the UDEAC terms, with respect to the recommendations provided by the Fund technical assistance mission. The structural benchmarks set up with respect to customs collection will be very helpful in this matter. As to expenditures, the progress already achieved following the implementation of the voluntary departure assistance program and the reorganization of several ministries should be consolidated. Moreover, close monitoring of current and investment expenditures remains essential to avoid any further slippages, especially as development expenses are supposed to increase by 9.5 percent when the M'Bali hydroelectric project is undertaken. Within this context of a fitting budgetary policy, the objective of reducing the budget deficit from 13.6 percent of GDP in 1990 to 7.9 percent in 1992 should be feasible in view of the goal of eliminating both domestic and external arrears in 1990 and 1991.

Concerning monetary and credit policy, improving the status of net banking system claims on the Treasury will allow a better allocation of resources toward the need of the private sector. Moreover, within the framework of the BEAC, the interest rate level is consistent with the necessity to increase gross domestic savings. Finally, cautious monetary and credit policy will pave the way to implement a comprehensive reform of the financial intermediation system with the assistance of the World Bank.

As to structural reforms, the main objective, as stated in the policy framework paper, is to diversify the productive base as well as to improve the overall competitiveness of the economy. For this purpose, the momentum of the ongoing reforms should be maintained while additional measures should be implemented in several areas.

In the agricultural sector, the arrangements made in 1989 to improve the productivity of the cotton and coffee "filières" are to be kept under close review, in line with the developments in international market prices. In addition, further progress should be made in rehabilitating the rural infrastructure in order to expand forestry production, food crops, and livestock activities.

On the other hand, the current process of price and trade liberalization should be firmly pursued in order to support industrial promotion. In this respect, the achievement of the tariff structure reform within the UDEAC, the liberalization of transport tariffs, and the adoption of the revised investment code are essential steps. Any delays in implementing these measures could jeopardize the progress already made. Mining and energy sectors are also to be closely monitored to avoid any further slippages, as diamond production is crucial for export receipts and as the new development project envisaged in the energy area will modify in a perceptible manner the overall prospects of the sector.

As far as the public enterprises sector is concerned, we are pleased to note the progress already achieved. However, the rigorous implementation of rehabilitation plans for CAISTAB, ENERGA, SNE, and OCPT in 1990 constitutes an indispensable step to durably strengthen the efficiency of the whole sector. We stress the fact that there is no room for complacency in this area.

Finally, we agree with the staff that structural reforms played an important part in the improved outcome in 1988-89, with a rebound of economic activity associated with price stability. In these circumstances, we are confident that both domestic savings and gross fixed capital formation will improve in line with the medium-term targets of the program.

Concerning the external sector, we share the staff's analysis of the situation. The program for 1990 is based on a temporary increase in the current account deficit owing to lower than expected export receipts and the partial settlement of external arrears. However, the overall balance will improve as of 1991. Moreover, the pursuit of a cautious debt management policy will allow for the debt-service ratio to decrease from 18 percent of exports in 1989 to 11 percent in 1994.

We welcome the specific arrangements the authorities have put into place to ease payments to the Fund in the future. We would also like to draw the authorities' attention to the necessity to sign the remaining bilateral agreements depending on the 1988 Paris Club. This is of the utmost importance in order to improve relations with the international financial community in the perspective of another Paris Club rescheduling.

To conclude, the prior actions requested by the staff for the first quarter of 1990, as well as the quantitative and structural benchmarks set up under the program for 1990, are consistent with the necessity to confirm the progress already achieved. Compared with some other sub-Saharan African countries, the Central African Republic is better endowed to resume sustainable growth, if the program is fully implemented in a timely and adequate manner. We support the proposed decision.

Mr. Enoch made the following statement:

It is now almost a full year since the Central African Republic's last Fund program expired. This hiatus reflects the mixed progress made by the authorities in their adjustment efforts since the Board last discussed the Central African Republic, in late 1988.

On the positive side, significant achievements have been notched up in the area of structural reform. Cotton producer prices have been more flexible, the civil service has been trimmed, a start has been made on rationalizing the public enterprise sector, and both international trade and domestic prices have been substantially freed. In addition, the growth of income in 1989 outpaced the continuing increase in the country's population, as the authorities took advantage of a shift in the terms of trade. At the same time, price inflation has remained subdued, reflecting the monetary authorities' firm grip on financial conditions.

