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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 84/56

10:00 a.m., April 6, 1984

J. de Larosière, Chairman

Executive Directors	Alternate Executive Directors
	J. K. Orleans-Lindsay, Temporary
	G. Ercel, Temporary
	X. Blandin
A. Donoso	M. Teijeiro
R. D. Erb	M. K. Bush
	J. C. Williams, Temporary
M. Finaish	T. Alhaimus
	T. Yamashita
J. E. Ismael	Jaafar A.
R. K. Joyce	L. Leonard
	H. A. Arias, Temporary
G. Laske	
G. Lovato	C. P. Caranicas
R. N. Malhotra	A. S. Jayawardena
	J. E. Suraisry
J. J. Polak	T. de Vries
	K. G. Morrell
G. Salehkhou	O. Kabbaj
	E. I. M. Mtei
M. A. Senior	J. L. Feito
	A. Lindø
N. Wicks	T. A. Clark
Zhang Z.	

J. W. Lang, Jr., Acting Secretary
R. S. Franklin, Assistant

<u>Also Present</u>
African Department: J. B. Zulu, Director; D. T. S. Ballali, R. O. Carstens, F. d'A. Collings, K. G. Dublin, P. J. Duran, C. Enweze, C. E. Hunter, J. W. Kratz, D. E. Syvrud. Exchange and Trade Relations Department: W. A. Beveridge, Deputy Director; E. H. Brau, S. Eken, M. Guitian, K. M. Huh, D. A. Lipton, R. L. Sheehy. Fiscal Affairs Department: J. Diamond, C. Schiller. Legal Department: G. P. Nicoletopoulos, Director; J. M. Ogoola, J. V. Surr. Research Department: N. M. Kaibni. Secretary's Department: A. P. Bhagwat. Western Hemisphere Department: S. T. Beza, Associate Director; H. M. Flickenschild, J. Jaramillo-Vallejo, J. F. van Houten. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: A. A. Agah, S. E. Conrado, J. Delgadillo, S. El-Khouri, S. M. Hassan, H.-S. Lee, G. E. L. Nguyen, Y. Okubo, D. I. S. Shaw, D. C. Templeman. Assistants to Executive Directors: H. Alaoui-Abdallaoui, I. Angeloni, J. Bulloch, M. Camara, M. B. Chatah, M. Eran, C. Flamant, I. Fridriksson, V. Govindarajan, D. Hammann, J. M. Jones, H. Kobayashi, E. Landis, G. W. K. Pickering, E. Portas, J. Reddy, D. J. Robinson, A. A. Scholten, A. Yasseri.

1. LIBERIA - 1983 ARTICLE IV CONSULTATION, AND STAND-BY ARRANGEMENT - REVIEW AND MODIFICATION

The Executive Directors considered the staff report for the 1983 Article IV consultation with Liberia together with a review under the stand-by arrangement and a request for a modification of performance criteria (EBS/84/54, 3/12/84; Sup. 1, 4/2/84; and Sup. 2, 4/3/84). They also had before them a report on recent economic developments in Liberia (SM/84/69, 3/30/84).

Mr. Mtei made the following statement:

Apart from the Article IV consultation reports, much has been written by the staff in recent years and much has been said in this Board on developments in the Liberian economy in connection with the ongoing stabilization efforts of the authorities. Just last September, the Board approved a request by Liberia for a 12-month stand-by arrangement. At that time, as we had done on previous occasions, we stressed the fact that, against the background of a difficult economic situation, the Liberian authorities have demonstrated quite convincingly in implementing preceding programs that not only do they wish to cooperate with the Fund in finding solutions to their economic problems but also that they are prepared to do what is necessary in order to improve the situation. Today, I can assure the Board once again that the authorities' commitment to the adjustment process remains firm.

Since the beginning of 1984, additional measures have been implemented aimed at ensuring that the objectives of the present program are achieved, particularly with respect to the budget. For instance, steps have been taken to effect further economies in the public sector wage bill and in the development budget, while the gasoline tax has been increased. These actions were deemed necessary after it became apparent that revenue was likely to increase by only half the rate projected in the original budget.

All performance criteria as of the end of February have been met, except the one relating to the limit on external borrowing. That target was slightly exceeded because the authorities had to borrow on commercial terms to complete the financing package for a palm oil mill. The project, which was judged to be economically viable, should contribute positively to Liberia's balance of payments, and it had the backing of bilateral lenders as well as the European Economic Community. The authorities have therefore requested a waiver with respect to the excess over the program limit on external borrowing. In view of Liberia's excellent record of cooperation with the Fund, I urge Directors to accede to the request.

The budget will continue to bear the major share of the adjustment burden, with the deficit expected to decline sharply from the equivalent of 9.5 percent of GDP in 1982/83 to 3.7 percent in 1983/84. Indeed, this would be an impressive development, especially when considered in the context of the large negative rate of growth in both nominal and real GDP in 1982/83 and in the wake of an expected shortfall in revenues. The situation, in the absence of other policy instruments, necessitated a much larger cut in expenditure in 1983/84 than initially envisaged at the start of the program. But more important, it is an indication that the courageous efforts of the authorities to contain expenditure with a view to restoring fiscal equilibrium under earlier programs have been frustrated by the depressed level of economic activity during the past three years, which have been largely responsible for shortfalls in revenues despite new tax measures and the steps that have been taken to strengthen the tax collection machinery. The crux of the matter is that the room for maneuver has narrowed considerably in terms of what can be done if the economy continues to deteriorate. There are signs, however, that the deteriorating trend will be reversed in the current fiscal year. Real GDP is projected to grow by 2 percent during the period, which is a slight improvement over the original forecast, compared with a negative growth rate of 7.2 percent in 1982/83.

It is clear that economic recovery is essential if the adjustment process in Liberia is to become less onerous. Although the authorities have been aware of this fact from the beginning of their stabilization efforts in 1980, they have been constrained in their adjustment efforts. A small, open economy like Liberia's--which is highly dependent on a few primary export commodities--could not insulate itself from the impact of global recession. Thus the recovery that is beginning to emerge in industrial countries is seen in Liberia as an opportunity to expand exports by seeking new markets while increasing production of traditional products. However, efforts to diversify the productive base of the economy remain paramount with a view to reducing Liberia's vulnerability to external developments over the long run.

The need for a substantial inflow of concessional capital to support the Government's investment program in view of the limited budgetary savings and the heavy external debt burden cannot be overemphasized. But I should also stress that the private sector is expected to play an important role in augmenting the level of investment in Liberia. As far as investment opportunities are concerned, prospects are most promising for the agricultural sector, both for food and tree crops (the palm oil project mentioned earlier is a part of the drive to diversify the economy). However, the mining sector is also expected to be an important part of the overall strategy to boost economic activity. It is the intention of the authorities to develop iron ore reserves to replace deposits which are likely to be depleted toward the end of the decade.

The tight liquidity situation adds to the difficulty of managing the economy efficiently. Real money balances are still below the 1979 level. However, this problem has begun to subside with the gradual restoration of confidence in the economy. There has been a dramatic change in the composition of domestic credit over the last three years. Whereas in 1980 the Government accounted for 36 percent of total credit and the private sector 62 percent, by June 1983 credit to the Government was 76 percent of total credit while the private sector accounted for only 20 percent. This is another indication of the extent to which private sector activity has shrunk over the years.

The outlook for the balance of payments is for an improvement in the current account and in the overall balance of payments position. However, many of the underlying problems remain. Export projections have been revised downward--an 8 percent increase is expected instead of 12 percent as initially projected--with imports expected to follow the same pattern. The public debt is also expected to take up a sizable share of the country's financial resources, although the situation has been eased somewhat by the rescheduling of debt service payments falling due in 1983/84. Despite the precarious reserve position of the National Bank of Liberia, the authorities remain committed to the goal of eliminating arrears.

