

of 2.25 percentage points between October 1995 and March 1996.

Developing Countries

Over the course of the 1996 financial year, the Board held more than ninety Article IV consultations with developing countries. Many countries were commended for their impressive pursuit of economic reform—often with the financial support of the Fund. Their aggregate record of strong growth with low or declining inflation was seen as reflecting the pursuit of prudent policies coupled with determined structural reforms. Most, however, require some further macroeconomic and structural adjustment; Directors counseled perseverance in creating the sound macroeconomic policy environment that is needed to sustain high-quality growth. Financial markets tended to react quickly to any faltering of countries' adjustment and reform efforts, and were now holding countries to a higher standard, Board members observed.

The robust aggregate performance of the developing countries masked widely divergent experiences among individual countries. While some countries had registered successive years of brisk growth, a number of other countries remained mired in a vicious circle of low growth, high inflation, and intractable external indebtedness. Directors stressed the vital importance of laying a solid foundation for growth and fostering the development of a vigorous private sector. For many developing countries with youthful populations about to swell the size of their workforce, a dynamic private sector was viewed as offering a key to higher growth and expanded employment opportunities. Directors emphasized that in many countries there was still considerable scope to reduce the role of government in the economy, encourage growth in the private sector, and shift needed resources to public sector investments in human resource development and infrastructure. They also noted the crucial role that governments play in shaping and sustaining a policy environment conducive to high-quality growth.

The Board cited civil order as a key precondition for both reform and growth. Sound macroeconomic policies and a vibrant private sector were unlikely to take root in conditions of strife and uncertain security. Directors hoped that several countries would soon be able to re-establish the conditions necessary for civil order and growth; they also commended a few countries that had recently emerged from conflicts and were, with the assistance of the Fund and others, attempting to rebuild their economies.

In most of their discussions with member countries, Directors stressed the importance of strengthening fiscal discipline. They frequently underscored the need to address public sector deficits to ensure that these did not produce inflationary pressures or stifle private sec-

tor development. They cautioned a number of countries about rising or persistently high public sector debt. More generally, they emphasized the role that strong fiscal policies play in achieving and consolidating macroeconomic stability, ensuring adequate revenues, promoting higher domestic saving (and lower government dissaving), and stimulating investment. To ensure the adequacy of revenues, they often recommended expansion of the tax base and, in some instances, implementation of sales or value-added taxes, as well as improved tax administration and efforts to combat fraud.

In many instances, however, revenue-enhancing measures needed to be complemented by firm expenditure restraint. In particular, Directors observed that restraint in the public sector wage bill, which figures as a key element in many developing country government expenditures, could free up resources for more productive public and private sector investment. In some instances, public sector wage restraint could also exert a useful demonstration effect on private sector wages—thus helping countries to maintain or enhance external competitiveness.

Directors underscored the need to make effective use of resources and eliminate unproductive expenditures. In this regard they counseled a number of countries to end general subsidies, reduce military expenditures, and better target social safety nets. Reduced spending on unproductive activities would allow countries to shift resources to needed investments in human and physical capital, notably in health, education, and physical infrastructure. In addition to identifying unproductive expenditures, some countries would need to take broad and basic steps to rationalize and prioritize expenditures and to improve budgetary management. In many of their discussions, Directors urged countries to complement expenditure restraint with accelerated privatization and public enterprise reform.

On the monetary side, Directors commended a number of countries for pursuing appropriate monetary policies that had produced low inflation and a stable macroeconomic environment. They urged continued diligence where progress had been made and greater effort, in the context of comprehensive reforms, to stabilize the economy and bring down inflation where high rates continued to undermine growth prospects. Directors noted that wage indexation in some countries posed a serious obstacle to efforts to subdue inflation.

Where a change in monetary policy was recommended, it was often a move to tighten the monetary stance in response to underlying changes in the economy. Directors considered, for instance, that tighter monetary policies were indicated in several countries that had enjoyed extended periods of strong growth

but now were running at near capacity and were at risk of overheating. More broadly, Directors encouraged a number of countries to move toward a greater reliance on market-based instruments in their formulation of monetary policies and in the setting of interest rates. They also noted the crucial role that positive real interest rates played in encouraging investment and growth.

Independent central banks have made a demonstrable contribution to the design and implementation of effective monetary policies, and Directors recommended that a number of countries strengthen the autonomy of their central banks. Directors also noted the dangers inherent in the automatic access of governments or public enterprises to credit. They likewise expressed great concern over credit policies in several countries that mandated or directed credit allocation, noting that such policies introduced distortions into the economy. In some instances, Directors made note of the use of bank-by-bank credit allocation but considered this an appropriate intermediate step until more indirect monetary policy instruments could be developed.

In their review of policies in the aftermath of the Mexican crisis, Directors weighed the impact of large and possibly volatile inflows of short-term capital and considered the effects of using capital controls to forestall sudden reversals in these flows. They noted that large capital inflows can complicate the management of monetary and exchange rate policy and suggested that policies designed to attract longer-term capital flows might be one means of addressing the issue. They had a mixed response to the use of capital controls, with many convinced that capital controls could not substitute for sound policy fundamentals.

To complement strong fiscal policies and the pursuit of low inflation, Directors stressed the role that structural reforms have in creating a flexible and responsive economy and ensuring the efficient use of resources. In many countries, Board members found considerable scope for implementing or expanding privatization efforts. More specifically, they pointed to the widespread need for civil service reform, which could both enhance the quality and effectiveness of the public sector and free up increased resources for investment. Board members also cited the need to restructure public enterprises to improve efficiency or to privatize these functions.

For a number of smaller economies, and particularly for many small island economies, Directors recommended increased diversification to improve the capacity of these economies to cope with fluctuations in demand for individual products. More generally, they stressed the need to retain external competitiveness and noted the vital importance of linking wage increases to productivity gains. Several countries were commended for their investments in education and training, which

would allow their workforces to shift from labor-intensive to more skill-intensive production.

In the financial sector, Directors noted the fragility of the banking sector in a number of countries and highlighted the serious problems that could arise for stabilization efforts or growth if insolvency were to undermine the health of the banking system. They urged greater attention to the maturity composition of loan portfolios and increased efforts to identify and address problem loans and problem banks, as well as improved prudential supervision and regulation.

On exchange rate policy, while Directors noted that existing exchange arrangements had served many countries well, they did observe that there was scope in some countries for greater flexibility. They also emphasized in some discussions the importance of developing a market-based exchange rate policy, noting that it could be useful in reducing the risk of destabilizing short-term capital inflows. Directors commended a large number of countries for their efforts to reduce exchange and trade restrictions. Where multiple exchange arrangements remained in place, Directors urged adoption of a market-determined, unified exchange rate.

Directors welcomed the decision of an increasing number of member countries to accept obligations under Article VIII of the Fund's Articles of Agreement. In so doing, these countries agree to refrain from imposing restrictions on payments and transfers on current international transactions and from discriminatory and multiple currency arrangements without the approval of the Fund. Board members expressed the hope that additional member countries would accept Article VIII status in the coming year.

While a number of countries successfully maintained or restored balance of payments viability, Directors cautioned that in most countries there was little room for a relaxation of policies and that further adjustment would be needed over the medium term. They pointed to several instances in which countries had relaxed policies prematurely, with a consequent serious deterioration in their external position.

Board members noted with concern the constraints posed by high debt burdens in a number of countries. They applauded steps taken by several countries to restructure their debt and debt service under the Naples terms and urged other countries to take similar steps. Directors urged a number of countries to refrain from borrowing on nonconcessional terms, so as not to jeopardize their external position or deepen their debt burden. They also stressed to a number of countries the grave importance of dealing expeditiously with domestic and external arrears and of moving to normalize relations with external creditors and donors.

Finally, the Board noted the critical role played by timely and adequate data in formulating appropriate

policies. Directors complimented several members on the high quality of their data but noted that many others needed to improve the coverage, timeliness, and transparency of their economic and financial statistics. They observed that, where needed, technical assistance was available from the Fund.

Argentina

After four years of rapid economic growth aided by large private capital inflows, there was an outflow of capital from Argentina in the aftermath of the Mexican crisis that, in turn, caused a sharp contraction in domestic demand and activity. In response, the authorities took strong measures to bolster public finances and provide support to the banking system within the constraints of the Convertibility Law. They added a temporary surcharge of 3 percentage points, increasing the value-added tax to 21 percent; cut wages for higher-paid public employees; and established two trust funds to facilitate the restructuring of private banks and the privatization of provincial banks. As a result, when the Board discussed in September 1995 the Article IV consultation with Argentina, its economy appeared to have stabilized: about half of the nearly \$8 billion outflow of bank deposits between December 1994 and mid-May 1995 had returned; bank credit was beginning to recover; the country had regained access to international capital markets; and international reserves were being rebuilt.

The events in early 1995, however, triggered a sharp fall in consumption and investment—and, consequently, in GDP—in the second quarter of 1995, and real GDP for the year was projected to show little growth (see Table 15). Moreover, despite the measures taken, the credit squeeze and decline in consumption were pointing to a major revenue shortfall in 1995, necessitating a revision in the program's fiscal policy objectives. Also, unemployment rose from 12 percent in October 1994 to 18½ percent in May 1995, principally as a result of the jump in the labor force participation rate.

The sharp outflow of deposits and the growth in nonperforming loans was attenuated by bank capital in

Table 15

ARGENTINA: SELECTED ECONOMIC INDICATORS

(Data as of Board discussion in September 1995; annual percent change unless otherwise noted)

	1992	1993	1994	1995 ¹
Domestic economy				
Real GDP	8.7	6.0	7.4	0.5
Unemployment rate	7.0	9.6	11.5	18.6 ²
Consumer price index (period average)	24.9	10.6	4.1	3.6
External economy				
Exports, f.o.b. (in billions of U.S. dollars)	12.2	13.1	15.8	21.4
Imports, c.i.f. (in billions of U.S. dollars)	14.9	16.8	21.6	19.9
Current account balance (in percent of GDP) ³	-2.8	-2.9	-3.5	-1.3
Direct investment ⁴	71.3	50.9	-70.2	94.7
Capital account balance (in percent of GDP)	4.5	3.8	3.6	0.3
External debt	-3.8	2.8	8.1	...
Debt-service ratio (in percent of exports of goods and nonfactor services)	40.8	47.1	38.1	42.5
Real effective exchange rate	13.8	9.8	-1.3	...
Net international reserves (in billions of U.S. dollars)	8.6	11.5	11.4	12.7 ⁵
Financial variables				
Overall public sector balance (in percent of GDP, excluding privatization receipts)	-0.2	0.9	-0.5	-0.8
Gross national saving (in percent of GDP)	13.9	15.3	16.4	17.5
Gross domestic investment (in percent of GDP)	16.7	18.2	19.9	18.8
Broad money (M3, period average)	69.4	40.9	14.1	...
Interest rate (interfirm, period average)	18.2	8.0	8.5	...

¹Projected.

²As of May 1995.

³The authorities estimate that the current account deficit in 1994-95 was narrower by about 0.3/0.5 percent of GDP on account of larger estimated interest receipts.

⁴Including privatization.

⁵As of September 1995.

excess of the Basle accord on bank capital adequacy and the relatively high average legal reserve requirements. This allowed the Central Bank to maintain its commitment to price stability while containing the budgetary impact of the sizable reduction in the number of private banks, from 172 in December 1994 to some 125 in August 1995. The trust funds provided support to 14 private banks. In addition, 15 provincial banks were either privatized or in the process of privatization. To strengthen the banking system's liquidity position and promote lower interest spreads, the Government announced that a uniform liquidity requirement would replace minimum reserve requirements by November 1995.

The real effective exchange rate of the Argentine peso depreciated by 8 percent between the beginning of 1994 and August 1995, and Argentina's exports (in

U.S. dollar terms) rose by 47 percent in the first half of 1995 over the corresponding period in 1994, boosted by the continued strong performance of manufactured goods exports. Meanwhile, the trade surplus for 1995 was projected to reach \$1.4 billion, compared with a deficit of almost \$6 billion in 1994, and the current account deficit for the year was expected to narrow to \$3.7 billion from the \$10 billion recorded a year earlier. The authorities estimated that the current account deficit in 1994–95 was about \$1.0–1.5 billion narrower, on account of larger estimated interest receipts.

In their review, Directors commended the authorities for the decisive actions taken early in 1995 to stabilize the economy; they noted that, in response to those measures, confidence was recovering and deposits were returning to the banking system. They also took note of the significant strengthening in the external current account. However, economic activity had slowed more sharply than envisaged because of the credit squeeze, and unemployment increased sharply.