On the other hand, the most critical challenge facing the authorities--the chronic weakness of the fiscal position--has still not been satisfactorily addressed. This has caused a number of problems over the past year; most notably, the authorities have repeatedly fallen into arrears to the Fund, a subject I will return to shortly. But given this pattern, it is clear that the main objective over the coming year must be to continue the process of fiscal consolidation, particularly by raising revenue and by keeping a firm control over current spending.

The staff gave considerable weight to this objective in its report. Nevertheless, I have some concern that the fiscal targets built into the new program may not be sufficiently ambitious. For example, on a cash basis, the fiscal deficit is expected to be nearly 2 percent of GDP larger than in 1989, and even on a commitments basis the reduction in the deficit is hardly impressive. This in turn reflects the authorities' continuing problems in raising government revenue. While receipts as a proportion of GDP are programmed to rise marginally in 1990, it seems that most of this improvement is attributable to a new levy on government imports, which will, of course, have no impact on the overall deficit. Aside from this essentially cosmetic exercise, the authorities appear to be pinning their hopes on a one-off increase in privatization receipts and miscellaneous improvements in tax administration. Overall, this does not add up to a convincing response to the structural weakness in the country's fiscal accounts. Until government receipts can be increased, the authorities' attempt to increase the level of domestic savings will have to rely upon continued control over government spending and improved private sector savings efforts.

As far as government spending is concerned, I welcome the authorities' ongoing drive to reduce the size of the civil service. However, this program of reform has not yet produced significant budgetary savings. For example, the wage bill in 1989 was larger in both real and nominal terms than three years previously, even if the costs of the voluntary departure scheme are ignored. With the wage bill still accounting for more than 50 percent of current spending, there would appear to be scope for further savings. In this context, I would be interested to hear from the staff how the average wage level in the civil service compares with wages in the private sector.

Turning to the private sector more generally, I was surprised that the staff report made no mention of financial sector reform. According to the policy framework paper, the financial sector is currently facing very serious difficulties. And with the total deposit liabilities of the commercial banks amounting to only 6 percent of GDP, it is clear that the banks are not yet in a position to play a central intermediation role in the economy. I would welcome staff comments on prospects for reforms in this sector.

The continuing fragility of the Central African Republic's fiscal position has not only thwarted the authorities' attempts to improve the country's competitiveness, but also weakened their ability to service Fund obligations falling due. As the staff report notes, the Central African Republic has been current with the Fund for only one month since December 1987. This is a very serious matter, and I welcome the extended treatment given to it in the staff report. I have two further comments in this area. First, given the authorities' poor track record, I would have expected to see a sensitivity analysis outlining the country's capacity to repay the Fund in the event of a major slump in export prices. Second, while I welcome the authorities' intention to establish procedures to provide some additional reassurance that future Fund obligations will be paid on time, and the update provided by the staff at the beginning of this meeting, I recall that when I raised this subject in December 1988, the staff assured the Board that such procedures had already been put into place. I would be very interested to hear what happened and, more specifically, why the assurances the Board received in late 1988 proved in the event to be without substance.

I wish to touch on two statistical issues. First, I was surprised and, I must say, somewhat skeptical, to see the staff projections for growth, inflation, and so on being calculated to the second decimal place. Growth, for instance, is projected at 3.42 percent for 1991. This goes well beyond any plausible degree of precision and gives a rather unreal sense of certainty to the staff analysis, particularly when set against some rather surprising rounding--for instance, on public sector wage expenditure in 1989. Second, I noted that cross-border transfers of CFA franc banknotes have been treated as a current transaction, not as a capital flow. Could the staff please explain this accounting?

I support the proposed decision. I would stress that if the Central African Republic were to request another form of support from the Fund in the future, the authorities would have to commit themselves to a far more comprehensive program than the one before us today, and would have to demonstrate a much stronger record of payments to the Fund than they have demonstrated over the past two years.