Past experience with short-term projections suggested that caution should be exercised in dealing with the medium-term prospects for the Liberian economy. But there are three points that are worth noting at this stage. First, the fiscal strain is likely to remain in the years to come and will therefore require sustained efforts on the part of the authorities. Second, Liberia's balance of payments is expected to move toward a sustainable position, but will remain under pressure. Finally, the growth path of the Liberian economy in the medium term will depend to a large extent on whether the recovery now under way remains strong, particularly in its major trading partners. A firm recovery will enable the authorities to pursue adjustment more smoothly while giving due attention to the issues of growth and development.

Mr. Blandin considered the stand-by arrangement with Liberia a good example of a flexible yet efficient presentation of the catalytic role of the Fund in Africa. The arrangement was the seventeenth with Liberia since 1953 and the fourth in succession. At the time it had been approved in September 1983, the Fund's holdings of Liberian dollars had been equivalent to more than 400 percent of Liberia's quota, although that had not hampered approval of the arrangement in an amount of SDR 55 million, or 99 percent of the previous quota. Moreover, the stand-by arrangement had been heavily front-loaded, with more than 50 percent of the SDR 55 million purchased within three and one half months following Board approval. In addition to financial resources, the Fund had provided a resident representative and a wide variety of technical assistance, which had helped to support Liberia's adjustment efforts without imposing the sort of unrealistic conditions that might have jeopardized the implementation of the program or weakened the commitment of the authorities.

The Fund's positive approach had borne some fruit, Mr. Blandin noted. As shown in the supplementary staff papers, the authorities remained strongly committed to implementing the program. In addition to adopting new tax measures, the authorities had agreed to implement a phased reduction in the public sector work force of 12 percent by June 30, 1984 and further reductions during FY 1984/85. Such cuts represented a sweeping departure from the policies that had been followed in the late 1970s that had resulted in an unsustainable growth in the number of government employees.

The support provided by the Fund had undoubtedly played a significant role in fostering confidence among other potential sources of financing, Mr. Blandin observed. The United States, for example, had decided to increase cash grants to Liberia by $10 million in 1984/85; and the World Bank was accelerating progress toward a structural adjustment loan in the amount of $30 million. It was to be hoped that that loan would address the long-term problems of the Liberian economy that were structural in nature. The most prominent of those problems concerned the exchange rate and was reflected in the appreciation of the currency; Liberia used the U.S. dollar as its currency. It was unfortunate that the Liberian authorities were unable to intervene on the exchange rate front. The world market for iron ore and timber had perhaps been helped by the appreciation of the U.S. dollar; but he wondered about the extent to which the appreciation would prevent Liberia from taking full advantage of the recovery in the world rubber market. Liberia's comparative advantage in the rubber market had been eliminated by the appreciation of its currency against those of its competitors in Asia.

While little could be done with regard to the exchange rate, there were other areas--such as the public enterprise sector--where much improvement was possible, Mr. Blandin continued. A number of public corporations, for example, had been plagued by overstaffing, either real or artificial; it was therefore reassuring that the rationalization of the public enterprise sector would be the main objective of the World Bank's structural adjustment loan.

On another matter, Mr. Blandin said that he had been surprised to observe from Table 8 of the staff report that no further Fund support was foreseen in the years to come. Rather, heavy repurchases were scheduled, which would mean a continuation of balance of payments deficits through 1986/87. The recent increase in quotas had provided some breathing space, bringing the Fund's holdings of Liberian dollars subject to repurchase to a level equivalent to only 212 percent of present quotas, excluding the compensatory financing facility; and that was far from the upper limits of 480-500 percent of quota that could apply to a country like Liberia. Table 8 showed that the overall balance of payments, excluding Fund repurchases, should be in surplus as early as 1985/86, even without additional adjustment measures; and it was mentioned on page 30 of the staff paper that those financing gaps could be covered with the implementation of such measures, which should induce Liberia's creditors to agree to consider debt relief. However, the main purpose of the debt relief would apparently be to finance repurchases to the Fund, which would be counterproductive. He failed to see how Liberia could be encouraged to take new adjustment measures if the net flow of resources was from Liberia to the Fund rather than the reverse. In conclusion, he appreciated the Fund's activities in Liberia and reiterated his support for the proposed decisions.

Ms. Bush stated that she was in broad agreement with the staff appraisal and could support both decisions. With regard to the requested modification of performance criteria, she could go along with the 68 percent increase in the limits on external public sector borrowing on commercial terms, provided that the proceeds were used further to diversify the productive sector. However, she was concerned with the larger implications of the proposed modification; a project analysis had presumably been done for the mills to be financed by the loans, and she wondered whether it showed that sufficient foreign exchange would be generated to service the debt as presently structured. She also wondered whether the private sector might not have played a larger role in the palm oil sector. The United States was fundamentally concerned about the dominance of government or parastatal corporations in the productive sectors of developing countries, particularly when those government entities did not perform efficiently. Without sufficient incentives to ensure economic and financial viability, scarce human and financial resources of countries could be squandered. In that respect, Liberia might have been better served if the authorities had provided incentives for greater private sector participation in the palm oil industry.

She commended the authorities' recent decision to proceed quickly to reduce public sector employment, which should yield significant benefits for Liberia over the medium term, Ms. Bush continued. Any additional information from the staff or Mr. Mtei on how the authorities intended to proceed would be welcome. Fiscal adjustment was the key to returning Liberia to a sustainable financial position; hence the original program objectives, while ambitious, were appropriate. The original budget had aimed at a nominal reduction of 59 percent in the overall deficit to US$42 million, or 3.7 percent of GDP. By end-November 1983, it had become obvious that, with a revenue shortfall of about US$14.5 million and unbudgeted expenditures of US$2.1 million, the overall fiscal target could not be achieved without compensating corrective measures. In that regard, additional measures considered by the staff to be sufficient to ensure the achievement of the 1983 program objectives had been announced on January 16, 1984. While pleased that the authorities had been able to take the necessary corrective action, she agreed with the staff that any attempt to reduce the government deficit beyond the targeted 3.7 percent of GDP in the current fiscal year could be counterproductive.

As the authorities began to make significant headway in improving Liberia's economic situation, they should perhaps consider what might be done to assist the development of a more vigorous local banking system, Ms. Bush remarked. There were only a few banking offices in the country, and their minimum deposit requirements ranged from US$500 to US$5,000. Under those conditions, the country could not be expected to mobilize significant amounts of domestic savings or to monetize more of its basic agrarian economy. She also strongly urged the authorities to pursue their stated objective of opening up petroleum imports to the private sector; progress toward that end thus far had been clearly insufficient.

In its comprehensive medium-term analysis covering central government finance, the balance of payments, and the external public debt, the staff had provided a base case and an alternative scenario for Liberia showing the impact of additional measures to strengthen the budget and of further cuts in the wage bill, Ms. Bush noted. Neither the base case nor the alternative assumed debt relief beyond the Paris Club and London Club rescheduling. The staff was of the view that the recommendations recently approved by Liberia's head of state were consistent with Scenario B, which led to a viable balance of payments position; however, the U.S. authorities felt that the staff projections for Liberia's budgetary and balance of payments positions shown in the tables might turn out to be optimistic. Specifically, they felt that, to ensure a better performance with respect to exports, the authorities should continue to take steps to eliminate policy and institutional impediments to the rejuvenation of iron ore mining and to implement proposals for the development of iron ore reserves in the western area and elsewhere in order to replace present ore deposits that were expected to be depleted as early as 1987. Finally, she agreed with the staff that the rationalization of the public corporations was an important element in the goal of achieving financial balance in the medium term. It was regrettable that progress in that area to date had been slow.