Against that background, Directors considered that the easing of the 1995 fiscal targets was warranted. At the same time, because the credibility and sustainability of the Convertibility Plan (which maintained parity between the Argentine peso and the U.S. dollar) required the maintenance of sound public finances, Directors underscored the critical importance of restoring fiscal equilibrium in 1996, including by combating tax evasion and further reducing expenditures. They also urged the authorities to deepen the process of reforming the provinces' public finances.

Directors believed that the new uniform liquidity requirements should help to narrow interest rate spreads and strengthen the financial system. They welcomed the recovery of bank deposits after May 1995 but expressed concern about the continued weak condition of parts of the financial system. It was also emphasized that further structural reforms, especially those aimed at increasing labor market flexibility, strengthening competitiveness, and addressing the unemployment problem, would help to speed the

Argentine economy's return to a path of investment, output, and employment growth. Directors noted that the recently announced phased reduction in employers' social security contributions could help to correct a major disincentive to employment.

In light of Argentina's strong export performance and the rapid adjustment in the external accounts, Directors viewed Argentina's present level of competitiveness as broadly adequate. The Board generally considered that Argentina's exchange rate framework had served the economy well. Finally, given Argentina's recent experience, Directors also considered that it would be prudent to strengthen the Central Bank's free reserves beyond the program targets to bolster the Convertibility Plan.

Botswana

Directors discussed the 1995 Article IV consultation report for Botswana in February 1996 against a background of encouraging signs of recovery from the economic downturn of the early 1990s. From an average 10 percent a year during the 1980s, real GDP growth in Botswana had slowed to an average 3 percent a year during 1991–95,

Table 16

BOTSWANA: SELECTED ECONOMIC INDICATORS

(Data as of Board discussion in February 1996; annual percent change unless otherwise noted)

	1992	1993	1994 ¹	1995 ²
Domestic economy				
Real GDP ³	-0.3	4.1	2.1	7.7
Consumer price index (annual average)	16.1	14.4	10.6	10.7
External economy				
Exports, f.o.b. (in millions of U.S. dollars)	1,725.2	1,725.1	1,879.5	2,030.4
Imports, c.i.f. (in millions of U.S. dollars)	1,539.5	1,457.9	1,508.7	1,627.0
Current account balance (in percent of GDP)	6.1	12.5	1.3	6.5
Direct investment, including retained losses (in millions of U.S. dollars)	-3.3	-288.3	-49.2	34.4
Portfolio investment (in millions of U.S. dollars)	0.1	0.2	-0.1	-0.3
Capital and financial account balance (in millions of U.S. dollars)	6.6	8.5	6.0	6.9
External debt (in percent of GDP)	15.8	16.7	16.7	18.3
Debt-service ratio (in percent of exports of goods and services)	5.1	4.7	4.5	3.9
Real effective exchange rate	1.2	3.7	-0.9	0.6
Gross international reserves (in millions of U.S. dollars)	3,793	4,097	4,402	4,436
Financial variables				
Central government balance (in percent of GDP)	10.6	8.9	1.7	-1.7
Broad money (M2)	14.3	9.3	4.5	10.1
Interest rate (prime lending)	14.5	15.0	14.5	14.5

¹Preliminary.

²Estimated.

³National accounts year beginning in July.

mainly because of weakness in the diamond sector, which had resulted in the imposition of a sales quota on diamond exports. Botswana's overall performance is dominated by developments in the diamond sector, which by 1990 accounted for about 30 percent of GDP, nearly 80 percent of exports, and 55 percent of central government revenue.

While the economic slowdown reduced growth in government revenues, a delayed response to contain the momentum of growth in government expenditure caused the fiscal balance to deteriorate from a surplus of 10 percent of GDP in 1991–94 to a surplus of below 2 percent in 1994–95 (see Table 16). The budget for 1995/96, which provided for reduced income tax rates and continued public wage restraint, was expected to result in a modest deficit. Since 1993 a tight monetary policy has moderated growth in money and credit, helping to bring inflation down, and has contributed to positive real interest rates.

In 1994, the value of merchandise exports increased by 9 percent in U.S. dollar terms, including a strong performance of textiles and vehicles, but import growth was limited to 3.5 percent because the economic slowdown reduced demand. The current account surplus dropped to 1.3 percent of GDP primarily because of lower earnings on international reserves, which by the end of 1994 had accumulated to the equivalent of 28 months of imports of goods and services. The nominal effective exchange rate of the pula depreciated by a cumulative 12 percent during 1991–95, reflecting the depreciation of the South African rand in relation to the U.S. dollar. Because inflation had been slightly higher in Botswana than in South Africa, reflecting in part the broadening of the sales tax, however, the real effective exchange rate appreciated by 4 percent in that same period.

Directors noted in their discussion that the authorities were continuing to pursue policies favoring a liberal economic system and that the economic recovery, although broadly based, was projected to moderate in the medium term because of uncertainties in the diamond market. They urged the authorities to strengthen financial policies further, to reduce inflation, and to deepen structural reforms. They pointed to a need to reduce dependence on mineral revenue and to broaden the tax base. Directors urged the authorities to phase out civil service loan guarantees and to secure appropriate funding for the civil service pension plan. They welcomed measures to strengthen cost recovery for public services, as well as recent reforms of public enterprises. They encouraged the authorities to expedite completion of the staffing of the Public Enterprise Monitoring Unit to coordinate reforms in the parastatal sector. Directors advised further sales of central bank instruments to absorb excess

liquidity. Greater coordination of fiscal and monetary policies would be essential, particularly as further reforms would increase the potential for capital inflows.

In the external sector, Directors welcomed the ongoing tariff reforms under the South African Customs Union and the measures adopted by the authorities to reduce taxes and contain wages and other costs so as to strengthen external competitiveness. They considered that the present exchange rate system served Botswana well and that it should continue to be supported by sound financial policies. Directors welcomed Botswana's acceptance of the obligations of Article VIII effective November 17, 1995 and expressed their appreciation for Botswana's contribution to the ESAF Subsidy Account.

Directors observed that Botswana was undertaking important structural reforms to encourage private investment. They urged the elimination of bureaucratic impediments to higher private investment.

China

Directors met in April 1996 to conclude the Article IV consultation with China. The discussion was held against the background of the economy's cooling down after prolonged overheating, without sharp deceleration in growth.

The Chinese economy entered a boom in early 1992. Domestic demand—especially investment—surged, fueled by expansionary financial policies, which contributed to an acceleration in inflation and to disorderly financial and exchange market conditions. Since mid-1993, economic policy has focused on cooling down the economy. Macroeconomic policies were tightened to reduce inflationary pressures and slow the growth of output and demand to a more sustainable pace. Despite some initial success, rapid monetary expansion and the effects of administered price increases and supply problems contributed to a resurgence of inflation in 1994. In 1995 the Government tightened financial policies, intensified controls on investment spending, and stepped up administrative measures to dampen inflation. Structural measures related to central banking, fiscal reform, the exchange system, and the legal framework were also implemented.

As a result, the overall inflation rate fell from its peak of 25 percent in October 1994 to about 8 percent by the end of 1995, and real GDP growth moderated from 12 percent in 1994 to about 10 percent in 1995 (see Table 17). The external sector remained strong: the current account was in surplus, large inflows of foreign direct investment continued, and international reserves rose from \$54 billion in 1994 to about \$77 billion at the end of 1995. These trends continued in early 1996.

Table 17

CHINA: SELECTED ECONOMIC INDICATORS

(Data as of Board discussion in April 1996; annual percent change unless otherwise noted)

	1992	1993	1994	1995 ¹
Domestic economy				
Real GDP	14.2	13.5	12.6	10.2
Urban employment	2.4	2.1	5.4	0.3
Retail prices (end of period)	6.7	17.6	23.3	8.3
External economy				
Exports (in billions of U.S. dollars)	69.6	75.7	102.6	128.1
Imports (in billions of U.S. dollars)	64.4	86.3	95.3	110.1
Current account balance (in percent of GDP) ¹	1.5	-2.8	1.5	0.2
Direct investment inflows (in billions of U.S. dollars)	12.0	27.5	33.8	37.7
Capital account balance (in billions of U.S. dollars; excluding errors and omissions) ¹	-0.2	23.5	32.6	38.7
External debt (in billions of U.S. dollars)	69.3	84.4	95.0	106.6
Debt-service ratio (in percent of exports of goods and nonfactor services)	9.8	10.2	9.3	7.3 ²
Real effective exchange rate ³	73.6	72.1	78.6	83.0
State gross international reserves (in billions of U.S. dollars) ⁴	21.2	23.0	53.5	76.0
Financial variables				
Overall budgetary balance (in percent of GDP)	-2.3	-2.0	-1.6	-1.7
Gross national saving (in percent of GDP) ¹	37.7	40.5	41.4	39.7
Gross domestic investment (in percent of GDP) ¹	36.2	43.3	39.9	39.5
Broad money (end of period)	31.3	24.0	34.5	29.9
Interest rate ⁵	7.56	10.98	10.98	10.98

¹Estimated.²Official estimate.³End of year, 1990 = 100; decline indicates a depreciation.⁴Since September 1992, the authorities have reported official reserves to include only the foreign assets of the People's Bank of China and not those held by the Bank of China and other specialized banks.⁵Interest rate on one-year time deposits at end of year.

In their discussion, Directors welcomed China's continued impressive economic performance and the moves toward a market-based system, to strengthen macroeconomic management, and to further integrate the country into the global economy. They commended the successful moderation of growth and demand toward more sustainable rates and the reduction of inflation to single digits. Directors urged the authorities to press ahead with cautious financial policies and bold structural reforms.

A cautious approach to financial policies, Directors stressed, was essential given the risk of renewed inflationary pressures. Moreover, deep-seated weaknesses in the state-owned enterprise and financial sectors needed urgent attention so as not to compromise the appropriate stance of financial policies. Directors also empha-

sized that, while sustaining low inflation would require a significant slowing of broad money growth, policy implementation would need to be flexible in view of risks and uncertainties.

Directors were concerned at the decline in the ratio of fiscal revenue to GDP, which had necessitated a compression in budgetary expenditure. Continued revenue weaknesses would preclude social spending to support enterprise restructuring and infrastructure. Directors welcomed measures to scale back and rationalize preferential tax policies. They emphasized that further actions to broaden the tax base and strengthen tax administration were needed to boost revenue and achieve the authorities' medium-term goal of eliminating the budget deficit while meeting prospective expenditure needs. Directors stressed that budgetary saving could be enhanced by rationalizing expenditures and further improving budgetary management and control.

Directors underscored that China's strong external position offered scope for accelerating trade and payments liberalization, and they welcomed the initiatives taken in those areas. Directors attached particular importance to reducing quantitative restrictions and liberaliz-

ing foreign trading rights. They welcomed the Government's experiments in liberalizing exchange controls in selected pilot zones and issuing an interim foreign exchange control regulation to provide a transitional framework for further exchange liberalization. Most Directors urged the early removal of the remaining restrictions on current international transactions and hoped that China would soon accept the obligations of Article VIII of the Fund's Articles. In addition, Directors emphasized that upward pressure on the exchange rate would be alleviated by early and substantial trade reform.

Directors endorsed the priority accorded to the problems of state-owned enterprises. They welcomed experimental initiatives, such as increased scope for diverse forms of ownership, and called for bolder

reforms, including establishment of a clearer legal framework. Directors remarked that successful and sustainable state-owned enterprise reform would require intensified efforts to establish a social safety net and to encourage labor mobility while promoting jobs in the nonstate sector. Directors urged the Government to build on nascent efforts to reduce subsidized credit and other financial support to state-owned enterprises.

Directors welcomed monetary and financial sector reforms, including open market operations in an integrated interbank market. They strongly supported plans to develop the infrastructure for indirect monetary management and to strengthen prudential regulation. Directors called for action to address the non-performing loans of the specialized banks. They welcomed the greater flexibility in selected short-term interest rates but emphasized the need to further simplify the rate structure and to adjust administered rates more frequently. Directors expressed concern about weaknesses in China's economic statistics but acknowledged China's efforts to address them, and they urged strong further actions.

Colombia

Directors discussed Colombia's 1995 Article IV consultation in January 1996. Against the background of the steady real GDP growth over the previous 25 years and the leveling off of inflation at 23 percent in 1994, the authorities' objectives in 1995 were to maintain output growth at 5.5–6.0 percent, reduce inflation to 18 percent, and increase international reserves moderately. To achieve these objectives, they set a target of fiscal balance or small surplus and planned the continuation of the firmer monetary policy adopted in the second half of 1994.