Mr. Fanna made the following statement:

In June 1987, the Government of the Central African Republic adopted a medium-term program designed to strengthen the country's economic structure and to achieve satisfactory growth in a stable financial environment. The economic and financial performance during the past three years was mixed. Regarding structural policies, particularly in the areas of pricing, marketing, and public sector efficiency, the measures adopted have to a large extent been implemented successfully. Major weaknesses however, were registered on the fiscal front, namely, on the revenue side of the budget. The fiscal deficit in 1989 again exceeded the structural adjustment arrangement target. Between 1987 and 1989, the fiscal deficit averaged 13.7 percent of GDP, rather than the programmed 12.2 percent, despite the Government's success in containing the increase in current expenditures. Consequently, and as a result in part of the lack of sufficient domestic counterpart resources, further external payments arrears were accumulated and amounted to SDR 20.84 million at end-1989. With regard to payments to the Fund, the Central African Republic continued to encounter difficulties in remaining current in its financial obligations to the Fund, as it did not accord the highest priority to payments to the Fund.

The medium-term objectives and measures, which are well described in the policy framework paper and the program for 1990, seem to be appropriate for the solution of these problems. In particular, the authorities' revised medium-term policy framework paper for 1990-92 announces strong fiscal measures, both on the expenditure and revenue sides. The implementation of such measures should make it possible to increase the ratio of budgetary revenue to GDP from 11.1 percent in 1989 to 12.8 percent in 1992, and to reduce current expenditure from 12.3 percent of GDP in 1989 to approximately 10 percent in 1992. Consequently, the fiscal deficit will be reduced during the program period from 11.8 percent of GDP in 1989 to 7.9 percent in 1992.

The program for 1990 rightly focuses on the fiscal area and has established a deficit target of 10.7 percent of GDP that will force the authorities to maintain firm control of current expenditure while implementing the program's revenue enhancement measures. An effective improvement of the budget will contribute substantially to a solution of the arrears problem, unless forecasts on the external sector turn out to be worse than expected and the financing gap envisaged for 1990 larger.

Past experience shows, however, that the success in obtaining medium-term fiscal objectives can only be considered as a necessary, but not a sufficient, condition to guarantee that the Central African Republic remains current in its financial obligations to the Fund. Indeed, a strengthening of the priority given to payments to the Fund in expenditure policy is also required. The authorities have indicated that they will give the highest priority to meeting obligations to the Fund, and to this end they will take the necessary administrative steps to ensure the timely discharge of these obligations. If realized appropriately, such measures should minimize the risks of overdue obligations to the Fund both in the near future and in the medium term.

In conclusion, the authorities seem to have found adequate solutions to the most urgent and worrisome problems which we should monitor in the years to come. The more basic economic difficulties faced by the Central African Republic, however, are of a structural nature and can be improved only in the long run. The Government should therefore persevere in its efforts to complete the structural reforms of the economy and to maintain a satisfactory growth path. I support the proposed decision.

Mr. Ichikawa made the following statement:

The Central African Republic's performance under the first- and second-year structural adjustment facility-supported programs was mixed. While the country implemented encouraging structural adjustment measures, including import liberalization and a significant reduction in price controls, the continued weakness in the fiscal area, particularly in tax and customs administration, is a matter of serious concern. It is discouraging that the Central African Republic failed to achieve the fiscal deficit target, despite the progress in containing expenditures.

Given the current exchange arrangements, the Central African Republic has only limited instruments for economic adjustment, and the importance of fiscal adjustment cannot be emphasized enough. Like other speakers, we strongly urge the authorities to strengthen their tax and customs administration. In this connection, I wonder whether it might not be necessary to introduce a more comprehensive value-added tax system. Acceleration of state enterprise reform is also needed to support the fiscal objectives. I wonder whether there is any plan to encourage foreign participation in the parastatal sector.

It is disappointing that the weak fiscal performance led to the nonobservance of the benchmarks for domestic and external payments arrears. Although the problem of external arrears should be addressed primarily by strengthening fiscal policy, there is an obvious need to obtain further external debt relief in order to close the financing gap.

While the current account balance is projected to improve over the medium term after 1991, the staff report is not clear on how this is to be achieved. The staff may wish to elaborate on the key assumptions on export commodity prices.

The Central African Republic's payment record to the Fund is not at all encouraging. In view of the absence of exchange restrictions, the country's capacity to maintain current payments to the Fund depends largely on establishing fiscal discipline, i.e., making repayment to the Fund a priority of expenditure policy. We welcome the plan for the advance acquisition of SDRs and encourage its early implementation. Meanwhile, the authorities should make every effort to remain current with the Fund.