The staff representative from the African Department, recalling Ms. Bush's concern about the lack of incentive for greater private sector participation in the palm oil industry, noted that private firms in Liberia had yet to regain sufficient confidence to take on so large a project. In 1983, the authorities had realized that, in the absence of sufficient inflows of public sector money, investment policies would have to be reoriented toward the private sector, and they were currently in the process of providing an appropriate environment for private sector investment. Until the private sector gained the confidence it needed, however, the potential of the palm oil industry had to be exploited somehow. The World Bank had made a study of the project in question and had pronounced it viable; the World Bank had also noted that the Buto Palm Oil Corporation handling the project was one of the best managed public enterprises in Liberia.

A question had been raised by Mr. Blandin regarding the competitiveness of the Liberian economy, the staff representative recalled. Most industries, both public and private, had improved their competitiveness in recent years through the introduction of cost-cutting measures together with exemptions from export taxes and import duties. Moreover, all industries were benefiting from the reduction in oil prices, which had provided significant cost savings, particularly for some of the energy-intensive mining companies. It was only the timber industry that appeared to be having difficulty competing abroad at present; and the situation should improve as the major markets--particularly in France--began to recover. In general, the Liberian export sector, because of the measures adopted during the past year, was in a position to take advantage of growing export markets; indeed, some of the industries were looking forward to making modest profits in 1984.

In response to a question by Ms. Bush regarding iron ore mining, the staff representative observed that the World Bank, as part of its structural adjustment loan program, would be looking into the potential for private firms to take advantage of various resources that lay within the interior of Liberia and in the coastal areas. He was not aware of any major impediments to iron mining in Liberia, although a number of companies had been using various tactics in an effort to obtain tax relief, which might imply some problems. In any event, because current iron ore reserves were being depleted, the companies would need to look ahead toward major investments; and it would be important for the Liberian authorities to deal equitably with those companies.

The Deputy Director of the Exchange and Trade Relations Department, responding to a question concerning assumptions about further Fund assistance to Liberia, observed that the standard staff practice was to assume no assistance from the Fund in closing the financing gap in the period following the conclusion of a program.

Mr. Mtei observed that the Liberian authorities were determined to ensure successful implementation of the program, as evidenced by their recent exploration of ways of furthering the adjustment effort, including the possibility of reducing public sector employment. As noted by Mr. Blandin, Liberia's problems were structural in nature and required longer-term financing. In that regard, he was pleased to note that concessional financing--including grants from friendly countries--might be forthcoming. Finally, while he understood the reason for the staff's decision not to make reference to any Fund assistance in meeting the financing gap beyond the program period, he hoped that the omission would not signal any unwillingness on the part of the Fund to be flexible and to provide assistance to countries that were able to implement programs designed to correct structural problems in the economy.

The Chairman made the following summing up:

Directors generally agreed with the appraisal in the staff report for the 1983 Article IV consultation with Liberia. They urged the authorities to persevere in implementing the additional measures that are essential for the medium-term viability of the Liberian economy. Directors acknowledged that strong adjustment measures had been taken over the past year that had resulted in a substantial reduction in government expenditures. They took note in particular of the unprecedented cut in salaries of all public sector employees in January 1983 and the recent courageous decision to reduce the public sector work force. Implementation of the latter measure was considered essential for achievement of a sustainable budgetary and balance of payments position.

The authorities were also urged to consider means of giving an impetus to economic activity and employment, particularly in the context of declining public sector employment. Directors indicated that the World Bank's proposed structural adjustment loan could be helpful in the restructuring of the economy toward the productive sectors. They noted, in particular, the comparative advantage that Liberia enjoys in rubber, palm oil, and other tree crops, and they urged the authorities to improve the conditions for expansion and diversification of the agricultural sector. Continued cooperation with the World Bank in rationalizing the public corporations--in particular, those in the energy sector--was considered important to the adjustment process, support for which could be improved through the establishment of a more vigorous banking sector.

Directors observed that, with full implementation of the fiscal measures described in the staff paper, the authorities would be able appropriately to direct their attention--in cooperation with the World Bank and various donors--to the structural imbalances in the economy, so as to improve the potential for productive investment, increased real output, and employment. In doing so, they should continue to avoid hindering sectors that could contribute to the improvement of the productive capacity of the country.

The next Article IV consultation discussion with Liberia is expected to be held on the standard 12-month cycle.

The Executive Board then adopted the following decisions:

Decision Concluding 1983 Article XIV Consultation

1. The Fund takes this decision in concluding the 1983 Article XIV consultation with Liberia, in the light of the 1983 Article IV consultation with Liberia conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

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

Decision No. 7662-(84/56), adopted
April 6, 1984

Stand-By Arrangement - Review and Modification

1. Liberia has consulted with the Fund in accordance with paragraph 4(d) of the stand-by arrangement for Liberia (EBS/83/175, Supplement 1, September 15, 1983) and paragraph 29 of the letter of July 14, 1983 attached thereto in order to review the progress made in the implementation of the program and to reach understand ings on the budget performance, the rescheduling of public debt, and the operation of the petroleum sector. Also by telex of March 20, 1984 from the Minister of Finance, Liberia initiated a consultation, pursuant to paragraph 4 of the stand-by arrangement, concerning the observance of the performance criterion on external borrowing referred to in paragraph 4(b) of the stand-by arrangement.

2. The letter of the Minister of Finance dated January 27, 1984 together with the telex of March 20, 1984 shall be annexed to the stand-by arrangement for Liberia, and the letter of July 14, 1983 shall be read as supplemented and modified by the letter dated January 27, 1984 and the telex of March 20, 1984. Accordingly:

a. the reference in paragraph 4(a)(ii) and (iii) of the stand-by arrangement to paragraph 27 of the letter of July 14, 1983 (relating to the limit on net credit of the banking system to the public sector and to the Government) shall be read as a reference to paragraph 10 of the letter dated January 27, 1984.

b. the reference in paragraph 4(b) of the stand-by arrangement and paragraph 22 of the letter of July 14, 1983 to the limit of US$5 million on the authorization of new public and publicly guaranteed foreign indebtedness shall be increased by the indebtedness of US$3.4 million referred to in the telex of March 20, 1984.

3. The Fund finds that no further understandings are necessary with respect to the other measures referred to in paragraph 4(d) of the stand-by arrangement or because of the non observance of the performance criterion on new public and publicly guaranteed debt; and that Liberia may make further purchases under the stand-by arrangement.

Decision No. 7663-(84/56), adopted
April 6, 1984

2. GHANA - REVIEW UNDER STAND-BY ARRANGEMENT

The Executive Directors considered a staff paper and proposed decision on a review under the stand-by arrangement for Ghana (EBS/84/60, 3/16/84; Cor. 1, 4/3/84; and Sup. 1, 4/4/84).

The staff representative from the African Department noted the indication in the staff paper that the Ghanaian authorities had been planning to eliminate by mid-March 1984 the 5 percent foreign exchange tax on foreign transfers and on purchases for education, travel, and medical treatment. That tax had constituted a multicurrency practice and had since been eliminated and replaced by a stamp duty.

Mr. Salehkhou made the following statement:

My Ghanaian authorities wish to express their appreciation for the staff's cooperation and assistance in completing this second review of the stand-by arrangement adopted last August, particularly with respect to the design of the 1984 economic and financial program. They broadly concur with the staff's appraisal of Ghana's present situation and medium-term prospects.