In the event, although output growth declined slightly in 1995, partly because of a slowdown in private consumption and investment in response to a monetary tightening in late 1994, it still remained above 5 percent (see Table 18). Output was stimulated by an increase in investment of 14.8 percent. The inflation rate decreased for the fifth successive year to 19.5 percent—the first time in ten years it had dropped

below the level of 20 percent. Despite the postponement of some large import-intensive projects in the oil sector, the current account deficit widened to 5¼ percent of GDP in 1995 from 4½ percent in 1994. Net international reserves increased about as projected in 1995, and gross reserves ended the year at \$8.5 billion, equivalent to some five months of imports of goods and services. The trade deficit narrowed to 3.2 percent of GDP in 1995 from 3.5 percent in 1994, as nontraditional exports grew by 20 percent in U.S. dollar terms.

The combined public sector deficit of 0.5 percent of GDP, although still within relatively conservative bounds, was higher than programmed owing to a

Table 18

COLOMBIA: SELECTED ECONOMIC INDICATORS

(Data as of Board discussion in January 1996; annual percent change unless otherwise noted)

	1992	1993	1994	1995 ¹
Domestic economy				
Real GDP	4.0	5.2	5.7	5.3
Unemployment rate	10.2	8.6	8.9	8.4
Consumer price index (period average)	27.0	22.4	22.8	20.9
External economy				
Exports, f.o.b. (in millions of U.S. dollars)	7,263	7,428	8,756	10,725
Imports, f.o.b. (in millions of U.S. dollars)	6,029	9,086	11,040	13,249
Current account balance (in percent of GDP)	1.8	-3.9	-4.6	-5.3
Direct investment	56.9	4.6	113.5	38.5
Portfolio investment (in millions of U.S. dollars)	65.0	203.0	-65.0	200.0
Capital account balance (in percent of GDP)	0.9	4.1	4.7	5.5
External debt	35.0	34.8	32.8	28.9
Debt-service ratio (in percent of exports of goods and services)	44.9	37.2	39.6	35.3
Real effective exchange rate (end of period)	8.6	7.3	10.5	-7.8 ²
Net international reserves (in millions of U.S. dollars)	1,326	153	128	185
Financial variables				
Nonfinancial public sector balance (in percent of GDP)	-0.1	-0.2	0.5	-0.7
Gross national saving (in percent of GDP)	19.0	16.0	15.3	15.3
Gross domestic investment (in percent of GDP)	17.2	19.9	19.8	20.6
Broad money	35.0	30.2	36.2	29.4
Interest rates				
90-day deposit rate	26.4	25.6	29.5	32.0 ³
Lending rate	37.3	35.8	40.5	43.1 ⁴

¹Estimated.

²Percent change from December 1994 to October 1995.

³January–December 14, 1995.

⁴January–November 1995.

shortfall in income tax collections, continued growth in public spending, and the lower-than-expected world market prices for coffee, which led to an unexpected deterioration in the finances of the National Coffee Fund.

In their discussion, Directors observed that the favorable performance and the ability of the Colombian economy to weather the shocks in the regional economy testified to the authorities' sound, consistent economic management. While welcoming the reduction of inflation by December 1995 to below 20 percent for the first time in many years, Directors emphasized that inflation was still excessive and that the further reduction of inflation remained the key policy challenge. They encouraged the authorities to implement a stronger, more balanced mix of financial policies than was currently envisaged to accelerate the reduction. In particular, Directors considered that a tighter fiscal stance was needed to relieve the burden

on monetary policy and improve the outlook for private sector activity. To break entrenched inflation expectations, they called for further progress in eliminating backward-looking wage settlements. At the same time, the importance of protecting social expenditures was noted. Directors called for the curtailment of nonessential current outlays and a slower, more selective increase in capital expenditure, and they welcomed the December 1995 measures to increase tax rates, improve tax administration, and reduce evasion. They also welcomed the efforts to tighten monetary and credit conditions and urged the authorities to persevere with monetary discipline to reduce inflation further.

Directors observed that the implementation of sound financial policies was also the key to the credibility of the managed exchange rate band, which had shown resilience in the face of adverse regional and domestic developments in 1995. Some Directors noted that a phased relaxation of the restrictions on external borrowing might be in order, provided that it was accompanied by a strengthening of fiscal and other policies designed to increase domestic saving. Some Directors expressed concern at the deterioration in the current account deficit. While this had been financed mainly by foreign direct investment, they considered that tighter financial policies and efforts to raise domestic saving were called for to reduce risks and to ensure sustained and balanced growth.

Côte d'Ivoire

Directors met in December 1995 to discuss the Article IV consultation with Côte d'Ivoire and to review the second annual ESAF arrangement (see the section on Fund Support of Member Countries). The discussion took place against a background of positive developments in the Ivoirien economy.

The devaluation of the CFA franc in January 1994, stronger macroeconomic policies, and structural reforms had placed Côte d'Ivoire back on a path of sustainable growth. GDP grew by 1.8 percent in 1994 and was projected to grow by 6.5 percent in 1995 (see Table 19). After the adjustment in tradable goods prices following the devaluation, by mid-1994 inflation had

Table 19

CÔTE D'IVOIRE: SELECTED ECONOMIC INDICATORS

(Data as of Board discussion in December 1995; annual percent change unless otherwise noted)

	1993 ¹	1994 ¹	1995 ²
Domestic economy			
GDP (at constant prices)	0.1	1.8	6.5
Consumer price index (end of period)	2.6	32.2	9.0
External economy			
Exports, f.o.b. (at current prices, CFAF basis)	-3.7	114.1	23.6
Imports, f.o.b. (at current prices, CFAF basis)	-5.9	87.2	32.2
Current account balance (in percent of GDP) ³	-10.8	-2.3	-2.3
Capital account balance (in millions of U.S. dollars)	47.1	656.9	138.5
External debt (in percent of GDP) ⁴	158.9	200.1	175.3
Debt service (in percent of GDP) ⁵	16.9	18.8	17.3
Real effective exchange rate ⁶	-2.4	-38.6	9.5
Net foreign assets ⁷	-10.7	67.0	22.4
Financial variables			
Consolidated government balance (in percent of GDP, payment-order basis)	-13.3	-7.6	-4.5
Gross national saving (in percent of GDP)	-2.2	12.4	13.7
Gross national investment (in percent of GDP)	8.6	14.8	16.0
Money and quasi-money (M2)	-4.4	46.9	19.5
Interest rates (average, end of period)			
Money market rate	7.5	5.5	6.0
BCEAO discount rate	10.5	10.0	7.5

¹Estimated.

²Projected.

³Including official transfers but excluding late interest on payments arrears to commercial banks.

⁴Including obligations to the Fund, short-term liabilities to the Banque Centrale des États de l'Afrique de l'Ouest (BCEAO) operations account, and all arrears to commercial banks.

⁵Including obligations to the Fund but excluding late interest on payments arrears to commercial banks.

⁶Based on end-of-period changes in relative consumer prices and nominal effective exchange rate; - indicates a depreciation.

⁷End of period (percent change in beginning-of-period broad money); for 1993, adjusted on the basis of the CFAF devaluation in January 1994.

been brought under control through tighter fiscal and wage policies and temporary price controls. However, largely because of food price increases in the first half of 1995, 12-month inflation was projected at 9 percent.

The external current account deficit was reduced by about 75 percent in 1994, to 2.3 percent of GDP, and was expected to stabilize at that level during 1995. The overall fiscal deficit, owing to strong government revenue performance and expenditure policies, was reduced to 7.6 percent of GDP in 1994; additional tightening in 1995 was projected to narrow the deficit to 4.5 percent of GDP. The Government had accelerated structural reforms in 1995, taking steps to liberalize further the internal market, as well as domestic and external marketing of cocoa and coffee; to remove nontariff barriers on imports; to increase labor market flexibility; and to quicken the pace of privatization.

In their discussion, Directors noted that the Ivorian economy had responded remarkably well to the shift in relative prices and the improved competitiveness made possible by devaluation of the CFA franc. Restrictive macroeconomic policies and structural reforms, they noted, had contributed to sizable reductions in fiscal and external imbalances and to progressive alleviation of structural rigidities, with the result that growth had resumed and saving and investment had increased. Directors observed that, although inflation had been rapidly controlled after the devaluation, there had been some residual pass-through effects during the first half of 1995. They welcomed the authorities' intention to further strengthen macroeconomic policies so that domestic demand and prices would be kept in check and competitiveness would not erode.

Directors considered that fiscal sustainability was the key to external sustainability, and they noted with regret the overruns in some expenditure categories, relative to program benchmarks, and the delays in privatization. They urged the Government to maximize the opportunity presented by favorable conditions—by consolidating the fiscal position in 1996 and accelerating structural reforms—so that the conditions for medium-term growth would be strengthened.

In the fiscal area, Directors stressed that it was important to achieve the programmed reduction in the fiscal deficit. They noted that broadening the tax base and improving tax administration had become more urgent because of tax cuts and the lowering of duties and levies on cocoa and coffee exports. Directors also stressed the need for greater control over spending commitments and for prioritizing expenditures. In this regard, they placed great importance on the Government's efforts to improve budgetary procedures and unify the budget. In the structural area, Directors welcomed labor market and price deregulations and liber-

alization of maritime transportation and cocoa and coffee marketing. In their view, however, attracting new private investment would require a critical mass of additional structural reforms, including restructuring and privatization of public enterprises, reducing the cost of economic and administrative regulations, establishing more efficient administrative regulations, and improving the judicial system.

Directors were concerned about the accumulation of nonreschedulable external arrears in September–October 1995 and urged the authorities to settle those arrears promptly. Although Côte d'Ivoire's fiscal and external positions had improved, the external debt burden remained heavy, and sizable residual financing gaps would remain. Consequently, Directors recognized that, for the country to attain financial viability, there would be a need for continued external financial assistance on concessional terms and for debt relief.

Directors urged the regional monetary authorities to develop new market-based instruments that could be used to regulate banks' lending capacity and mop up excess liquidity. They emphasized the need to deepen and modernize financial intermediation in a number of areas, ranging from the creation of improved rural credit facilities to developing the stock market, so that the mobilization of saving and the financing of investment might be improved.

India

Directors met in July 1995 to conclude India's Article IV consultation. The discussion took place against the background of a robust economic expansion and solid external position. Recovery had become well entrenched—real GDP growth was estimated at about 6 percent in 1994/95 (see Table 20)—reserves had risen to a comfortable level, the current account deficit was modest, exports were growing rapidly, and the exchange rate was broadly competitive.

Nonetheless, inflation had been in the double digits for much of 1994/95, reflecting strong domestic demand and easier monetary conditions associated with heavy capital inflows. In response to these conditions, the authorities had taken measures to curb monetary growth, moderate capital inflows, and address supply bottlenecks. Against this background, inflation had recently declined to less than 10 percent, while interest rates had risen. Insufficient progress in fiscal adjustment complicated management of this situation. There had been some adjustment at the central government level in 1994/95, but the states' finances had deteriorated. Consequently, the consolidated public sector deficit was estimated at about 10½ percent of GDP, close to its 1990/91 level.

Structural reforms had continued to progress in some areas over the preceding year, but the process was slow, and further efforts would be needed before

Table 20

INDIA: SELECTED ECONOMIC INDICATORS

(Data as of Board discussion in July 1995; annual percent change unless otherwise noted)¹

	1992/93	1993/94	1994/95 ²	1995/96 ³
Domestic economy				
Real GDP	4.3	4.3	6.3 ⁴	6.2 ⁴
Wholesale prices (end of period)	7.0	10.8	11.0	8.0
External economy (in billions of U.S. dollars unless otherwise noted)				
Exports, f.o.b.	18.9	22.7	26.7	30.7
Imports, c.i.f.	23.2	24.0	29.5	35.0
Current account balance	-3.9	-0.6	-1.4	-4.0
Direct investment	0.3	0.6	1.0	1.5
Portfolio investment	0.2	3.5	3.5	1.1
Capital and financial account balance	2.8	8.5	7.8	4.8
External debt (in percent of GDP, end of period) ⁵	36.9	35.8	31.2	27.9
Debt-service ratio (in percent)	30.4	25.4	27.3	27.1
Real effective exchange rate (annual percent change, end of period)	-3.2	3.8	-5.1	...
Gross official reserves (end of period)	6.4	15.1	20.8	20.1
Financial variables				
Consolidated public sector deficit (in percent of GDP) ⁶	8.4	11.0	10.5	9.9
Gross national saving (in percent of GDP)	20.0	20.2	21.4	22.5
Gross national investment (in percent of GDP)	22.0	20.4	21.9	23.6
Broad money (end of period)	15.7	18.4	21.2	15.5
Interest rates ⁷	11.1	10.1	11.2	...