In conclusion, the slow pace of adjustment and discouraging repayment record with the Fund, together with the absence of radical policy improvements envisaged for the coming year, raise questions about the appropriateness of the Fund's further support under the structural adjustment facility. On the other hand, withdrawal of Fund support at this critical juncture could well jeopardize the achievement made so far. Therefore, while we strongly encourage the authorities to accelerate their adjustment efforts and urge them to remain current with the Fund, we can go along with the proposed decisions.

Mr. Scheid made the following statement:

I join previous speakers in broadly endorsing the staff appraisal. It is certainly most welcome that the Central African Republic has made considerable progress in a number of structural areas during the first and second years of the structural adjustment arrangement. But I also fully share the staff's concern that, on balance, the program implementation so far has been rather unsatisfactory, as reflected in particular in the continued fiscal slippages as well as in the accumulation of external payments arrears and the unsatisfactory payments performance vis-à-vis the Fund. In view of the repeated problems encountered in these areas, it is only with considerable reservations that we are prepared to support the request before us; and these reservations have been reinforced by the substantial delays in the recent program negotiations with the staff, which are giving rise to some doubts about the authorities' commitment to fully sustain their adjustment effort.

The irregular servicing of the financial obligations to the Fund is a cause for serious concern, particularly as I had thought that this problem had already been solved through appropriate arrangements as indicated on the occasion of the previous program approval. I certainly welcome the confirmation just given by the staff that the authorities are now taking the appropriate measures in order to keep their payments to the Fund on track. I should stress the critical importance of a prompt discharge of external obligations for the confidence in the country's adjustment effort, which is all the more important as the staff expects a substantial increase in the external financing requirement over the next few years. In the same vein, I should also urge the authorities to conclude without delay the outstanding bilateral agreements with the creditors of the Paris Club, including my own country. An early solution of that problem seems to be most essential in view of the expectation that the financing gap for 1990 will need to be closed by a new Paris Club rescheduling.

On fiscal policy--which, of course, is closely related to the arrears problem--the deficit target for 1990 is rather on the modest side. Moreover, by shifting the emphasis of adjustment on to expenditure restraint, rather than addressing the severe weaknesses in revenue generation, it appears that the authorities are trying to circumvent the root cause of the persistent budgetary difficulties. Considering further that the strong reliance on taxes on international trade can only be a second-best solution, at least in the longer run, I strongly recommend early implementation of the plan to reform the tax system. This would appear to be advisable also because undue emphasis on expenditure restraint may raise doubts about the sustainability of the adjustment effort which--I might note in passing--seems to be complicated further by the existing exchange rate arrangement. In this latter regard, I might also refer to what we said recently, on Cameroon.

In conclusion, although I can go along with the proposed decision quite reluctantly, this is only in the expectation that the Central African Republic will take full advantage of the third annual structural adjustment arrangement to substantially improve its track record. Such an improvement would be a prerequisite for further Fund involvement, which seems to be implied by the substantial financing requirements over the medium term and the expectation of further Paris Club rescheduling.

Miss Hashim noted that the Central African Republic had achieved some progress in structural reforms during the past two years. However, the economy remained vulnerable to external shocks, the fiscal budget and external deficits were expected to remain large, and the debt burden remained heavy. That situation continued to represent major challenges to the authorities in the years ahead.

She basically agreed with the staff that the program for 1990 should focus on the fiscal area, Miss Hashim said. It was in that area where slippages had repeatedly occurred during the past years. The economy could no longer afford to deviate from the program if sustainable growth was to be achieved. It was important that the authorities maintain firm restraint on current expenditures and fully implement the revenue enhancement measures as outlined in the program in order to achieve the medium-term revenue objectives. In that connection, she welcomed the proposed targets in the fiscal area for 1990, in particular the reduction of current expenditure by about 1.5 percent and the increase in budgetary revenue to 12.4 percent of GDP. Equally important, both domestic and external payments arrears should be reduced significantly.

As to monetary and credit policies, the authorities should remain prudent while providing room for adequate expansion in credit to the private sector and to sustain the present level of real interest rates, Miss Hashim continued. On structural policies, continued progress in reforming the public enterprises and encouraging the private sector was extremely important. While she was pleased with the improvements so far, she wished to stress the need to implement the rehabilitation plans of some of the public enterprises and to grant independent pricing authority to some selected enterprises.