Despite large initial uncertainties in relation to the scope of the measures and policies implemented under the adjustment program and with regard to their real impact on an economy where the correction of deep domestic and external distortions had been long overdue, Ghana's performance under the stand-by arrangement remains to a large extent satisfactory and well within original targets and criteria. However, the implementation of the program has coincided with severe weather conditions, and the task of removing many bottlenecks--most of them arising from unfulfilled external commitments by some donors and creditors--proved to be much slower than originally expected. As a result, imports and economic activity did not recover as projected, which made it necessary for the authorities to adopt additional measures and accelerate the implementation of some policies in order to achieve the program's financial objectives. Thus, while considerable progress was made in the implementation of the adjustment program and the elimination of economic distortions, a decisive improvement in the real economy is still to materialize, which could in turn further strengthen domestic support for the program's bitter medicine and restore external confidence.

My Ghanaian authorities are, however, encouraged by the economic trends observed in the second half of the year, particularly with respect to inflation, the level of imports, and the rehabilitation of productive and export sectors. As in the previous review, they have confirmed their strong commitment to the program by taking additional measures and by further strengthening the adjustment policies late in 1983, and more recently within the 1984 budget.

In the last eight months, Executive Directors had twice examined Ghana's economic conditions and adjustment efforts. Thus, I wish to limit my comments to a few elements of the policies under the program which are comprehensively covered by the staff in the main report and the supplement.

External policies

Performance in this area has been generally much less favorable than expected under the program largely due to unforeseen developments which affected export earnings, the volume of imports, and net capital inflows. The shortfall in earnings resulted from depressed world prices as well as a late 1983-84 cocoa crop and slower than expected recovery in the production of gold, timber, and other exports. The lower volume of imports, which has markedly delayed the rehabilitation of export sectors, was undoubtedly affected by difficulties associated with the huge depreciation of the exchange rate and the overcautious approach by commercial banks to the policy changes introduced. However, the insufficient level of imports seems to have also been affected by Ghana's low level of foreign exchange and by reduced net inflows of both private and official capital.

While balance of payments performance for 1983 as a whole was less satisfactory than expected, the prospects for external adjustment relatively improved in the second half of the year as the authorities tackled with some success the issue of imports and as new efforts were directed toward the acceleration of the rehabilitation program and the removal of structural bottlenecks. The Government's actions included moral suasion and guarantees to commercial banks to ensure the expansion of credit to importers and a further simplification of the import licensing system. It also included the continuation of a flexible exchange rate policy with a new depreciation of the cedi beyond the movement of the index measuring the inflation differentials between Ghana and her trading partners.

The improved prospects for attaining the program's external objectives for 1984 are also associated with the large increases of export earnings projected for most products, including cocoa which should considerably benefit from the recent surge in the world price despite the projected decline in volume by about 15 percent.

Net capital inflows will continue to be crucial to the successful implementation of Ghana's adjustment policies. In this regard, while the success of the consultative group meeting last November and the assistance provided by multilateral organizations (such as the World Bank, the EC, the ADB, and the OPEC Fund) have been encouraging, it should be noted that actual disbursement remained very slow through 1983. Moreover, although Ghana has demonstrated an unequivocal adherence to adjustment policies, taking additional measures to secure the observance of original targets under the Fund program when necessary, the response of her partners has been below expectations as evidenced by lower than projected direct capital investment and by the stringent terms attached to the recent international credit of $120 million.

Financial policies

Largely because of sluggish economic activity and weak trade movements in 1983, total government revenues and grants were even lower than the already reduced estimates in the previous program review. However, the shortfall was to a large extent matched by a new substantial scaling-down of expenditures, and the slightly larger than projected budgetary deficit was financed without increase in the government recourse to the banking system.

As for the 1984 budget, the projected increase in total government revenues and grants may seem optimistic, particularly in the light of the 1983 downward revision of original estimates. Such an increase is, however, largely consistent with the trends related to imports and economic recovery in the second half of 1983 and with the much improved financial position of the Cocoa Marketing Board. This improvement should be accompanied by a substantial increase in total expenditures so as to allow for a much needed 40 percent average increase in civil service salaries, which will nonetheless remain below their real level at the inception of the program, and for a resumption of development expenditures. It should be noted that development outlays are budgeted at the minimum level compatible with the supplies and repairs needed for the effective implementation of the program. It should also be noted that the oil subsidy projected at $500 million is likely to be below this amount following the authorities' decision to advance from June to March 1984, the date of a full pass-through to domestic prices of petroleum import costs.

With regard to monetary and credit policy, developments in 1983 have been well within the program's original targets, while 1984 projections should allow for accommodation of the private sector's credit needs without excessive monetary expansion.

On the interest rate policy, considerable upward adjustment has already taken place. However, it should be noted that, in view of the substantial deceleration of inflation in the second half of 1983 and early 1984, present real rates are much less negative than earlier estimates. Furthermore, any additional adjustment in present interest rates should take into account not only the rate of inflation (which is heavily influenced by the program's bold exchange rate and price policies), but also its effect on fundamental objectives of the program such as the revival of economic activity. Above all, such an adjustment should realistically consider how the expected impact on savings could materialize in an economy where incomes continue to be extraordinarily depressed.

Price and incomes policies

The authorities have markedly accelerated the implementation of the program in this area through their decision to phase out the petroleum subsidy about three months ahead of schedule and through a significant reduction in the list of goods subject to direct price control. Further action by the Government under these policies includes a 50 percent increase in the cocoa producer price for the 1984-85 crop, which was adopted in consultation with the World Bank.

However, an important point of internal consideration is the very sensitive politics of pricing in a sophisticated and deeply institutionalized marketplace, which should be carefully appraised when price policy is to be formulated.

The issue of salaries, particularly in the civil service, should remain a matter of concern. Indeed, despite large increases in 1983 and 1984, these salaries are in real terms even lower than their level before the adoption of the adjustment program and represent only 12.5 percent of their real value in 1975. This issue is undoubtedly crucial to the successful implementation and monitoring of the program as it directly affects the authorities' efforts to enhance administrative capacity and to strengthen the support for adjustment policies.

In sum, my Ghanaian authorities have again demonstrated their commitment to the Fund program and their ability to monitor its implementation and move swiftly to counter any unforeseen difficulties. They have already achieved considerable progress in correcting many domestic and external economic distortions and have seriously paved the way for reviving economic activity and resuming real growth. Improvement in the real economy has been, however, much slower than originally expected, while decisive progress in this area will continue to be dependent not only on the satisfactory implementation of the program, but also on the prospects for an end to the prolonged drought, on the timely disbursement of external loans, and on the realization of the expected increase in total imports. Ghana's ability to attract more capital inflows, at concessionary or normal market terms, will be particularly crucial to the attainment of the program's medium-term objectives.

Mr. Wicks said that, as emphasized in previous discussions, the program in question was not just important for Ghana, but for some of the Fund's other African members as well. It was therefore especially encouraging that the authorities had adhered so commendably to the performance criteria and had continued to take required measures ahead of schedule. Domestic prices of petroleum already fully reflected the price of imported crude oil, and the pace of reduction of external arrears had been faster than targeted. Price controls had been reduced, and, perhaps more important, the new exchange rate policy had been working well. He welcomed the further devaluation announced in the March budget. However, despite those impressive achievements, the economy had thus far responded more slowly than might have been hoped, partly due to the drought. There were some hopeful signs, however. The new exchange rate system had given a boost to the timber industry, and production in the mineral industry had begun to improve in 1983, a development that was expected to continue into 1984. Still, as the staff had noted, Ghana's recovery from what had been a position of very severe imbalances should be viewed in a medium-term context. In that respect, there was likely to be a need for support and advice from the Fund for many years to come, which should be closely coordinated with the World Bank.