¹Fiscal years (April 1 through March 31).²Estimated.³Projected.⁴Data revised subsequent to the Board discussion.⁵Including military debt.⁶For 1995/96, projection based on 1995/96 budget proposals.⁷Rate on 364-day treasury bills, end of period.

the full benefits fed through. In a number of areas—such as public enterprise reform and agricultural policy—reforms had lagged well behind.

In their discussion, Directors commended India's robust economic recovery and external strengthening, which were the result of the reforms initiated in 1991. Fiscal consolidation was seen as critically important to sustaining this progress. Directors pointed to inflationary pressures and rising interest rates as evidence of emerging strains and also expressed concern about the high level of public debt. Because of the urgency of fiscal consolidation, they could not subscribe to a strategy of more gradual adjustment and stressed that, at a minimum, any slippage from budget targets for 1995/96 should be avoided. They also emphasized the importance of hardening budget constraints on the states to encourage them to progress with reforms of state finances

and to share the burden of fiscal adjustment.

In the absence of major fiscal consolidation, Directors observed, a heavy burden was being placed on monetary policy. They welcomed the progress in slowing inflation and endorsed the authorities' inflation target of 8 percent by the end of 1995/96. Attaining this goal would require a sustained reduction in monetary growth. To signal anti-inflationary commitment, the authorities would need to adhere to agreed limits on automatic government access to Reserve Bank of India credit in 1995/96 and to phase out such borrowing as soon as possible.

Provided that fiscal consolidation was sustained and reform continued, Directors considered that the prospects for India's external position remained sound. They endorsed India's cautious approach to managing capital inflows and encouraged a greater role for foreign direct investment. Many Directors also encouraged more vigorous import liberalization. While noting that the level of the exchange rate was broadly appropriate, Directors supported greater flexibility in exchange rate policy. They urged maintaining the momentum of structural reforms in the current year, including accelerating planned tax and trade reforms, and removing

the remaining obstacles to private participation in infrastructure investment.

Looking beyond the immediate policy situation, Directors emphasized that achieving rapid growth, price stability, and sustained poverty reduction would require a vigorous promotion of the private sector, including participation of foreign investors. The Government would be required to sustain fiscal adjustment and embark on a bold second wave of reforms to further raise saving and investment. Fiscal consolidation should be based on raising revenue by broadening the tax base, improving cost recovery, and pruning low-priority spending. Additional structural reforms were needed in areas that so far had received less attention, including restructuring and privatization of public enterprises, reform of the labor market and exit policies, import liberalization for consumer goods, agricultural sector reform, and liberalization of the financial

sector. Directors welcomed India's acceptance of the obligations under Article VIII of the Fund's Articles, and they encouraged removal of remaining exchange restrictions.

Indonesia

In July 1995 Directors met to conclude the Article IV consultation with Indonesia. The country's economic management had been impressive, although the authorities faced the challenge of a short-term overheating of the economy. Monetary policy had been eased in mid-1993 to support growth. Fixed investment picked up, private consumption rose considerably, and GDP growth reached about 7¼ percent in 1994 (see Table 21). Domestic demand expansion led the increase in activity and exceeded GDP growth in 1994/95. Although export growth increased, import growth rose more, and the external current account deficit widened slightly, to 2 percent of GDP. Monetary aggregates grew rapidly during 1994/95, with an expansion in domestic assets more than offsetting a decline in international reserves. This expansion occurred despite a gradual increase in interest rates since April 1994. Inflation remained high—in June 1995, the 12-month inflation rate was 10.5 percent.

Fiscal policy, which had been tightened in mid-1993 when monetary conditions were eased, continued to have a dampening effect. Oil prices were slightly above budget assumptions, revenues and current expenditures were on target, and development expenditures were relatively slow. The overall central government position was in balance in 1994/95, with the deficit (excluding oil and gas revenue) falling to 3¼ percent of GDP. The external current account deficit was financed mainly by long-term capital inflows. Short-term capital flows, which had fluctuated widely in 1993/94, stabilized in early 1994/95.

In their discussion, Directors warmly commended Indonesia's policies, which had led to an impressive economic performance, reduced reliance on the oil sector, and improved living standards. Policies to achieve macroeconomic stability and high saving and investment rates, combined with market-based structural

Table 21

INDONESIA: SELECTED ECONOMIC INDICATORS

(Data as of Board discussion in July 1995; annual percent change unless otherwise noted)¹

	1992/93	1993/94	1994/95 ²	1995/96 ³
Domestic economy				
Real GDP (calendar year)	6.5	6.5	7.3	7.5
Consumer price index (end of period)	5.0	10.2	9.6	9.5
External economy (in billions of U.S. dollars unless otherwise noted)				
Exports, f.o.b.	35.3	36.5	42.0	...
Imports, c.i.f.	30.3	32.3	37.7	...
Current account balance	-2.9	-3.0	-3.6	-5.3
Direct investment	1.7	2.0	2.5	...
Portfolio investment	1.2	2.0	0.8	...
Capital and financial account balance ⁴	7.7	3.3	2.2	5.4
External debt	83.5	89.1	97.6	101.1
Debt-service ratio (in percent of exports of goods and nonfactor services)	21.5	21.3	20.3	20.8
Real effective exchange rate (annual percent change)	-3.9	-2.7	-3.3	...
Gross official foreign assets	18.3	18.6	17.1	17.3
Financial variables				
General government balance (in percent of GDP)	-1.5	-0.5	0.2	-0.3
Gross national saving (calendar year; in percent of GDP)	33.3	31.3	32.0	31.3
Gross national investment (calendar year; in percent of GDP)	35.9	33.2	34.0	33.8
Broad money (end of period)	22.2	21.2	21.5	18.9
Interest rates ⁵	13.5	9.3	12.8	14.3

¹Fiscal years (April 1 through March 31) unless otherwise noted.

²Estimated.

³Projected.

⁴Inclusive of monetary movements of commercial banks and errors and omissions.

⁵Cutoff rates in auctions of 30-day central bank debt certificates in December of calendar year (for 1995, the rate is for March).

reforms, had provided the basis for continued confidence of both domestic and foreign investors. Directors particularly welcomed the Government's recent trade reforms.

Directors noted that, given the high level of external debt and the need to contain the current account deficit, a significant fiscal adjustment would be required over the medium term, with the emphasis falling on revenues. Other medium-term challenges would include prioritizing expenditures, further liberalizing trade and investment, and promoting the private sector. Overheating of the economy in the short term was also of concern: already inflation had been higher than targeted, and the current account deficit had widened. A strategic decision to bring inflation down substantially was needed. To achieve that goal and to improve the sustainability of medium-term growth objectives, tighter fiscal and monetary policies com-

Table 22

ISRAEL: SELECTED ECONOMIC INDICATORS

(Data as of Board discussion in September 1995; annual percent change unless otherwise noted)

	1992	1993	1994	1995 ¹
Domestic economy				
Real GDP	6.6	3.4	6.5	5.0
Unemployment rate (average)	11.2	10.0	7.8	7.2
Consumer price index (average)	11.9	10.9	12.3	10.2
External economy				
Exports, f.o.b. (in billions of U.S. dollars)	13.3	14.8	16.5	17.8
Imports, c.i.f. (in billions of U.S. dollars)	-18.3	-20.4	-22.6	-25.9
Current account balance (in billions of U.S. dollars)	0.2	-1.4	-2.8	-4.8
Capital account balance (in billions of U.S. dollars)	-2.1	2.0	1.1	7.0
External public debt	19.0 ²	21.0	20.0	...
Real effective exchange rate ³	-4.9	1.6	2.4	...
Net debt service ⁴	15.4	15.7	16.6	...
Gross official reserves (end of period) ⁵	2.2	2.6	2.5	4.1
Financial variables				
Gross national saving (in percent of national income)	21.6	19.5	18.1	19.0
Gross domestic investment (in percent of national income)	21.7	21.3	21.7	...
Nominal broad money (end of period)	33.0	25.0	26.0	...

¹Fund staff estimates.²Average 1990-92.³Based on Fund staff estimates (using consumer prices); fourth quarter over fourth quarter.⁴As percentage of total exports of goods and services.⁵In months of total imports of goods and services.

bined with greater flexibility in exchange rate policy were required.

While recognizing the authorities' impressive fiscal adjustment in the face of declining oil revenues, Directors stressed that additional fiscal adjustment would be essential to increase public saving over the medium term and to limit short-term demand pressures. Tax changes that had been introduced recently, they noted, would adversely affect revenues in the short run, and they encouraged additional measures during 1995/96 to increase revenue from sources other than oil and natural gas. Directors also pointed out the scope for further improving tax administration and widening the tax base. On the expenditure side, limiting spending to the budgeted amounts and resisting pressures for extrabudgetary financing were of priority.

Directors supported the gradual increase in interest rates since April 1994 and strongly recommended further tightening of monetary policy. If higher interest rates led to excessive capital inflows, Directors encouraged the authorities to allow market forces to play a greater role in exchange rate determination, including an effective appreciation of the rupiah. Directors wel-

comed efforts to widen the exchange rate band and urged further steps in that direction. With regard to the problem of nonperforming loans in the banking system, they stressed the need to accelerate the program to improve the quality of new loans, resolve existing problem loans and problem banks, and improve prudential supervision.

Directors welcomed the recently announced tariff reductions and called for further efforts to reduce nontariff barriers and to liberalize trade in key commodities. While commending Indonesia's exemplary record of foreign debt service, Directors urged re-establishing prudential ceilings on both external commercial borrowings and export credit facilities contracted by the public sector and supported the use of privatization receipts to repay expensive external debt. They encouraged the authorities to improve statistics, including better monitoring of private capital flows and private external

debt stocks, nonbudgetary public transactions, and public enterprise accounts.

Israel

In September 1995, Directors met to discuss the Article IV consultation with Israel. Over the previous five years, Israel's economic policies had been influenced by a massive wave of immigration from the countries of the former Soviet Union. Since 1990, over 600,000 immigrants had been absorbed into the domestic economy.

Real GDP expanded by 6.5 percent in 1994, and unemployment, which had peaked at 11.2 percent in 1992, fell to 6.9 percent in the first quarter of 1995 (see Table 22). Inflation accelerated to 14½ percent in 1994, from 11.2 percent in 1993, but declined to 9½ percent in the first half of 1995.

Private consumption rose by almost 9 percent in 1994, while nonresidential investment grew by an impressive 17 percent. The private saving rate, which had reached around 20 percent of GDP at the beginning of the 1990s, dropped to 16¼ percent of GDP. In the public finances, the overall deficit declined to 1 percent of GDP, from 2.8 percent in 1993, and the

public debt fell from 99 percent of GDP in 1993 to 92 percent in 1994.

In July 1993, the Bank of Israel reduced the pre-announced crawl of the exchange rate from an annual rate of 8 percent to 6 percent, consistent with the 8 percent inflation target set for 1994. Failure to meet the inflation target resulted in a real effective appreciation of the currency between mid-1993 and early 1995 of 6 percent. This, coupled with the strong growth in aggregate demand, led to a current account deficit of 4 percent of GDP in 1994 and about 6 percent in the first quarter of 1995.

To finance the deficit, Israel drew on its loan guarantee with the United States. With the private sector also borrowing heavily abroad to take advantage of lower interest on foreign currency loans, official net international reserves rose from \$6.5 billion at the end of 1993 to a record \$9.6 billion in May 1995.

Directors commended the Israeli authorities on the economy's impressive growth since 1990 and for successfully absorbing the new immigrants, while reducing unemployment. They were also pleased that growth prospects had been enhanced by the peace process; however, the overheating of the economy was of concern. While not considering the external current account deficit an immediate financing problem, Directors agreed that its present level was not sustainable.

They saw strengthening domestic saving as the key policy challenge and emphasized that fiscal policy would need to play a crucial role in this regard. To that end, they recommended a more ambitious fiscal effort based on tight control over expenditures. Fiscal retrenchment was also needed to reduce public debt, meet future pension obligations, and prepare for any future reduction in unilateral transfers from abroad. In this connection, Directors praised efforts to reform the pension system but warned that without further action, the system would impose a heavy burden on future budgets.

Noting the disappointing price performance in 1994, Directors cautioned against a premature reduction in interest rates, stressing that monetary policy must be directed at meeting the Government's inflation target in 1995 and at laying the basis for a further decline in inflation thereafter. Directors considered that the exchange rate band system had served Israel well. Nevertheless some Directors, noting that the conduct of monetary policy had been complicated by short-term capital inflows, warned that without further fiscal restraint, the authorities could face further exchange rate appreciation or larger capital inflows.