That the authorities had continued over the past year to experience difficulties in remaining current with their financial obligations to the Fund was a cause for concern, Miss Hashim said. However, the staff's assessment that the problem was not a foreign exchange constraint was encouraging, and the authorities' intention to give highest priority to meeting their obligations to the Fund was welcome. She was pleased to learn from the staff that the administrative procedures to ensure timely discharge of their obligations had been implemented. She supported the proposed decision.

Mr. Newman made the following statement:

> The latest C.A.R. economic program represents a continuation of the adjustment strategy pursued under the first and second annual structural adjustment arrangements. With external adjustment constrained by the requirements of a fixed exchange rate, the entire burden is placed on the domestic economy, with tight fiscal policies responsible for restraining domestic demand and reducing financial imbalances while the supply-side effects of structural reforms and fortuitous developments in world markets provide the sole sources of growth. The results to date have been similar to those in other CFA countries: low growth; continuing financial difficulties, marked by increased arrears; and weak competitive positions, despite substantial price and wage reforms.
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> The Central African Republic has fared somewhat better than its CFA partners, although the current situation remains precarious. Growth last year was better than expected, primarily owing to improved foreign demand for cotton and diamonds. We are skeptical, however, that the staff's projections for sustained growth at this level are attainable with current policies. The supply-side effects of structural reforms will take time to be realized and are likely to be constrained by weak domestic demand and an overvalued currency. Furthermore, the projected increase in domestic savings only represents a rephasing of objectives that were not attained in previous programs.
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> With regard to the fiscal position, progress has been made in reducing the financial imbalances that emerged in the mid-1980s. These imbalances were due in large part to the appreciation of the CFA franc in 1985-87 and the authorities' efforts to offset the competitive effects through export subsidies and taxes on imports. Subsidies have been scaled back substantially as the financial situation deteriorated, although they remain large relative to the available resources and the room for further reductions may have

been adversely affected by the continued weak competitive position. With a larger share of available funds used to deal with the consequences of the Central African Republic's exchange rate policies, other government spending had to be cut back. In particular, public sector employment and wages have been curbed, and the new program provides for further reduction through additional layoffs and a continued wage freeze. We note, however, that the public sector wage bill absorbs nearly 65 percent of total revenue, and a recent study of wage rates in the region indicates that C.A.R. public sector employees receive wages that are three times the level of other countries in the area.

On the revenue side, a substantial shortfall emerged, even with higher import taxes, as import volume plummeted under the impact of the economic program and anticipated improvements in customs collections proved illusory. Nevertheless, the new program again envisages sharp increases in revenue from import taxes but does not provide new measures that are more likely to succeed than in previous programs. We are also concerned that heavy emphasis on import taxes could be a covert form of protectionism that would damage efforts to improve the competitiveness of domestic industries. Therefore, we urge the authorities to consider broadening the tax base and adopting measures to improve net exports which do not either contribute to the drain on the budget or rely on further demand compression.

The Central African Republic has made commendable progress on structural reforms, and the policy framework paper provides for further efforts in this area. The reform of the trade sector, the scaling down of the civil service, and the privatization and rehabilitation of key public enterprises are all important steps. Moreover, pricing reforms in key agricultural commodities will help reduce the budget drain and strengthen competitive positions. In this context, we understand that there has been considerable resistance to reforms in the transport sector, which remains a roadblock to effective reforms in other areas and improved competitiveness. We would be interested in learning from the staff whether there are plans for additional efforts in this area. We would also be interested in knowing the prospects for developing new commodity exports, such as cocoa and rubber, with the current exchange rate relationships.

Despite several years of slow growth and major structural reforms, the Central African Republic's external position shows no signs of significant improvement, with a current account deficit of about 14 percent of GDP over the medium term. The financial position remains extremely precarious, with further increases in arrears, including continued difficulties in meeting payments to the Fund, and a financing gap that can be closed only through exceptional arrangements by donors. In these circumstances, we remain concerned that the current exchange rate arrangements are contributing significantly to the tight wire act that the Central African Republic must pursue and are unlikely to be sustainable for much longer in view of the financing available from the CFA anchor country or the international community. As we have said previously, an appropriate exchange rate adjustment needs to be seen as a complement to, not a substitute for, sound macroeconomic and structural policies. However, it would provide a means of achieving a more balanced approach to adjustment that could improve the prospects for growth and a sustainable financial position.