Fiscal policy in Ghana had been made difficult in 1983 by the 20 percent shortfall in revenues, due largely to the slower than anticipated increase in imports, Mr. Wicks continued. The Ghanaian authorities' prompt actions to cut expenditures in response to those developments had been commendable; and, while the slightly higher than expected deficit was disappointing, it had probably been unavoidable. In 1984, a further decrease in the fiscal deficit was expected, with expenditures and revenues projected to rise substantially. He agreed with the staff that the increase in projected expenditures was necessary to ensure that the program as a whole worked effectively. The increased spending on infrastructure, for example, should help to alleviate major transportation bottlenecks and so to remove obstacles to exports and improve incentives for private direct investment in Ghana. On a related matter, while it was not the practice of his chair to favor increases in civil service salaries, he agreed with the staff that such increases were necessary in Ghana's case to stem the alarming outflow of trained manpower. A graphic example of those losses could be seen from a recent World Bank report that indicated that one third of all secondary school teachers had left the country. Still, he underlined the staff's point that such levels of expenditure as were projected could only be sustained if anticipated revenue increases were realized. He thus commended the commitment of the authorities in the letter of intent to introduce offsetting measures--as had been done in 1983--if any slippages appeared likely.

On monetary policy, Mr. Wicks took note of the authorities' commitment to achieving positive real interest rates in the medium term. However, it might be better if, in keeping with their admirable practice of adopting measures well ahead of schedule, the authorities were to push for positive real interest rates somewhat sooner. Not only would such increases improve the allocation of resources; they would also be helpful in raising Ghana's low rate of domestic savings, which was currently about 3 percent of GDP, compared with an average of 23 percent of GDP for the remainder of sub-Saharan Africa.

The substantial progress made by the authorities in dismantling price controls--particularly those on imported foodstuffs--and improving incentives in agriculture were to be welcomed, Mr. Wicks remarked. As Mr. Salehkhou had noted, progress in the fight against inflation in the second half of 1983 had also been encouraging, and he hoped that price controls on the remaining 23 products could soon be removed, perhaps in the context of a follow-on program with the Fund. It was important that the authorities ensure that the Prices and Incomes Board reference price system should not amount to a form of disguised price control, as had happened in certain other instances.

Commenting on external policy, Mr. Wicks observed that the current account deficit of 7 percent of GDP in 1983, although better than expected, was still high; and a further increase in the deficit to 9 percent of GDP was projected in 1984, in part to allow for essential imports of oil, spare parts, and equipment necessary for the expansion of production and exports. It was important in the circumstances to ensure that the exchange rate remained competitive and that bottlenecks in the export sector were reduced as quickly as possible. The sharp reduction in reserves in 1984, due largely to much lower than expected capital inflows, allowed that much less room for maneuver. The staff's medium-term projections made it clear that Ghana's external position would be difficult for some time. Substantial financing gaps were projected, particularly in 1985, and Ghana would remain heavily dependent on foreign financing, which underlined the need to keep up the pace of adjustment. As he had said on earlier occasions, Ghana's rich natural resources provided considerable scope for increased direct investment in the country. At present, direct investment played a small role in the staff's projections for traditional industries like those in the cocoa sector as well as in the more embryonic petroleum sector. He understood that the authorities were working on an investment and company tax code that, when implemented, would have important consequences for direct investment.

With regard to the supply side of the economy, Mr. Wicks considered that there were two obvious reasons for the slow response thus far. The first was the weather, which had seriously affected both agriculture and industry. Recent press reports, for example, suggested that the Volta Lake Dam, Ghana's main source of power, would close within six weeks. Second, there were serious transport difficulties, including bottlenecks that had hampered both cocoa and timber production. The World Bank report showed that 70 percent of all road vehicles were out of service, that more than one third of railway locomotives were awaiting spare parts, and that the road network was deteriorating rapidly; indeed, in various places the roads were impassable. He understood that progress had recently been made in resolving some of those difficulties, but he would be interested in the staff's latest assessment of both the weather and transportation problems and whether the staff saw any other reason--such as shortages in imported inputs--for the sluggishness of the supply-side response.

He had mentioned the supply-side aspects of the economy to make the point that normal Fund policy prescriptions, while clearly necessary, might not be sufficient in themselves to restore the Ghanaian economy to prosperity. A recent World Bank report noted that "a program to rehabilitate the roads, ports, railway and transport infrastructure will also be needed. Other necessary tasks include improvement of parastatal operations, a review of the role of the public and private sectors, and strengthening government capacity for planning and economic management." Such improvements could take place only if resources were available to finance them, and he hoped that the World Bank would play an important role in providing those resources. He wondered in that connection whether plans were being made to implement the sorts of improvements to which he had referred and without which the Fund program could not, by itself, restore the economy to prosperity. That again raised the question of the relationship between the Fund and the Bank. The World Bank report to which he had already referred suggested that cooperation between the two institutions was close; however, he would like to see more information in future Fund documents about measures to help improve the supply side of the Ghanaian economy. What was really needed when the time came to consider a follow-on program for Ghana was a rather extensive discussion in the Fund paper--perhaps prepared by World Bank staff--on the Bank's role in improving the supply side of Ghana's economy and how that role could or should be played in conjunction with the proposed Fund program. An even more revolutionary suggestion worth considering would be to invite a senior World Bank official to the next Fund Board meeting on Ghana in order to answer any questions that Executive Directors might have. Finally, he had no hesitation whatsoever in supporting the proposed decision.

Mr. Orleans-Lindsay stated that he could endorse the staff appraisal and, like Mr. Wicks, could support the proposed decision. The progress made in Ghana thus far was encouraging, and he commended the authorities for their determination to continue with policies adopted in April 1983 and for their flexibility in adapting their fiscal and pricing policies in response to changing economic and financial circumstances in order to avoid slippages under the program. It was also encouraging to note that, after effecting the unification of the currency system nine months ahead of schedule, the authorities had taken further exchange rate action by devaluing the cedi by 14 percent in terms of the U.S. dollar.

The elimination of the 5 percent foreign exchange tax on private transfers and on foreign exchange for education, travel, and medical treatment was also welcome, Mr. Orleans-Lindsay continued, as was the authorities' determination to pursue a flexible exchange rate policy to ensure the economy's competitiveness. In support of that action, the authorities had taken measures in the fiscal and monetary areas that were intended to strengthen the policies aimed at reducing liquidity expansion and improving the effectiveness of resource allocation. Their efforts to revive economic activity had, however, been frustrated by the poor weather conditions prevailing in the region that had caused a decline in Ghana's agricultural output. The revival that had occurred had been inadequate to offset the decline in the contribution of agriculture to economic growth; as a result, the expansion in real GDP in 1983 had been less than 1 percent, compared with a projected increase of 2 percent under the program. Since prospects for an improvement in food production in 1984 would depend crucially on favorable weather conditions, it was to be hoped that increased food assistance from bilateral sources would be forthcoming if drought conditions were to persist.

In the area of pricing policy, the authorities had continued to show flexibility in effecting a further reduction in retail prices for petroleum products, thus eliminating the petroleum subsidy ahead of schedule, Mr. Orleans-Lindsay observed. Also, the effort to ensure that producer prices for cocoa were maintained in real terms should help to revive production under the World Bank rehabilitation project. In general, the price deregulation that had taken place was in the right direction; however, in the light of recent developments and the additional information provided in the supplement to EBS/84/60, the authorities should pay particular attention to the underlying inflationary pressures in the economy and adopt strong policies that would ensure the attainment of the targeted reduction in the inflation rate from 120 percent to 30 percent.

In placing strong emphasis on restoring the fiscal balance, the authorities had not hesitated to reduce budget expenditures and to introduce new revenue-yielding measures, Mr. Orleans-Lindsay noted. Given the slow revival of economic performance and the uncertainties regarding revenue receipts, particularly from imports, the authorities should continue with their cautious fiscal policies. The benefits that were accruing to the export sector from the flexible exchange rate policy would contribute to a gradual strengthening of the revenue position.