Aggregate demand policy, in the view of Directors, needed to be complemented by a reinvigorated supply-side approach. Regretting that the privatization process had slowed, they supported the Government's recently

proposed option distribution scheme and urged its early implementation.

Directors welcomed the opportunity to review recent economic developments in the West Bank and Gaza Strip and the Fund's increased involvement in providing technical assistance to the Palestinian Authority. They considered that the development strategy in that region should be outward oriented and led by the private sector and attached the highest importance to establishing sound and transparent public finances.

Korea

At the time of the conclusion of Korea's Article IV consultation in October 1995, the growth forecast, which had been revised upward several times since the beginning of the year, pointed to an increase in real GDP of more than 9 percent in 1995 (see Table 23). The expansion, which had begun in 1993 and had gained momentum in 1994, was underpinned by the continued rapid rise in exports and equipment investment. As a result of the surge in growth, the emergence of a small positive output gap for 1995 seemed likely.

Although producer price inflation had increased to almost 6 percent in June 1995 in response to pressures from prices of imported raw materials, consumer price inflation remained subdued and even fell slightly. Wage increases were moderate, following a boost in earnings in manufacturing in 1994 that had outpaced productivity gains.

Fueled by a continuing rise in imports, the current account deficit more than doubled in January–May 1995 over the same period in 1994 but remained moderate in relation to the size of the economy. The balance of payments recorded a small surplus over this period while international reserves grew further, largely because of valuation effects associated with exchange rate movements. Against the background of the broadly balanced external payments position, the won depreciated by 2¼ percent in real effective terms during January–May 1995, primarily because of the sharp decline of the dollar against the yen, before strengthening in June–August.

With the momentum of growth expected to remain strong, the authorities in 1995 accelerated the move toward macroeconomic restraint begun earlier in the expansion. The 1995 consolidated central government budget implied a small withdrawal of stimulus, and the target range for M2 growth was lowered to 12–16 percent. However, monetary expansion in the first half of 1995 exceeded the upper limit of the target range.

In their discussion, Directors commended the authorities for Korea's remarkable economic record, particularly the continued subdued inflation in the face of rapid growth. Nevertheless, they cautioned that,

Table 23

KOREA: SELECTED ECONOMIC INDICATORS

(Data as of Board discussion in October 1995; annual percent change unless otherwise noted)

	1992	1993	1994	1995
Domestic economy				
Real GDP	5.1	5.8	8.4	9.0
Unemployment rate	2.4	2.8	2.4	2.0
Consumer price index	6.2	4.8	6.2	4.5
External economy				
Exports, f.o.b. (in billions of U.S. dollars)	75.2	80.9	93.7	123.2
Imports, f.o.b. (in billions of U.S. dollars)	77.3	79.1	96.8	128.0
Current account balance (in percent of GDP)	-1.5	0.1	-1.2	-2.0
Direct investment (net, in millions of U.S. dollars)	-496	-540	-1,318	-1,703
Portfolio investment (net, in millions of U.S. dollars)	5,742	10,725	6,805	8,518
Overall balance (in billions of U.S. dollars)	3.7	3.0	4.6	...
External debt (in percent of GDP)	14.0	13.3	14.7	...
Debt-service ratio (in percent of exports of goods and nonfactor services)	6.0	9.1	6.2	...
Real effective exchange rate ¹	-0.7	-0.9	0.4	4.3
Gross international reserves (in billions of U.S. dollars, end of period)	17.1	20.2	25.6	32.7
Financial variables				
Consolidated central government balance (in percent of GDP)	-0.7	0.3	0.5	0.5 ²
Gross national saving (in percent of GDP)	34.7	35.1	34.7	35.1
Gross domestic investment (in percent of GDP)	36.6	35.1	35.9	37.0
Broad money (M2)	18.4	18.6	15.6	15.5
Interest rate (yield on corporate bonds, period average)	16.2	12.6	12.9	13.8

¹Average for December over the same period of the previous year.²Preliminary estimate of outturn.

with the economy approaching full employment, there was a need for a cautious macroeconomic approach to avoid the dangers of overheating. In that connection, Directors felt that the withdrawal of fiscal stimulus in 1995 was appropriate, and they welcomed the authorities' intention to expand investment in social overhead capital to ease infrastructure bottlenecks without weakening the overall fiscal position. The Board also welcomed the deceleration of the M2 growth rates in recent months. In addition, it considered that, as the demand for M2 had become less stable, the authorities should pay more attention to a broader range of indicators, including interest rates.

Directors welcomed the authorities' commitment to steady implementation of the structural policy agenda, emphasizing that the Government should further deregulate and open the economy to complete Korea's transformation into an advanced industrial country,

fully integrated into the world economy. The present conditions were optimal to accelerate the needed structural reforms in the financial system, the capital account, and trade. Directors pointed to the importance for the financial reform program of developing a fully market-based system of monetary control; they also noted that most lending and deposit rates had been liberalized but remained more sticky than expected. Directors commended the Foreign Exchange Reform Plan announced late in 1994 to support the opening of the capital account but urged the authorities to develop a more specific timetable and accelerate the liberalization. Directors generally thought that, with the opening of the capital account, exchange rate flexibility was becoming increasingly important. Accordingly, they supported the case for more flexibility in the exchange rate and for greater use of the widened band in the market average rate system. They also considered that the recent strengthening of the real effective exchange rate had been in line with cyclical requirements and the improved external situation.

Mexico

Directors met in June 1995 to discuss the staff report for the 1995

Article IV consultation with Mexico and the second review under the stand-by arrangement that was approved in February 1995 for SDR 12.1 billion, of which SDR 6.8 billion was subject to augmentation and was later made available.

In early January 1995, the Mexican authorities adopted an economic program to deal with the financial crisis that followed the sharp depreciation of the peso in late December 1994. This program, which was supported by the stand-by arrangement, did not succeed in calming financial markets, and, in early March 1995, the authorities enacted additional measures, including greater fiscal adjustment and a tightening of monetary policy, which allowed an orderly reduction in 1995 of the external current account deficit to \$654 million from the \$14 billion projected initially.

The subsequent reaction of the markets was encouraging. The peso appreciated from about MexNS7.60 per U.S. dollar in early March to about MexNS6.20

per dollar in early June. During the same period, interest rates on one-month treasury bills fell from over 85 percent to 54 percent, and the stock market recovered by about 32 percent. In this context, since the second quarter of 1995 Mexico was able to gradually return to the international capital markets. In response to the marked improvement in confidence, the Mexican Government resumed issues in May 1995 of 182-day treasury bills.

The need to amortize short-term external liabilities of the Government (mainly *tesobonos*) and the commercial banks in the first quarter of 1995 led to an increase in net domestic assets of the Bank of Mexico and a decline in net international reserves. However, the sharp rise in interest rates and the liquidity problems facing many banks resulted in a fall in credit to the private sector in real terms. An increase in net international reserves of \$3.4 billion was observed in the second quarter of 1995, as the share of maturing *tesobonos* amortized in pesos rose and as commercial banks began to repay U.S. dollar-denominated loans that had been previously granted to them by the Bank of Mexico through Fobaproa (the Fund for Savings Protection). Meanwhile, the sharp decline of noninterest expenditure and a greater than envisaged collection of income taxes enabled the authorities almost to double the program target for the primary surplus of the nonfinancial public sector in the first quarter of 1995.

The trade surplus increased dramatically to a cumulative \$1.3 billion in April 1995, compared with a deficit of \$5.7 billion over the first four months of 1994. Real GDP in the first quarter of 1995 fell by 2.9 percent from the preceding quarter, but a slow recovery began in the third quarter of 1995. Real GDP contracted by 6.9 percent for the year as a whole (see Table 24). Inflation was expected to continue the decline observed in May 1995 until reaching 42 percent at the end of the year; in the event, worsening price pressures, originating from a larger-than-expected depreciation of the peso and adjustments to wages and public prices in December as part of the economic pro-

Table 24

MEXICO: SELECTED ECONOMIC INDICATORS

(Data as of Board discussion in June 1995; annual percent change unless otherwise noted)

	1992	1993	1994	1995 ^{1, 2}
Domestic economy				
Real GDP	2.8	0.7	3.5	-6.9
Open unemployment rate	2.8	3.4	3.7	6.3
Consumer price index (end of period)	11.9	8.0	7.1	52.0
External economy				
Exports, f.o.b. (in billions of U.S. dollars)	32.3	35.4	40.4	53.4
Imports, f.o.b. (in billions of U.S. dollars)	48.2	48.9	58.9	46.3
Current account balance (in percent of GDP)	-7.4	-6.5	-7.8	-0.3
Direct investment (in billions of U.S. dollars)	4.4	4.4	11.0	7.0
Portfolio investment (bond placements and equity investments, in billions of U.S. dollars)	8.3	17.0	6.4	0.9
Capital account balance (in percent of GDP)	8.0	8.4	3.0	-0.2
Public sector external debt ^{2, 3}	81.7	83.5	89.3	116.8
External debt (in percent of exports of goods, services, and transfers) ²	254.1	263.0	249.3	240.7
Real effective exchange rate (average depreciation, -)	7.5	7.4	-4.0	-33.3
Change in net international reserves (in billions of U.S. dollars; increase, -)	-1.9	-7.1	17.9	1.3
Financial variables				
Primary balance (in percent of GDP)	5.8	3.9	2.3	5.6
Gross national saving (in percent of GDP)	14.1	14.2	13.9	14.7
Gross domestic investment (in percent of GDP)	21.5	20.6	21.7	15.0
Broad money (M2) ²	29.4	17.6	22.8	34.7
Interest rate on one-month treasury bills (average of primary auction)	15.6	15.0	14.0	48.4

¹Preliminary.²Data revised subsequent to the Board discussion.³Includes debt to the Fund.

gram for 1996, resulted in an end-year inflation rate of 52 percent.

In their discussion, Directors noted the encouraging marked improvement in Mexico's economic performance since March 1995. They considered that the current policy stance was appropriate, while they emphasized the need to maintain a tight monetary policy to reduce inflation further and stabilize financial markets. Continued strong macroeconomic policies and implementation of structural reforms should keep the external current account at a sustainable level while promoting an economic recovery.

Directors emphasized that the assurance of sufficient international funding would strengthen market confidence and contribute to the further accumulation of

Table 25

MOZAMBIQUE: SELECTED ECONOMIC INDICATORS

(Data as of Board discussion in June 1995; annual percent change unless otherwise noted)

	1992	1993	1994 ¹	1995 ²
Domestic economy				
Real GDP	-0.8	19.3	5.4	4.3
Consumer price index (December 1989 = 100)	54.5	43.6	70.1	24.0
External economy				
Exports, f.o.b. (in millions of U.S. dollars)	139.3	131.8	149.5	170.0
Imports, c.i.f. (in millions of U.S. dollars)	-855.0	-954.7	-1,018.5	-868.7
Current account balance, including grants (in millions of U.S. dollars)	-239.1	-321.3	-305.4	-310.1
Direct investment, net	25.3	32.0	35.0	45.0
Capital account balance (in millions of U.S. dollars)	-155.1	-107.0	-22.1	25.7
External debt (in millions of U.S. dollars)	5,083.0	4,999.0	5,403.9	5,610.0
Debt-service ratio (in percent of exports)				
Before debt relief	144.5	134.7	119.2	116.2
After debt relief ³	88.3	82.8	69.7	82.1
Real effective exchange rate	6.4	-18.1	19.1	...
Gross reserves (in millions of U.S. dollars; end of year) ⁴	384.8	372.1	427.6	475.2
Financial variables				
Gross national saving (in percent of GDP)	34.6	37.8	39.4	34.6
Gross national investment	53.2	59.7	60.2	55.3
Money and quasi-money (M2)	52.8	63.0	49.3	26.5
Interest rate (on 6- to 12-month deposits; end of period)	43.0	43.0	69.7	...

¹Preliminary.²Program target.³The ratios exclude the effects of the debt cancellation granted by the Netherlands.⁴Gross foreign assets of the banking system.

international reserves in the remainder of the year. In that context, they welcomed the decision by the United States to disburse \$2.5 billion in July 1995 and its reiteration that additional funds would be available as needed in August 1995 to help amortize short-term external liabilities. They also agreed that the next two purchases from the Fund—through August—were essential as signals to markets of the continued official support for Mexico's program and to support the reconstitution of external reserves. (Purchases were made in July and August 1995, respectively.) Directors generally believed that, with the continuation of appropriate policies, confidence should be sustained and normal access to international capital markets could be restored. While recognizing the important programs that have been put into effect, they welcomed the authorities' intention to forgo purchases if the balance of payments and international reserves improved as projected under the program and to make early repur-

chases from the Fund as reserves permit.