My authorities reluctantly supported the second annual structural adjustment arrangement, and our reservations have only increased as a result of the experience under the program. The previous program quickly went off track following the Fund's disbursement. Arrears, albeit temporary, emerged on payments to the Fund, and special arrangements have now been developed to assure timely payment in the future. Yet the new program continues the basic approach of the old, at times simply rephasing performance objectives that had been missed earlier. The commitment of Fund resources is, however, extremely modest, amounting to little more than a refinancing of current Fund obligations. On that basis, and in view of the new arrangements to assure timely repayment to the Fund, we will again reluctantly go along with the program, although without any great confidence that it will succeed in alleviating the problems confronting the Central African Republic.

Ms. Napky considered that the economic performance of the Central African Republic during 1989 was satisfactory. Indeed, the Central African Republic's adjustment efforts, concentrated mainly on important structural reforms and complemented by gains in the terms of trade, had created a favorable economic climate that had bolstered growth with relative price stability. The trade and price liberalization, the strengthening of market mechanisms, the enhancement of public sector operations, and the reduction of the role of the state in the economy had contributed to both the elimination of some rigidities in the economy and the improvement in the allocative efficiency. For all that progress, the Central African Republic's authorities deserved to be commended.

With regard to the program that supported the request for the third annual arrangement under the structural adjustment facility, Ms. Napky continued, she welcomed the modest upward revision of the annual rate of growth target for the period 1990-92 to 3.6 percent, which, with a population growth rate of 2.6 percent, would permit a slight increase in per capita income.

The cornerstone of the program for 1990 was the strengthening of public finances, Ms. Napky remarked. Although she shared the staff's view on the urgency of the need to improve revenue performance and to enhance fiscal administration, the estimated increase in revenues of 20 percent seemed to be on the optimistic side. In addition, in the case of the Central African Republic, as in many African countries, the reliance of tax revenues on taxes on international trade was very high, amounting to 33.1 percent in 1989, and taxes and imports would be increased by 5 percent during 1990. She wondered whether those taxes could jeopardize the trade liberalization process, and she would appreciate some comments from the staff on that issue. In addition, it was essential to improve the expenditure process in order to remain current with the Fund.

The medium-term outlook showed the vulnerability of the Central African Republic's economy, Ms. Napky commented. Although the balance of payments projections did not reflect a financing gap, the deficit in the current account, before official transfers, during the period 1990-94 remained substantial and would be financed mainly by donations and concessional financing. Therefore, in order to restore the external viability of the Central African Republic, the support of the international financial community remained essential.

In supporting the proposed decision, she encouraged the C.A.R authorities to continue with the structural reform program, Ms. Napky said.

Mr. Zhang stated that the authorities were to be commended for the remarkable progress achieved under the first two annual structural adjustment programs. It was encouraging to note that effective structural reform measures had been taken in the import, export, and public sectors and had yielded good results.

However, despite great efforts by the authorities to curtail expenditure and to bolster revenue, the fiscal deficit target under the structural adjustment facility-supported program had not been achieved because of revenue shortfalls, Mr. Zhang noted. The quantitative benchmarks on domestic credit, the banking system's net claims on the Treasury, reductions in external payments arrears through cash payments and through rescheduling, and new external debt were all observed for June 30, 1989, while those relating to reductions in domestic payments arrears and nonaccumulation of new external payments arrears were not met.

He welcomed the authorities' revised medium-term framework for 1990-92, Mr. Zhang said. He broadly agreed with the staff's appraisal and recommendations. He endorsed the key macroeconomic objectives for 1990, as outlined in the authorities' Memorandum on Economic and Financial Policies. However, the policies in the fiscal area remained crucial to successful realization of the adjustment program objectives. The fiscal deficit for 1990 had been targeted at the equivalent of 10.7 percent of GDP.

The authorities were encouraged to undertake appropriate policies and measures to improve fiscal performance through strengthened revenue collection procedures and continued restraint on expenditure, Mr. Zhang commented. In addition, he welcomed the reform program for public enterprises and measures taken by the authorities to increase economic efficiency and improve productivity in the agricultural sector. Finally, he supported the proposed decision.