The road to recovery of Ghana's economy was likely to be a long and bumpy one, Mr. Orleans-Lindsay considered. The scope and strength of most of the economic and financial policies adopted and implemented thus far were appropriate, but they must be reinforced. Moreover, special attention should be devoted to restructuring the economy in the medium term; and, in that regard, Mr. Wicks had put forward some useful suggestions for consideration by the authorities. It was the responsibility of the authorities to formulate and implement a realistic investment program that could be supported by foreign capital resources, the availability of which seemed to be assured by the Consultative Group for Ghana. As for the present stand-by arrangement, it was apparent that the policies for strengthening the economy were in place, and the program therefore deserved continued Fund support.

Mr. Williams said that he too was in broad agreement with the staff appraisal and proposed decision. The policy actions adopted at end-March 1984 provided convincing evidence of the authorities' continuing commitment to the adjustment effort. The program had led to a number of important policy changes, and recent performance had been encouraging. For example, in spite of the adverse exogenous factors that had buffeted the economy in 1983, all performance criteria had been observed.

There were three areas in which performance in 1983 had been particularly positive, Mr. Williams continued. First, the authorities had shown flexibility in adapting expenditures to unanticipated revenue shortfalls. Second, the phasing out of the petroleum subsidy and the full pass-through of exchange rate changes to the domestic prices of imported products had been faster than programmed. Third, the exchange rate adjustments indicated that the authorities had accepted the pursuit of a more active exchange rate policy.

Despite the positive developments he had mentioned, there had been some deviations in 1983, Mr. Williams noted. A number of statistical indicators showed somewhat slower improvement in the rate of growth of the money supply and in the fight against inflation; and other indicators seemed to be moving in the wrong direction for 1984, such as the ratio of the current account deficit to GDP, the debt service ratio, and the reserve position. Part of the problem appeared to be attributable to the weather and its impact on agricultural exports. Nevertheless, further policy changes might be required, and it was important that the authorities be prepared to strengthen the adjustment effort, particularly given their dependence on external financing.

Commenting on the program for 1984, Mr. Williams observed that substantial increases were projected in both revenues and expenditures. Given the vulnerability of revenue projections to adverse developments over which the authorities had little control, preparations should be made to adjust expenditures rapidly if shortfalls in revenues developed during the course of the year. He noted in that context that government-financed development spending would increase substantially in 1984; however, as others had noted, the increase seemed to be justified in light of the country's needs.

No adjustment in the exchange rate had taken place in the fourth quarter of 1983, and the most recent adjustment had been based on inflation differentials with major trading partners, Mr. Williams commented.

The implication seemed to be that the exchange rate was currently at an appropriate level and that future changes would be based solely on inflation differentials. At the beginning of the program, and during the previous review, he had questioned whether the cedi was still overvalued and whether further changes might not be required, over and above the inflation differential, until a more appropriate rate could be reached. He would appreciate the staff's judgment on the adequacy of the existing exchange rate.

Commenting on the balance of payments, Mr. Williams remarked that the current account deficit was expected to deteriorate from $345 million in 1983 to $435 million in 1984, which was equivalent to a 2 percent increase--from 7 percent to 9 percent--in the ratio of the deficit to GDP. The current account was critically dependent on increased cocoa exports which, despite higher prices from forward sales, would depend on a long rainy season following the record drought. Unfortunately, the rainy season had not yet begun. Imports were projected to increase by 30 percent in 1984 to support a 3 percent annual real GDP growth.

In conclusion, Mr. Williams said, while a number of important policy changes had been achieved under the program, and recent performance had been encouraging, some of the emerging trends were disturbing. In particular, the program called for large increases in imports--mainly for government investment--to be financed by official borrowing. That was especially worrisome, given the large financing gaps that were projected even if capital inflows increased substantially.

Mr. Polak joined Mr. Wicks and others in stressing the importance of the stand-by arrangement, not only for Ghana but also for the Fund's work in Africa in general. Like Mr. Wicks, he had found the staff paper lacking somewhat on supply-side information, and he could support the proposal for closer Fund/Bank cooperation and contributions to the Fund's work in those countries where the World Bank played a large role.

Fund experience with Ghana was that many assumptions had not materialized and that projections had often needed to be substantially revised, Mr. Polak went on. Some of those revisions had been the result of exogenous factors such as the weather; others had been more difficult to explain. For example, declines in production could be attributed to drought, as could shortfalls in electricity supplied by a hydroelectric plant; however, the reasons for a reduced volume of imports--which then caused a shortfall in government revenues and reduced transportation--might not be clear. Even the explanation in the staff paper for the shortfall in net official capital in Ghana--which was currently estimated to have been $118 million less in 1983 than earlier projected--was lacking in detail. The staff had said that it was "due to lower disbursements than projected." The staff had similarly attempted to explain the shortfall in suppliers' credit by noting that the gold mining industry had not reacted to the exchange rate policy as rapidly as earlier assumed. Finally, in a summary statement, the staff had noted that the attainment of the objectives of the 1984 program would "largely depend on the main rains expected to begin around April 1984, and on the expected increase in the flow of imports." It was fortunate that the authorities were less fatalistic than the staff about prospects for their economy. They had shown a strong determination to follow the program and to respond quickly to changing conditions.

In most areas, policies continued to be in line with principles that were entirely appropriate, Mr. Polak considered. The exchange rate had been set to avoid a loss of competitiveness; cocoa prices were being kept in line and were being set by market forces; and increases in petroleum prices were ahead of schedule and were at present fully based on international costs converted at the current rate for the cedi. It was only with respect to interest rates that sufficient movement had not yet been made. The authorities had promised real positive exchange rates for the medium term, but progress toward that end should perhaps be more rapid. In that regard, he had had difficulty in determining from the paper the precise level of real interest rates at present.

The balance of payments for 1984 was expected to improve substantially, with exports projected to rise by 40 percent and non-oil imports by 30 percent, Mr. Polak observed. Of course, those increases would begin from a low base, and further rises would be more modest, although the longer-term expected increase in exports at 13 percent a year remained respectable. The projected increase in exports was only 8 percent, and half of that would be necessary just to maintain a real economic growth rate of 3 percent. Unfortunately, the difference between the movement in exports and imports would not bring Ghana out of its balance of payments difficulties, mainly because of the increase in debt servicing costs. The overall deficit was projected to decline slowly, but that was before repurchases to the Fund and the repayment of arrears that had to be made through 1988. The staff had calculated a financing requirement of $150-200 million a year between 1985 and 1988 but had not put forward any suggestions about how that requirement could be met.

On a related matter, Mr. Polak wondered whether--assuming the staff was correct in observing that, at present exchange rates, a 3 percent real growth in GDP would require a 4 percent growth in real imports--the country should not perhaps adopt a more depreciated exchange rate to ensure a higher growth in GDP and a somewhat slower growth in imports. That was an issue that the staff might perhaps have attempted to answer in the context of its balance of payments projections. If those projections were more than mechanical exercises to check the consistency of various components of the balance of payments, they should be used to explore issues that had policy implications for the medium term.

Commenting on the balance of payments projections in Table 7 of the staff paper, Mr. Polak noted that the current account deficit as a proportion of GNP was projected to fall sharply by 1988. However, the current balance in 1988 in absolute dollar terms was practically the same as in 1984, and he wondered whether the bottom line ratio was comparable with an assumed growth of real income of only 3 percent and a dollar inflation rate of about 4 percent (i.e., a growth rate of GDP of 7 percent). He would appreciate staff comment on the matter. Finally, while the Ghanaian economy's dependence on the vagaries of the weather could not be changed on short notice, the authorities should view such a change as a priority project over the longer term. What could be modified in the short term was the pace of the flow of imports and aid. And, in all areas that could be improved through their actions, the Ghanaian authorities deserved every support in pursuing their goals.