Directors observed that the main monetary policy risks over the balance of the year would come from possible financial market pressures (if external financing were inadequate) and from a further deterioration in commercial banks' loan portfolios. They emphasized that the restoration of the banking system's health would depend mainly on the restoration of macroeconomic stability and a financial restructuring of the weaker banks. Directors commended Mexico on the recent improvement in the scope and quality of statistical information being made available for publication.

Mozambique

Directors met in June 1995 to discuss the Article IV consultation with Mozambique. In October 1992, Mozambique's 16 years of strife came to an end with the signing of peace accords between the Government and the Renamo movement. Since then, 80,000 troops have been demobilized, internationally supervised elections have been held, and resettlement of refugees and displaced persons has almost been completed. Removal of land mines and reconstruction are under way.

Since 1987, the Fund has assisted Mozambique with its adjustment

efforts with financing from the structural adjustment facility (SAF) and the ESAF. Despite being one of the poorest countries in the world, Mozambique made considerable progress in reversing its economic decline, implementing structural reforms, and liberalizing its economy.

In 1994, Mozambique's economic growth remained broadly based and strong at 5.4 percent (see Table 25). Production grew in every major sector except industry, where for the fifth year in a row it declined. Construction expanded at a real rate of 7.5 percent; transport and communications grew by 5.7 percent; and agricultural production increased by 5.0 percent, following a recovery of 21.3 percent in 1993.

In the wake of the 1994 elections, however, some economic indicators exceeded their targets under the Fund-supported economic and financial program for 1994, despite the authorities' efforts to restrain them:

inflation reached 70 percent in 1994 and broad money grew by 49 percent. A revenue shortfall and excess expenditure caused a widening in the Government's overall budget deficit before grants to 30 percent of GDP—5 percent over target.

The balance of payments improved considerably in 1994. The current account deficit after grants amounted to \$305 million, or 77 percent of exports of goods and services. Exports increased by 13 percent, or less than projected, partly owing to lower exports of cashew nuts. Imports rose by about 7 percent, a decline of 3 percent from the 1993 level, triggered by a fall in official transfers.

Since the exchange rate policy was further liberalized in mid-1994, with the elimination of the special exchange rate on tied aid funds, the market rate has been determined freely. The real effective exchange rate appreciated cumulatively by 19 percent from December 1993 to December 1994. Social issues continued to be a priority for public policy in 1994, particularly poverty alleviation.

In their discussion, Directors commended the Mozambican authorities for the smooth completion of the demobilization program and the resettlement of millions of displaced persons and refugees. They noted that with the restoration of peace, the new Government had a historic opportunity to reorient the country's efforts toward achieving sound export-led and self-generating growth.

Directors expressed concern that the fiscal deficit and inflation had substantially exceeded the economic and financial program targets. They, therefore, urged the authorities to make every effort to carry out fully the 1995 program, in support of which Mozambique had requested an extension of the ESAF arrangement. Directors stressed that early implementation and careful monitoring of the program would be critical for the success of the Government's development strategy.

Directors welcomed the actions taken by the authorities since the elections to bring the program back on track, the proposed cuts in military outlays, and the shift in government expenditure in favor of primary health care and education. The need for improving revenue collection and customs administration and tackling the problem of tax evasion to reduce the fiscal imbalance was emphasized by Directors.

With regard to structural reforms, Directors urged rapid privatization of most public enterprises and the two state-owned commercial banks. Because agriculture was critical for export growth and poverty alleviation, Directors stressed the importance of early attention to land tenure rights. A few Directors also stressed the urgency of implementing the proposed reforms in public administration, the importance of good governance, and the need to further enforce the rule of law.

Although exports were expanding, they were still insufficient to reduce the country's dependence on foreign aid, Directors noted. Prospects for electricity and gas exports were good, but other exports needed to be increased. Directors recognized that Mozambique would require generous debt relief, given the external debt burden, including multilateral debt. Directors also noted the need for improving the administrative capacity to monitor closely foreign aid flows and uses, as well as counterpart fund generation.

Nigeria

Directors concluded the Article IV consultation with Nigeria in early November 1995. The discussion took place against a background of four consecutive years (1990–94) during which the rate of real GDP growth was in decline, inflation was accelerating, and the external position was weakening. Frequent swings in economic policy and expansionary financial policies had eroded confidence and discouraged long-term planning and investment, while inadequate infrastructure maintenance and poor performance by public utilities had raised production costs. During 1990–94, Nigeria's trade surplus was more than halved, the current account balance shifted from a surplus of 10 percent of GDP to a deficit of 3 percent, and reserves fell to one month of imports. External payments arrears exceeded \$9 billion at the end of 1994 (see Table 26).

Preliminary information for the first half of 1995 indicated that a fiscal surplus had been realized in part as a result of constraints on spending, including a surplus in the newly formed Petroleum Trust Fund. By May, despite tightened monetary policies, inflation had risen 89 percent over the previous year. In addressing the distressed banking system, the authorities took vigorous action and appointed management teams in 17 insolvent banks. They were considering regaining control of the three largest banks, which had been privatized in 1993.

Although in their discussion Directors noted with concern the deterioration of Nigeria's economic performance in 1994, they welcomed the tightening of fiscal policy and the establishment of an autonomous market for foreign exchange in 1995. At the same time, Directors stressed that additional corrective measures would be essential and emphasized the inadequacy of a piecemeal approach to economic stabilization. Directors underscored the urgency of implementing a comprehensive set of macroeconomic policies in a medium-term framework, including a realistic unified exchange rate and wide-ranging structural policies that would open up the economy.

Directors regretted the continuation of controls on interest rates, which were negative in real terms and discouraged domestic saving and the efficient allocation of domestic resources. They therefore urged the

Table 26

NIGERIA: SELECTED ECONOMIC INDICATORS

(Data as of Board discussion in November 1995; annual percent change unless otherwise noted)

	1992	1993	1994 ¹	1995 ²
Domestic economy				
Real GDP	2.9	2.3	1.3	3.3
Consumer price index (end of period)	48.8	61.3	76.8	35.0
External economy				
Exports, f.o.b.	1.5	-8.2	-15.6	10.0
Imports, f.o.b.	10.7	-7.0	-17.9	8.1
Current account (in percent of adjusted GDP)	-1.9	-2.8	-2.9	-1.6
Direct investment (in billions of U.S. dollars)	0.8	0.6	0.6	0.6
Capital account balance (in billions of U.S. dollars)	-7.0	-2.2	-1.7	-1.8
External debt (in percent of adjusted GDP)	90.7	89.7	90.6	90.3
Debt service (in percent of exports of goods and services)	69.9	43.3	47.7	46.1
Real effective exchange rate	-17.2	9.0	83.2	-27.5
Gross international reserves (in billions of U.S. dollars) ³	0.8	0.7	0.9	1.1
Financial variables				
General government balance (in percent of GDP)	-7.9	-18.1	-8.8	-1.4
Gross national saving (in percent of GDP)	22.6	13.7	15.2	18.7
Gross domestic investment (in percent of GDP)	24.5	16.7	17.7	19.7
Broad money	51.3	48.0	38.4	18.1
Interest rate (discount rate)	17.5	26.0	13.5	...

¹Estimated.²Projected.³Data on gross international reserves provided subsequent to the Board discussion by the Nigerian monetary authorities are as follows: 1992, \$0.7 billion; 1993, \$1.3 billion; 1994, \$1.7 billion; and 1995, \$1.4 billion.

authorities to liberalize interest rates and called for reform of the practice of the mandatory holding of government paper at negative real interest rates and the provision of cheap central bank credit to the Government. Directors stressed the importance of prudent use of the resources in the Petroleum Trust Fund and the central bank's profits to strengthen fiscal discipline. Directors were concerned about the proliferation of distress cases in the banking system, whose soundness could be restored only through corrective measures at the individual bank level and reinforcement of supervision and control. They were disappointed at the authorities' decision to maintain the official exchange rate at a substantially overvalued level, which involved economic and administrative costs, and urged an early move to a unified market-based exchange rate system. While improvements in government accounting practices had been implemented, Directors were concerned

about the lack of transparency and timeliness in the prior reporting of the Government's accounts, and were of the view that further enhancements were needed.

Finally, Directors urged the authorities to work closely with Fund staff to formulate a comprehensive package of adjustment measures. They supported the idea of a good staff-monitored program, provided that there first be a significant improvement in policy implementation.

Pakistan

In December 1995, Directors met to conclude the Article IV consultation with Pakistan and to consider its request for a stand-by arrangement (see the section on Fund Support of Member Countries). A sharp drop in external reserves during July–November 1995 led Pakistan to embark on a comprehensive medium-term program of macroeconomic adjustment and structural reform. In 1994/95 policy implementation had been relaxed and poor weather and crop disease had affected growth and increased inflation.

Real GDP growth recovered to 5.5 percent in 1994/95, but this was lower than the target. Inflation, which peaked at 15.3 percent in the 12 months ended in January 1995, was 12.1 percent over the year.

National saving in 1994/95, at 12.9 percent of GDP, was slightly lower than in 1993/94 (see Table 27).

Despite the macroeconomic imbalances, Pakistan had taken a number of steps to liberalize its exchange system since 1993–94. The rupee became fully convertible for current transactions; ceilings on foreign exchange purchases and other currency restrictions were abolished; and in July 1994 Pakistan accepted the obligations of Article VIII of the Fund's Articles. To maintain an adequate level of competitiveness and provide stability for the economy, Pakistan had followed a managed floating exchange rate policy, based on small periodic adjustments of the rupee vis-à-vis the U.S. dollar.

Directors regretted that Pakistan's adjustment and reform effort had faltered but were nonetheless encouraged by the reinvigoration of the authorities' efforts in October 1995. They stressed that the new

economic program should be rigorously implemented to achieve its objectives and rapidly re-establish confidence and urged the authorities to take additional corrective actions if necessary. It was noted that the large stock of short-term external debt and low international reserves allowed no scope for policy slippages.

Fiscal consolidation was a cornerstone of the adjustment program, Directors observed. They pointed out that a key element of the overall reform would be the removal of the regulatory import duty and a further reduction of tariff rates and urged the authorities to advance tariff reform. Structural reforms to improve the budget also needed vigorous implementation. Directors placed strong emphasis on extending the general sales tax, broadening agricultural taxation, and phasing out tax exemptions and concessions.

Directors underscored the need to control government expenditure and improve its efficiency and composition. They called for greater efforts to reduce unproductive spending, including military expenditures, and to increase developmental outlays. Directors emphasized that privatization proceeds should not be used to finance unsustainable increases in government expenditure and that it was critically important for Pakistan to improve the transparency of its budget management.

Key elements for bringing down monetary growth substantially in 1995/96 were strengthening of the fiscal accounts, reducing government-directed credit, and containing credit to public enterprises. To that end, Directors welcomed the removal of the credit-to-deposit ratio mechanism and the ceiling on rates of return.

Directors stressed that it was imperative that exchange rate policy be supported fully by restrained fiscal and monetary policies to contain inflation and preserve competitiveness. Most Directors felt that the flexible management of the exchange rate was appropriate.

Several Directors observed that, in today's globalized financial system with swift financial market reactions, it was essential for Pakistan to establish a strong

track record of fundamental and sustained adjustment. By doing so, it would restore and maintain the confidence of the markets and the international community.

Peru

In December 1995, Directors met to conclude Peru's Article IV consultation and to discuss the midterm and financing-assurances reviews of the third year of the extended arrangement for Peru.

The Peruvian Government began implementing a macroeconomic and structural adjustment program in 1990 to reverse the hyperinflation, negative real growth, and external arrears that had developed over the previous decade. Under the program, economic activity rebounded strongly during 1993-94, and this improvement continued in 1995. Economic growth,

Table 27

PAKISTAN: SELECTED ECONOMIC INDICATORS

(Data as of Board discussion in December 1995; annual percent change unless otherwise noted)¹

	1992/93	1993/94	1994/95	1995/96 ²
Domestic economy				
Real GDP at factor cost	2.3	4.5	4.4	6.0
Consumer price index (end of period)	9.1	11.9	12.1	9.0
External economy				
Exports, f.o.b. (in millions of U.S. dollars)	6,782	6,685	7,884	8,988
Imports, f.o.b. (in millions of U.S. dollars)	-10,049	-8,685	-10,137	-10,926
Current account balance (in millions of U.S. dollars)	-3,326	-1,650	-2,091	-2,665
Direct investment	310	360	440	949
Portfolio investment	137	289	1,090	116
Capital account balance (in millions of U.S. dollars)	2,737	3,234	2,338	2,063
External debt (in percent of GDP)	45.5	48.2	44.7	44.1
Debt-service ratio (in percent of GDP) ³	22.5	22.7	22.5	24.2
Real effective exchange rate ²	2.1	-4.9	-0.3	...
Net international reserves (in millions of U.S. dollars)	512	-1,880	-349	515
Financial variables				
General government balance	-9.8	-6.8	-6.7	-5.0
Gross national saving (in percent of GDP)	13.4	14.4	12.9	15.1
Total investment (in percent of GDP)	20.5	18.2	16.8	19.7
Money and quasi-money ⁴	18.0	16.0	16.6	12.1
Nominal interest rate(s)	12.3	12.4	11.7	12.0

¹Fiscal years (July 1 through June 30).