The staff representative from the African Department said that the cash deficit was projected to increase in 1990 because of the expected payment of a substantial portion of the accumulated domestic and external payments arrears. As to the suggestion that the fiscal deficit target on a commitment basis was not ambitious enough, the staff had wished to be conservative, given the experience of the first two years of the program supported by the structural adjustment facility; that was especially true with respect to revenues, given the substantial shortfalls that had occurred. With respect to the wage bill, the number of employees was to be reduced by 13 percent over the coming year as a result of the implementation of staffing plans and the voluntary departure assistance program. On that basis, the estimated reduction in the wage bill in 1990 might be on the conservative side. Wages in the public sector had fallen sharply relative to those in the private sector. In fact, 1990 would mark the eighth consecutive year in which there had been no upward adjustment of government wage scales, and it was hoped that in coming years there could be scope for increases in wages in the public sector once the number of employees had been scaled back sufficiently.

On the financial sector reform, the staff representative said that the outlook was for progress in 1990 and 1991, especially with the implementation of the third World Bank structural adjustment loan, the negotiations on which had just been completed, and a possible UDEAC regional reform, which would encompass both fiscal and monetary measures.

The question of the CFA notes had to do with data collection, the staff representative commented. Admittedly, the purchase of the CFA notes involved both capital and current transactions, but the relatively weak statistical administration in the country did not permit making precise and complete distinctions. The discussion in the staff report merely followed the procedure used by the central bank of the Central African Republic.

As to the projections for the principal exports, the staff representative from the African Department remarked that the prices in Table 7 were based on world economic outlook assumptions, with some minor adjustments for country specific information, and the volume projections were based on what the Fund and World Bank staff in the field believed to be reasonable and conservative estimates for the various products, especially in the light of the substantial structural efforts that were being made to promote export diversification.

Mr. Mawakani stated that the authorities were committed to pursuing the adjustment program as formulated in the memorandum in the staff report. There had admittedly been some weaknesses in the implementation of the program, but substantial progress had been achieved during the second year of the structural adjustment arrangement.

As to the capacity to repay the Fund, the authorities had agreed with the Central Bank on a procedure to be followed during the implementation of the program for the payment of all the financial obligations falling due to the Fund, Mr. Mawakani commented. The difficulties that had arisen in this area in the recent past were due to the revenue shortfall, not to the authorities' wish to avoid paying the Fund. The authorities had given a high priority to paying the Fund, but the availability of resources had been limited, and, with the agreement with the central bank, he hoped that the performance in the future would be improved.

In the fiscal sector, the authorities were undertaking reform with the assistance of the Fund and the World Bank, Mr. Mawakani noted. Hence, he hoped that the outturn on the fiscal side would be better in the coming months.

The Chairman made the following summing up:

> Executive Directors welcomed the implementation of far-reaching structural reforms in the Central African Republic, notably the streamlining and scaling down of the public sector, measures to contain government expenditure, the reform of the cotton sector, and the liberalization of prices. Economic activity was recovering in a climate of price stability. However, Directors continued to be greatly concerned over the persistent serious weaknesses in tax administration and, consequently, in the overall fiscal position. The major tasks ahead for the authorities were the strengthening of domestic savings and capital formation and further structural reforms to promote economic diversification and sustainable growth. In that connection, Directors underscored the much-needed longer-term fiscal improvement.
>
> In view of the existing exchange arrangements, it was considered particularly important that adjustment efforts focus on measures to raise productivity and reduce costs, as well as to improve the fiscal situation. In this context, firm restraint will have to be maintained on current government outlays, including measures to ensure the programmed reduction in the wage bill; the income tax and customs reforms will have to be implemented; and strong actions will need to be taken to enhance fiscal revenue--particularly customs--collections. Directors also encouraged the authorities to pursue their cautious monetary and credit policy and to maintain interest rates positive in real terms. Financial sector reforms

were also urgently required in order to permit the banking system to play its intermediation role in the financing of the private sector.

Despite the projected narrowing of the external current account deficit relative to GDP over the medium term, the prospective financing requirements were larger than had been envisaged earlier. A sustained rigorous implementation of strong financial and structural adjustment policies is unavoidable to attract the external financing that is required.

In view of the repeated difficulties of the Central African Republic in remaining current with the Fund, Directors underscored the importance for the authorities to adhere henceforth strictly to their commitment to accord the Fund preferred creditor status. In this regard, they welcomed the administrative arrangements that had been agreed to ensure the prompt discharge of obligations to the Fund as they fall due.

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

The Executive Board then approved the following decision:

1. The Government of the Central African Republic has requested the third annual arrangement under the structural adjustment facility.

2. The Fund has appraised the progress of the Central African Republic in implementing the policies and reaching the objectives of the program supported by the first and second annual arrangements, and notes the updated policy framework paper (EBD/90/139).