Mr. Laske remarked that Ghana had been beset by severe economic difficulties for more than 20 years. The adjustment program adopted by the authorities in April 1983, which was supported by a Fund stand-by arrangement, represented a serious attempt to correct the long-standing maladjustments and distortions in the economy. If fully implemented, it should improve the prospects for an eventual return to sustainable real growth and to a viable external position. Despite adverse exogenous conditions, the authorities had already implemented an impressive array of basic adjustment measures and had reconfirmed their commitment to the objectives established in the program.

A major stumbling block to past adjustment efforts had been the exchange rate policy, Mr. Laske observed. By giving up their resistance to changing the exchange rate--which had become totally unrealistic--the authorities had demonstrated their willingness to address the country's pressing problems with an open mind. The more flexible regime applied since April 1983, the early unification of the multiple rate system, and the substantial depreciation had corrected the most conspicuous distortion in the economy.

The authorities had also acted in a determined way in the area of pricing policies, Mr. Laske considered. He encouraged them to continue their price liberalization efforts while, at the same time, monitoring producer prices for cocoa in order to forestall a potential decline in its real value. Such monitoring should strengthen the agricultural sector, which seemed to be poised for a revival.

On monetary policy, Mr. Laske said that he could support the staff's recommendation for further interest rate increases. Although rates had been raised substantially, they remained largely negative in real terms. Additional interest rate adjustments would likely have a stimulative effect on the very low domestic savings ratio, which had been only 1.4 percent in 1982 as against a ratio in Liberia that had been as high as 13 percent in 1982/83 and was expected to rise to more 17 percent in 1984. The large discrepancy in the savings behavior of Ghana and Liberia was remarkable; he wondered whether the explanation lay in differences in economic performance or in institutional arrangements. Staff comments on that matter would be welcome.

Despite the continuation of a cautious fiscal policy, the public sector deficit would increase in nominal terms by nearly 20 percent in 1984, Mr. Laske commented. The projected increase in revenues would be outpaced by an even stronger rise in expenditures. The most conspicuous increase would be in expenditures for development; however, a considerable increase was also planned for current expenditures, part of which probably represented the general wage increase, which was designed partially to compensate for the strong rise in the cost of living in 1983. Although the expenditure increases might be considered necessary, they could have a multiplier effect that, in the years to come, could be difficult to contain. The deficit was projected to decline by a small margin in 1984 as a share of GDP, but its expected rise in nominal terms was strong and worrisome. He would welcome staff comment on the potential for deficit reductions in future years.

The various balance of payments projections for 1983, the mid-year revisions, and the provisional outturn for 1983 all demonstrated the risks involved in forecasting, Mr. Laske said. The trade account, the current account, the capital account, and the overall balance had all turned out to be quite different from both the original and the revised projections. In the circumstances, he was cautious about accepting the projections for 1984 at face value, although the base for such projections had become firmer than a year previously. Exports were expected to recover, but the current account would suffer a further deterioration, partly owing to a strong increase in the cost of external borrowing. He had noted from the tables in the supplementary paper and from the text of the main paper that, in 1984, the needed financing would be provided exclusively by purchases from the Fund. However, that seemed to apply only to the first half of the year; requirements for the second half of the year still needed to be covered. He would appreciate staff comment on that matter.

The medium-term projections for the balance of payments revealed that the Ghanaian economy would be plagued by sizable financing gaps for some time to come, Mr. Laske commented. It was disturbing to note that the current account would show very little improvement, especially if seen in the context of the heavy debt service burden, which would be increasing further over time. In ordinary circumstances, he would wonder whether the Fund was the appropriate institution to be involved in a country where the balance of payments prospects were so uncertain. However, the authorities were obviously determined to correct the misdirected or faulty policies of the past. Unfortunately, the task was a difficult one, and the Fund certainly would not be able to provide a very large proportion of the financing that appeared to be needed. Hence, he agreed with Mr. Wicks that any Fund assistance to Ghana must be closely coordinated with assistance from the World Bank; and he could thus fully support the proposal for a more detailed description of the activities of the Bank in future Fund staff papers on Ghana. The authorities would, of course, have to prove with their policies that they were progressively becoming a better credit risk for financing of longer duration.

Mr. Mtei remarked that the staff report on Ghana confirmed his impression that the authorities were firmly determined to implement the adjustment program in spite of the hardships facing them. All performance criteria as of end-December 1983 had been met, and the authorities seemed to be well on their way toward implementing the 1984 program. One of the key decisions taken recently involved the exchange rate, which had been depreciated further by 14.3 percent relative to the U.S. dollar. The cedi currently stood at C 35 = $1, compared with a rate of C 2.75 = US$1 a year previously. The latest decision to depreciate the exchange rate further reflected the authorities' understanding of the need to manage the exchange rate in a flexible manner. Efforts to keep the rate at realistic levels should go a long way toward helping to correct distortions that had emerged in the economy over many years.

The severe impact of the drought had led to slower recovery in 1983 than expected, Mr. Mtei noted. However, he was encouraged that the declining trend in real GDP had been checked and that a more robust performance was expected for 1984. In the absence of bad weather, the economy should be helped by the authorities' decision to maintain the producer price for cocoa at an appropriate level and by the expected increase in imports of equipment, spare parts, and supplies, which would be needed to sustain industrial production and to increase output in the mineral and forestry sectors.

The recently announced budget was an indication that the authorities were continuing to give priority to fiscal adjustment while taking into account what was necessary for the effective operation of the Government and for its recovery program, Mr. Mtei continued. In that connection, like Mr. Wicks, he could support the recent salary increases in the civil service. Efforts to reduce bank financing of the budget deficit--which would contain the growth in liquidity--appeared to be steps in the right direction, particularly in view of the need to bring inflation under control. Although a significant rise in export earnings was projected for 1984, an adequate inflow of capital would be necessary to prevent the recovery from stalling. In that regard, it was important that disbursement of assistance be made in a timely manner, which meant that the authorities might have to work hard in consultation with the donors to eliminate bottlenecks that would otherwise slow the disbursement process, as had happened in 1983.

The staff's analysis of Ghana's prospects seemed realistic in that it gave no illusions of quick fixes but, rather, placed the recovery in a medium-term framework that combined adjustment with policies that were intended to ensure resumption of growth at the earliest opportunity, Mr. Mtei concluded. He agreed with Mr. Wicks that a Fund program alone could not solve the problem and that assistance from the World Bank as well as from other multilateral and bilateral donors and private sector investors would have to be forthcoming on a substantial scale. Nevertheless, the continued presence of the Fund would create an environment in which the problems confronting Ghana could be tackled.

Mr. Suraisry, expressing general agreement with the staff appraisal, observed that part of the problem faced by Ghana in 1983 had been due to the severe drought, the impact of which unfortunately would not be limited to that year alone. Notwithstanding Ghana's vulnerability to external shocks, the authorities' commitment to adjustment had not weakened. The exchange rate system had been unified earlier than envisaged in the program; flexible pricing policies had been implemented; and strong financial and monetary measures had been adopted, all of which showed commendable efforts.

Both revenue and expenditures in the 1984 budget had been increased substantially over the preceding year, Mr. Suraisry noted. While the increases were justifiable under the conditions and assumptions that the staff had mentioned, the realization of the authorities' budgetary goal would depend mainly on weather conditions and on the flow of capital. In that context, he joined Mr. Wicks in welcoming the authorities' commitment to reducing expenditure in case the projected revenues did not materialize. He welcomed the role that the World Bank was playing in supporting Ghana's adjustment efforts, and he hoped that that role would continue.