²Fund staff estimates.

³Excludes foreign currency deposit liabilities. Medium- and long-term debt service in percent of goods and services and net private transfers.

⁴Changes in percent of the initial stock of domestic liquidity.

Table 28

PERU: SELECTED ECONOMIC INDICATORS

(Data as of Board discussion in December 1995; annual percent change unless otherwise noted)

	1992	1993	1994	1995 ¹
Domestic economy				
Real GDP	-1.8	5.6	13.0	7.5
Unemployment rate	9.4	10.1	8.8	...
Consumer price index	73.2	48.5	23.7	11.0
External economy				
Exports, f.o.b.	4.2	-0.5	29.6	20.4
Imports, c.i.f.	15.9	-0.1	38.6	34.2
Current account balance (in percent of GDP)	-4.8	-5.2	-5.4	-7.4
Capital and financial account balance	6.4	7.0	11.5	8.9
External debt	3.7	4.2	7.2	7.1
Debt-service ratio (in percent of GDP)	60.9	64.8	57.1	...
Real effective exchange rate	2.8	-7.5	6.5	...
Net international reserves (in millions of U.S. dollars)	308	264	2,337	906
Financial variables				
General government balance (before privatization, in percent of GDP)	0.3	0.6	0.7	0.5
Gross national saving (in percent of GDP)	11.6	13.3	16.1	16.5
Gross domestic investment (in percent of GDP)	16.4	18.6	21.5	23.9
Broad money (end of year)	84.1	75.2	46.8	29.9
Interest rate (lending, end of year)	16.9	15.2	15.2	...

¹Projected.

while slowing to a more sustainable level than that registered in 1994, remained above 7 percent (see Table 28), while the 12-month rate of inflation fell to about 10 percent in October 1995. The current account deficit widened in the first half of 1995, reflecting higher imports associated mostly with private investment. However, net official international reserves continued to increase on the strength of capital inflows.

The nonfinancial public sector balance (excluding privatization receipts) was in surplus by 0.2 percent in January–June 1995, compared with a projected deficit of 0.4 percent. Lower noninterest spending and higher net operating revenues of public enterprises more than compensated for a shortfall in central government current revenues due to delays in implementing tax administration measures. Meanwhile, a more selective implementation of projects enabled the authorities to keep capital outlays below programmed levels.

During the first six months of 1995 the net domestic assets of the Central Reserve Bank contracted by about 24 percent with respect to currency in circulation at the beginning of the year, compared with 1 percent in the program. This development reflected the stronger fiscal position, larger commercial bank reserve requirement deposits, and larger placements of Central

Reserve Bank certificates of deposits. During April–August 1995 the Central Reserve Bank raised the rediscount rate by more than 5 points, increased the effective reserve requirements of banks by reducing their average period of computation, and tightened regulations to ensure full compliance with the reserve requirement. The 12-month growth rate of credit to the private sector, although decelerating from about 34 percent in December 1994 to 28½ percent in September 1995, remained higher than envisaged under the program. The new sol depreciated by 2.6 percent in real effective terms between December 1994 and August 1995, mainly because of the U.S. dollar's depreciation against other major currencies.

Peru is currently providing adequately the core data to the Fund in terms of periodicity, timeliness, coverage, and quality. In their discussion, Directors commended the authorities for the impressive and successful implementation in recent years of sound macroeconomic policies and structural reforms, which had resulted in a significant

reduction of inflation, the resumption of rapid economic growth, and the strengthening of the external position to a comfortable level. The widening of the current account deficit in 1995 resulting from the rapid growth of domestic demand raised important questions whether that development could be sustained. However, Directors noted that the widening of the external current account deficit reflected, in part, investments undertaken by the private sector that were essential to Peru's economic development over the medium term.

Directors emphasized that a further strengthening of the fiscal stance was essential to ease demand pressures and reduce inflation while allowing room for private sector growth. They urged the authorities to persevere in their efforts to enhance revenue collection and welcomed their efforts to tighten spending. Directors also expressed admiration for the authorities' interest in alleviating poverty and improving social conditions.

Because of the heavy burden placed on monetary policy by strong private capital inflows, the Board called for a continuing close review of the rapid growth of credit to the private sector. In that connection, the need to strengthen the supervision of financial institu-

tions to promote effective financial intermediation was also emphasized.

Directors noted that the large private capital inflows were putting pressure on the currency to appreciate, but they generally advised against introducing capital controls, which were not seen as a viable policy option. Directors emphasized the importance of a tight fiscal policy and the pursuit of a prudent wage policy to help preserve competitiveness.

Directors commended the far-reaching reforms introduced in labor market regulations, land rights, and the pension system. They encouraged the Government to persevere in its efforts to deepen the structural reforms and, in particular, to move forward decisively in privatizing state enterprises. In the context of Peru's still difficult medium-term outlook, Directors welcomed the agreement reached in principle with commercial creditors on a debt package and encouraged the authorities to accelerate negotiations with non-Paris Club bilateral creditors.

Philippines

The Board met in September 1995 to conclude the Article IV consultation with the Philippines. It did so against a backdrop of a stronger-than-expected economic performance, but a policy performance that, despite substantial progress, still had fallen short of plans.

Economic activity had begun to accelerate in the second half of 1993, in response to policies enacted to promote export-oriented growth, overcome power shortages, liberalize the foreign exchange system, maintain fiscal restraint, and improve the country's external position. To ensure a durable expansion, the Government in 1993 formulated a medium-term economic program that had at its core an overhaul of the tax system and restructuring of government expenditure and that formed the basis for the extended arrangement approved by the Fund in June 1994.

In 1994, the elements for a strong recovery were in place. GNP growth rose to 5.3 percent, remittances increased by 32 percent, the current account deficit narrowed to 4½ percent of GNP, increased foreign investment swung the overall balance into surplus, and inflation fell to 7.2 percent by year's end (see

Table 29

PHILIPPINES: SELECTED ECONOMIC INDICATORS

(Data as of Board discussion in September 1995; annual percent change unless otherwise noted)

	1992	1993	1994	1995 ¹
Domestic economy				
Real GNP	1.6	2.1	5.3	5.7
Unemployment rate (in percent)	9.8	9.3	9.5	9.5
Consumer price index	8.9	7.6	9.0	8.1
External economy				
Exports (in billions of U.S. dollars)	9.8	11.4	13.5	17.4
Imports (in billions of U.S. dollars)	14.5	17.6	21.3	26.4
Current account balance (in percent of GNP)	-1.6	-5.5	-4.5	-2.5
Direct and portfolio investment (net, in millions of U.S. dollars)	737	812	1,558	2,280
Capital and financial account balance (net, in millions of U.S. dollars)	1,693	2,306	4,498	2,437
External debt (in billions of U.S. dollars)	30.9	34.3	37.7	40.6 ²
Debt-service ratio ³	17.0	17.1	17.4	14.5
Real effective exchange rate (period average)	12.0	-2.3	6.6	5.9
Adjusted gross official reserves (in billions of U.S. dollars) ⁴	5.2	4.7	6.4	6.7
Financial variables (in percent of GNP unless otherwise noted)				
Consolidated public sector balance	-1.9	-2.2	-0.5	-0.1
Gross national saving	19.1	17.4	19.2	21.5
Gross national investment	21.0	23.4	23.5	24.8
Broad money (end of period)	27.8	31.7	34.7	38.3
Interest rate (annual average, in percent) ⁵	16.1	12.3	13.6	11.3

¹Data revised subsequent to the Board discussion.

²As of June 1995.

³In percent of exports of goods and services; after rescheduling.

⁴Gross reserves less securities and gold pledged as collateral for short-term loans.

⁵Interest rate on 91-day treasury bills.

Table 29). These favorable trends had continued through mid-1995: growth and inflation both remained steady, reserves rebounded sharply in response to a tightening of monetary policy in the second quarter, and exports surged.

The Government in July submitted to Congress legislation to redesign the tax system and reorganize the Government. In June, the Oil Price Stabilization Fund balance turned negative, but the Government initiated measures to increase oil prices and, more important, submitted legislation to establish an automatic oil price mechanism and to lift oil price controls.

In their discussion, Directors praised the authorities' continuing efforts to open and liberalize the economy and to restore macroeconomic balance, which, along with greater political stability, had sparked the strong rebound in growth. Given the improvement in the Philippines' external position, including the rapid growth in exports and the sharp decline in the debt-

service ratio, most Directors agreed with the authorities' decision to consider the extended arrangement with the Fund as precautionary.

Considerable further efforts, however, would be needed to transform this recovery into a sustained economic expansion, in the Board's view. Foremost among the policy requirements would be an increase in national saving, which would require prompt and decisive fiscal consolidation, and Directors urged the Government to move forward with planned reforms as quickly as possible. Tax reform would need to raise a significant and steady stream of revenues for the government budget, and it was important to proceed with rationalizing expenditures. Government reorganization should aim to achieve a substantial reduction in the civil service.

Apparent shifts in the demand for money and the presence of large capital inflows have complicated the task of monetary management. In response, Directors noted, the authorities have shifted toward a limited form of inflation targeting. Directors urged the authorities to err on the side of caution in conducting monetary policy, by maintaining base money below the

program ceilings. They also noted that monetary conditions would need constant monitoring if the gains in reducing inflation were to be secured.

In this context, a variety of financial indicators should be monitored, and, when warranted, policy should be further tightened. In these circumstances, they observed, the authorities should not resist market pressures for an appreciation of the exchange rate.

Directors urged the Government to accelerate structural reforms and concurred with the authorities that the fundamental solution to problems in the oil sector would be prompt and full deregulation. In the interim, they urged the Government to adjust domestic oil prices and to eliminate the deficit in the Stabilization Fund speedily. Directors commended the Philippines' acceptance of obligations under Article VIII of the Fund's Articles. They welcomed the Government's medium-term tariff reduction program and urged the lifting of remaining quantitative restrictions on agricultural products. Finally, Directors commended the Philippines for the timely and comprehensive statistics provided to the Fund.

Subsequent to the Board discussion, in early 1996, the Government implemented a major extension of the value-added tax and a substantial upward fuel price adjustment. In addition, it approved laws providing for deregulation of the oil sector and the removal of quantitative restrictions on agricultural products. Economic recovery also continued. GNP growth rose to 5.7 percent in 1995, propelled by manufacturing and exports. Inflation, however, increased to 11.5 percent in the first four months of 1996 mainly as high prices persisted pending full normalization of rice supply. The implementation of the expanded value-added tax and fuel price adjustment also exerted a short-term impact.

Senegal

Directors met in June 1995 to conclude Senegal's Article IV consultation report and to conduct the midterm review of the country's first annual arrangement under the ESAF. (The second annual arrangement under the ESAF was approved in December 1995; see the section on Fund Support of Member Countries.) The discussion took place against the background of the

Table 30

SENEGAL: SELECTED ECONOMIC INDICATORS

(Data as of Board discussion in June 1995; annual percent change unless otherwise noted)

	1992	1993	1994 ¹	1995 ²
Domestic economy				
Real GDP	2.8	-2.1	2.0	4.5
Consumer price index	-0.1	-0.6	32.1	7.8
External economy				
Exports, f.o.b. (in millions of SDRs)	587.9	514.7	554.3	612.8
Imports, f.o.b. (in millions of SDRs)	852.0	789.0	716.9	774.5
Current account balance (in percent of GDP) ³	-9.6	-10.2	-9.2	-7.7
Overall balance (in millions of SDRs)	-92.5	-199.5	89.8	17.9
External debt (in percent of GDP)	56.0	62.5	80.2	72.5
Debt-service ratio ⁴	22.7	22.5	18.9	17.7
Real effective exchange rate	-1.0	-2.4	-35.2	...
Gross official foreign reserves (in weeks of imports)	0.6	0.1	1.0	6.4
Financial variables				
General government balance (in percent of GDP) ⁵	-3.8	-4.0	-5.7	-2.6
Gross national saving (in percent of GDP)	4.4	3.0	4.4	7.9
Gross domestic investment (in percent of GDP)	14.0	13.2	13.6	15.6
Broad money (M2)	3.6	-12.6	39.2	19.6
Interest rate (discount, end of year)	12.5	10.5	10.0	...