3. The Fund approves the arrangement set forth in EBS/90/88, Supplement 1.

Decision No. 9441-(90/82), adopted
May 25, 1990

3. HONDURAS - OVERDUE FINANCIAL OBLIGATIONS - REVIEW FOLLOWING DECLARATION OF INELIGIBILITY - POSTPONEMENT

Mrs. Filardo said that it would be most helpful to reschedule the discussion on Honduras' overdue financial obligations from May 30, 1990 to July 2, 1990.

The Executive Board then approved the following decision:

> Paragraph 4 of Executive Board Decision No. 9417-(90/65), adopted April 25, 1990, shall be amended by substituting "on July 2, 1990" for "not later than May 31, 1990."

Decision No. 9442-(90/82), adopted
May 25, 1990

APPROVED: April 18, 1991

LEO VAN HOUTVEN
Secretary

May 23, 1990

Mr. Michel Camdessus
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Mr. Camdessus,

On May 21 the Minister of Economy of Argentina has sent a telex to the chairman of the Bank Advisory Committee requesting a meeting as soon as possible, to resume discussions with commercial banks in the aim of regularizing the country's relation with its external creditors.

Following that request, I met today with Mr. William Rhodes and we have agreed that a meeting with the Advisory Committee will take place on June 7th at 10:00 a.m.

On that occasion, we shall make a presentation of the Argentine program, and within this framework, I can confirm our decision to resume a regular flow of payments on debt owed to creditor banks of Argentina commencing no later than June 6. The amounts and sequence of subsequent payments will be specified at the above-mentioned meeting.

At the eve of the Executive Board's consideration of the Argentine program I would like to reiterate, on behalf of my Government, our firm commitment to our program objectives and we expect the full support of the international financial community.

Yours sincerely,

/s/

Javier González Fraga
Vice President
Central Bank of Argentina

To: The Republic of Argentina
Ministry of Economy
Attention: Antonio Erman González,
Minister of Economy of Argentina

Telex No.: 39021952 MINEC AR

Banco Central de la República Argentina
Attention: Javier González Fraga
Vice President

Telex No.: 39024035 BCATD AR

From: The Working Committee for Argentina

Date: May 24, 1990

We have received a copy of the telex dated May 21, 1990 from Dr. Antonio Erman González, Minister of Economy of Argentina to Mr. William Rhodes, Chairman of the Working Committee for Argentina, relating to a proposed new letter of intent from Argentina to the International Monetary Fund (IMF) concerning revisions to the stand-by arrangement approved by the Executive Board of the IMF last November and requesting a meeting with the Working Committee as soon as possible. We have also received a copy of the letter dated May 23, 1990 from Mr. Javier González Fraga, Vice President of the Banco Central de la República Argentina to Mr. Michel Camdessus, Managing Director of the IMF, confirming Argentina's decision to resume a regular flow of payments on debt owed to creditor banks of Argentina commencing no later than June 6.

Based on the foregoing telex and letter, the Committee is prepared to meet with you on June 7, as agreed with the chair of the Working Committee after several discussions.

We welcome your initiative. However, as we have previously advised you, the failure of Argentina to meet its obligations to the commercial banks, including its failure to pay interest for over two years on its commercial bank debt, has materially adversely affected Argentina's relations with the commercial banks. Therefore, you should be aware that in our view, unless the interest payments to the commercial banks referred to in your letter are substantial and are made on a frequent and regular basis, meaningful progress on the many issues relating to Argentina's commercial bank debt will probably not be possible and further meetings with the Committee may not be useful. Argentina's decision to resume interest payments is a positive step, and we hope that it will be another step toward a regularization of Argentina's relationships with its commercial bank creditors. For our part, we are ready to engage in a serious negotiation to that end.

With respect to the privatization waivers for ENTEL and Aerolineas, we have advised you in previous discussions and in our telex of May 16 that you should continue to work with the syndicate agents for the commercial bank debt of those companies. As stated in our May 16 telex, the Working Committee supports in principle the privatization of Argentine public sector companies.

Finally, the head of the economic subcommittee of the Working Committee is currently in Argentina and, we understand, has met with Mr. González Fraga and several other government officials and is in the process of collecting technical information. This work should help us to get off to a good start in our discussions.

We look forward to our meeting with you on June 7.

Regards,

Working Committee for Argentina