¹Estimated.

²Projected.

³Excluding official transfers.

⁴In percent of exports of goods, services, and private transfers.

⁵On commitment basis, excluding grants.

strengthened adjustment strategy adopted by the authorities in early 1994 to tackle the serious difficulties besetting the economy: deterioration in the terms of trade, slowdown in real GDP growth, widening of domestic and external imbalances, and accumulation of external payments arrears. The comprehensive adjustment program was predicated on the 50 percent devaluation of the CFA franc in January 1994 and comprised two main elements: the implementation of strong supporting fiscal and monetary policies, and the acceleration of structural reforms to improve incentives for the private sector and promote growth.

Overall results in 1994 were encouraging. Real GDP grew by 2 percent, close to the year's program objective, and inflation—expected to be high after the price increases following the devaluation of the CFA franc—was kept below the projected rate of 39 percent (see Table 30). In the external sector, the fall in the real effective exchange rate—by some 35 percent after the devaluation—improved the economy's competitiveness and shifted consumer demand toward domestically produced goods. However, disbursements of external budgetary assistance fell short of projections, owing mainly to delays in reaching agreement with the World Bank on the release of credits.

The authorities held the line on spending, particularly on wages. Government revenue performance was weaker than projected, however, primarily because of administrative weaknesses for which corrective actions were subsequently implemented. The overall fiscal deficit thus exceeded the program target by about 1 percentage point. Net bank credit to the Government and the net domestic assets of the banking system remained well under the applicable program ceilings; moreover, credit demand rose moderately in the second half of the year but was contained below the program's limits.

Most of the structural reform measures planned for 1994 were implemented. Price controls on 12 commodities were eliminated as planned, and the marketing and processing of domestically produced rice was completely liberalized. However, the privatization of the groundnut marketing company was lagging behind schedule.

Directors remarked that, despite some setbacks, developments in Senegal had been generally encouraging in 1994. Economic growth had recovered, and the authorities had succeeded in containing inflationary pressures. There had also been sizable reflows of capital and a strong improvement in the net foreign assets of the banking system. Directors noted that most performance criteria and the quantitative and structural benchmarks under the ESAF arrangement had been observed, except for those related to the elimination and nonaccumulation of external payments arrears and government revenue.

In view of Senegal's still fragile economic situation, Directors urged the Government to persevere with and intensify its adjustment and reform efforts. They emphasized that, to achieve the targeted fiscal deficit reduction in 1995, revenues would have to be increased by reinforcing the tax and customs administrations, widening the tax base, and reducing tax fraud. On the expenditure side, the authorities would need to contain the wage bill as programmed, limit public sector recruitment, hold down nonpriority outlays, and avoid extrabudgetary spending. The Board also underscored the importance of eliminating domestic and external payments arrears.

Directors urged the authorities to pursue a prudent credit policy and to strengthen monetary management by using indirect instruments more effectively. Efforts to accelerate economic integration and intensify the coordination of fiscal and monetary policies within the West African Economic and Monetary Union were also seen as essential.

Directors considered that the CFA franc devaluation had given the Government a window of opportunity to promote private sector development and diversify the economy. They called on the authorities to accelerate the implementation of the reforms already under way, in particular the privatization of the groundnut marketing company. The authorities were also encouraged to accept the obligations under Article VIII of the Fund's Articles of Agreement at an early date.

Tunisia

Directors discussed the Article IV consultation with Tunisia in February 1996. Since 1986, Tunisia had made steady progress in implementing comprehensive structural reforms and had pursued consistently prudent macroeconomic policies. As a result, real GDP growth during 1986–93 averaged 3.8 percent a year, driven mostly by rising exports of manufactured goods and tourism. Structural reforms had included gradual reduction of nontariff trade barriers, liberalization of domestic prices and the incentive system, elimination of restrictions on current account transactions, and financial sector reform.

In 1994, real GDP growth stood at 3.4 percent and was estimated at 3.5 percent in 1995 (see Table 31). This was due to continued strong growth in manufacturing industries, mining, and services and offset declining oil production and a sharp contraction in the agricultural sector caused by drought. Inflation rose from 4.0 percent in 1993 to an estimated 6.2 percent in 1995, in part because of increased food prices.

The drought and lower-than-expected economic growth complicated fiscal consolidation. The overall fiscal deficit, excluding foreign grants, hovered around 3 percent of GDP in 1994 and 1995. In 1995, total

Table 31

TUNISIA: SELECTED ECONOMIC INDICATORS

(Data as of Board discussion in February 1996; annual percent change unless otherwise noted)

	1992	1993	1994	1995 ¹
Domestic economy				
Real GDP	7.8	2.3	3.4	3.5
Consumer price index, average	5.8	4.0	4.7	6.2
External economy				
Exports, f.o.b. (in U.S. dollar terms)	8.2	-6.5	23.7	16.5 ²
Imports, c.i.f. (in U.S. dollar terms)	24.2	-4.4	6.9	20.8 ²
Current account balance, excluding grants (in percent of GDP)	-7.0	-7.7	-2.9	-4.5
Direct investment (in percent of GDP)	3.1	4.3	2.4	1.5
Capital account balance (in millions of SDRs)	861	794	674	679
External debt (in millions of SDRs, end of period)	5,444	5,609	5,922	6,318
Debt-service ratio ³	20.2	20.6	18.5	18.7
Real effective exchange rate ⁴	2.1	-1.2	0.5	2.1
Gross official reserves (in months of imports)	1.8	1.9	2.8	2.8
Financial variables				
Central government balance, including foreign grants (in percent of GDP)	-2.4	-2.9	-2.7	-2.8
Gross national saving (in percent of GDP)	22.2	21.3	21.4	21.1
Gross investment (in percent of GDP)	29.1	28.8	23.8	25.0
Money and quasi-money	7.2	7.0	7.8	7.6
Interest rate (in percent) ⁵	11.3	8.8	8.8	8.8

¹Estimated.²Reflecting mainly the depreciation of the U.S. dollar against the currencies of Tunisia's European trading partners.³As percent of exports of goods and services; including Fund charges.⁴Information Notice System.⁵Money market rate.

revenue rose only by about 8 percent, well below the budget target of 15 percent.

External accounts improved sharply in 1994, with the current account deficit, excluding grants, narrowing to 2.9 percent of GDP. This reflected the strong growth of nonenergy exports, including large shipments of olive oil stocks, and a slowdown in import growth following the completion of two major energy projects. In 1995, the current account deficit was estimated to have widened to 4.5 percent of GDP, in part because of the drop in olive oil exports.

Directors commended the authorities for their steadfast pursuit of structural reforms and prudent macroeconomic policies. They welcomed the authorities' commitment to build on the progress achieved and to pursue further structural reforms and macroeconomic consolidation in a medium-term context. Directors considered the medium-term strategy based on raising domestic saving and fostering a market-oriented, open, and private-sector-driven economy

appropriate to achieving higher and sustainable economic growth and lower unemployment.

Directors welcomed the conclusion of the Association Agreement with the European Union. This was seen as a critical framework for the expansion of trade and a clear signal of the authorities' commitment to the further development and modernization of the Tunisian economy and its full integration into the global economy. Continued adjustment and reform were essential to reaping the full benefits of the Association Agreement.

To preserve macroeconomic stability and free resources for higher private investment, Directors emphasized the need for further fiscal consolidation. In particular, they noted that achieving the fiscal target for 1996 would require forceful implementation of the envisaged revenue and expenditure measures. The authorities' intention to develop and strengthen the value-added tax system with a view to offsetting the revenue losses resulting from trade liberalization was welcomed. Directors also encouraged increased efforts to contain the growth of the wage bill in the context of the ongoing civil service reform and to reduce consumer subsidies. Directors observed that a

strengthening of public finance would facilitate the continued implementation of a prudent monetary policy.

Directors broadly supported the Central Bank's policy of keeping the real effective exchange rate stable in the context of restrained financial and incomes policies. They, nonetheless, stressed that the exchange rate policy should continue to be kept under close review.

The importance of strengthening the incentive system in parallel with industrial restructuring to promote higher saving and investment and attract large flows of foreign direct investment was underscored. Directors encouraged completing the liberalization of domestic prices, introducing greater flexibility in the labor market, strengthening human capital development, and moving further with trade liberalization. They welcomed the accelerated pace of privatization and urged its widening to all sectors and to large public enterprises.

Directors encouraged the acceleration of financial sector liberalization and urged that remaining controls

on interest rates be phased out and savings institutions reformed to help increase saving and the efficiency of financial intermediation.

Economies in Transition

In the Fund's classification of countries, transition economies cover three groups: central and eastern Europe and the Baltic countries; Russia and the other countries of the former Soviet Union; and Mongolia. Although each of these displays unique traits, a characteristic common to all of them is the transitional state of their economies from a centrally administered system to one based on market principles.

Among the central and eastern European countries and the Baltic countries, the Board concluded Article IV consultations with Albania, Bulgaria, Croatia, the Czech Republic, Estonia, Latvia, Lithuania, the former Yugoslav Republic of Macedonia, Poland, Romania, the Slovak Republic, and Slovenia. In general, economic performance in these countries continued to improve; attempts to keep inflation under control were mainly successful; and further advances were made in the liberalization of trade and payments systems. Some worrying fiscal developments had emerged in many countries, however, and progress in implementing structural reforms—especially in the financial sector—was uneven.

All of these countries were pursuing serious stabilization and reform efforts. Those countries that had adopted strong programs at an early stage and were more advanced in the transition—such as Albania, the Czech Republic, Poland, the Slovak Republic, and Slovenia—were reaping the benefits in the form of rapid growth. Directors observed, however, that signs of possible overheating had emerged in the Czech Republic, and that in Poland reducing inflation had proved more difficult than anticipated.

Although most countries had succeeded in keeping inflation in check, price stability would continue to pose a major challenge. For those countries where there was a potential for overheating, Directors stressed the need to strengthen policies to achieve an early slowing of inflation and wage increases. In this context, Directors noted with concern the relaxation of fiscal policy in many countries and underscored the need for continued vigilant and prudential fiscal management.

Progress in achieving structural reform was mixed. In particular, fragile banking systems and financial indiscipline had been a major source of macroeconomic instability in some countries. In Latvia and Lithuania, the slow pace of banking reforms and the failure to react quickly to signs of trouble had resulted in full-scale banking crises. Enterprise restructuring and privatization efforts had also bogged down in many countries—even in some of the more advanced economies, such as the Slovak Republic and Slovenia.

In other countries, such as the former Yugoslav Republic of Macedonia and Romania, stabilization remained fragile because of slow progress in implementing structural reforms.

Directors expressed broad support for the flexible exchange rate policies adopted by most of these countries—which gave appropriate scope to the play of market forces. Many urged other countries, such as the Czech Republic and Poland, to introduce more flexibility into their exchange rate regimes. Some other Directors counseled the authorities to guard against significant erosion of competitive positions in the wake of strong inflows of capital and their potential impact on the exchange rate. Several Directors called into question the efficiency of capital controls, however. In general, Directors urged the authorities to monitor the external situation carefully and to stand ready to adjust the policy stance as needed.

Virtually all countries in this group had taken further steps to liberalize their trade and payments systems, and several were moving toward—or had achieved—full current account convertibility. A worrisome exception was Romania: Directors noted renewed problems in the exchange market, and they underscored the importance of sustained and consistent application of the policy understandings that had been reached regarding exchange rate management as a basis for continuing Fund support.

In the case of the other transition economies, Article IV consultations were concluded in 1995/96 with Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Moldova, Mongolia, Russia, and Ukraine. Directors welcomed the determined efforts in most of these countries directed at stabilization and market-oriented reforms, although they regretted that Ukraine's effort had faltered in the second half of 1995 after a promising start. Many countries still had to contend with external and domestic instabilities, however, and slow progress in structural reform continued to keep even the more successful of them from realizing their full economic potential.

The fiscal situation in most of these countries remained fragile. Directors noted that permanent reductions in unproductive spending, together with measures to improve revenue performance, were needed. Directors cautioned, however, against deep, unsustainable expenditure cuts, emphasizing, rather, the importance of revenue-enhancing measures. In this context, they suggested that stronger efforts were required to improve tax collection and administration. Containing inflation continued to pose a major challenge, and for some countries—notably Russia—further reduction in inflation remained the policy priority. Nevertheless, Directors noted that in some countries, such as Belarus and Kazakhstan, tight monetary and fiscal policies had succeeded in reducing inflation.