Table 7 of the staff paper showed that the balance of payments was expected to remain under pressure at least through 1988, Mr. Suraisry observed. Obviously, there was little room for slippage. However, the adjustment efforts that the authorities had been making, together with their commitment to continued adjustment, would have a favorable impact on the balance of payments in 1984 and over the medium term.

Ghana's debt service ratio was high by any standard and was expected to remain so until the end of the decade, Mr. Suraisry remarked. Hence, he welcomed the cautious approach the authorities had been taking in managing their external debt and payments arrears, and he encouraged them to continue with their prudent policy.

It was evident that many of Ghana's economic problems were structural in nature, which required structurally oriented policies such as those the authorities had been implementing, Mr. Suraisry said. As the staff had mentioned, policies should continue to be designed in a structural framework if the balance of payments was to be made viable in the medium term. He had found Table 6 on page 15 of the staff paper to be very helpful, and he hoped that the staff would follow the practice of including such a table in other cases in future. Finally, he could support the proposed decision.

Mr. Joyce remarked that, like others, he was impressed by the progress Ghana had made thus far and by the determination of the authorities to take the measures necessary to meet the goals and objectives of the program, even when economic conditions turned out to be less propitious than originally envisaged. In 1983, the economy had not grown as rapidly as forecast, largely because of the effects of the drought in the agricultural sector and the resulting consequences for the balance of payments, government revenues, and the population itself. The outlook for 1984 was more promising, in part because the authorities had taken all the measures originally agreed as well as additional ones to compensate for the shortfall in revenues. Moreover, they had moved more rapidly than expected on the exchange front--a full nine months ahead of schedule--introducing a unified rate of exchange that better reflected market realities.

The trade and current account balances had been heavily in deficit in 1983, Mr. Joyce noted. However, the deficits had been markedly lower than originally targeted, despite a poor export performance. Unfortunately, that progress had been achieved through drastic reductions in imports of goods and services, which was not a sustainable solution to Ghana's problem. There were signs that they export performance of cocoa would improve in 1984 and that mineral and timber exports would continue to grow so that the current account deficit, as a percentage of GDP, would decline over the next few years. It was thus apparent that the Ghanaian authorities were meeting their problems and were beginning to deal with some of the more fundamental structural weaknesses in the economy, including those in the area of the exchange rate and in pricing policy. His only real concern was with interest rates. The authorities had already taken a number of steps to make interest rates more realistic and were committed to positive real interest rates in the medium term. However, he agreed with the staff that swifter action was required if a greater measure of savings was to be encouraged.

He was worried about the medium term generally, Mr. Joyce said, especially since the authorities would no doubt have to formulate proposals for follow-on arrangements with the Fund. The balance of payments outlook was not promising, and the projections for financing requirements through 1988 were for fairly large amounts that were not yet assured and that seemed to indicate a need for future debt rescheduling and additional donor assistance throughout the period. Moreover, the debt service ratio, even assuming more optimistic expectations with regard to exports and imports than the authorities had at present, would remain above 40 percent throughout much of the period until 1988. The prior commitment of external earnings that such a debt ratio implied would place constraints on the future management and growth of the economy. And the better growth in export performance that it was hoped would flow from the structural reforms currently being adopted would need to be sustained for several years, an uncertain prospect, given the fluctuations that traditionally occurred in world prices for commodities such as cocoa.

Like others, he was concerned about the major investments that would be required if the Ghanaian economy was to become more viable, Mr. Joyce commented. He was also worried about how those investments would be financed. Clearly, the World Bank had a crucial role to play in conjunction with the traditional donors and private investors. It would be helpful if the donors could begin to define more precisely the magnitude of Ghana's aid gap and the extent to which they were prepared to commit themselves in providing concessional resources over the period of adjustment. Some thought should also be given to the apparent delays in aid disbursements to Ghana. He was uncertain of the extent to which those delays could be attributed to the lack of absorptive capacity or to shortcomings in the donor programs themselves. Of course, such matters were for discussion on another day; at present, it was sufficient for him to congratulate the authorities on the progress made thus far and to urge them to persist in implementing the present program, including whatever further adjustments might prove necessary. It was, nonetheless, time for the authorities to begin working out detailed plans for the medium term in advance of discussions on the extent to which a continuation of the adjustment process might warrant additional Fund support. Also, like Mr. Wicks, he could support closer cooperation between the World Bank and the Fund in helping the authorities to develop medium-term scenarios.

Mr. Finaish observed that the Ghanaian authorities had demonstrated a firm commitment to the far-reaching adjustment policy embarked upon in 1983. In spite of the major drought--which had had a significant impact on agriculture and industrial output--the authorities had adhered to the policies in the program; and, in a number of areas, such as the exchange rate and the pricing of petroleum products, they had implemented program measures ahead of schedule.

Unfortunately, the pickup in economic activity had been slower than expected, Mr. Finaish continued. The staff had offered two reasons for that development: the first was the severe drought, which it was to be hoped would not continue much longer; the second was the much lower than projected level of imports, which the staff attributed to a temporary cash flow squeeze and inadequate bank financing of imports. During the October review of the stand-by arrangement, he had raised questions about the availability of adequate financing for the projected level of imports and had been told by the staff at the time that financing would be sufficient. He also wondered in retrospect whether the exchange rate adjustment of the cedi had perhaps been excessive, in view of the sharp impact on imports and growth.

With respect to the balance of payments, Mr. Finaish noted that, in dollar terms, the current account deficit would be approximately the same in 1988 as in 1984; however, as a percentage of GDP, the deficit was projected to drop from 9 percent in 1984 to 3 percent in 1988, which would imply a very large (30 percent) annual rate of growth in GDP, or a tripling of GDP over the four-year period. Unless the staff assumed a substantial depreciation, nominal or real, of the cedi over the period, which itself would warrant explanation, it was not clear how such an increase in GDP would come about, and he would welcome staff comment on the matter.

As others had noted, the authorities had shown firm commitment to their adjustment policies and a readiness to do what was needed in order to turn the economy around after a long period of decline, Mr. Finaish continued. The need for structural adjustment and for financing was also clear; and it was to be hoped that those countries that were in a position to do so would assist Ghana in its efforts to adjust. In that regard, he took note of the favorable response of the donors during the consultative group meeting in November 1983. The rescheduling of oil credit payments, which had recently been agreed upon by some of Ghana's suppliers, should also be helpful during the difficult period ahead. In conclusion, he could support the proposed decision.

Mr. Morrell said that he too could endorse the staff appraisal and could support the proposed decision. The Ghanaian authorities should be commended for the strong actions that they had taken under the program and for their demonstrated commitment to the adjustment effort. Fiscal adjustment had evidently been particularly strong, although he sensed some uncertainties regarding the revenue forecasts. The latest supplementary staff paper indicated the authorities' willingness to continue the flexible exchange rate policy, although, like other Directors, he would be interested in the staff's assessment of the current level of the exchange rate. The decision to eliminate the petroleum subsidy ahead of schedule was another indication of the authorities' commitment to the program, which had been maintained even in the face of severe adverse climatic conditions.

Like Mr. Wicks and others, he would have preferred more supply-side information and more World Bank-related data on Ghana, particularly in view of the country's deteriorating infrastructure, Mr. Morrell remarked. He also shared the concerns of the staff and other Directors about interest rate policy. The level of domestic savings in Ghana was low and, despite recent adjustments, interest rates remained negative. It was essential that strong and early action be taken to raise interest rates to positive levels.

As others had mentioned, the medium-term projections indicated a need for balance of payments support over a number of years, despite the strong adjustment measures currently being taken, Mr. Morrell commented. They also demonstrated the importance of continued concessional financing for Ghana. In that regard, since its help was likely to be required for some time, the Fund should be careful--in designing any follow-on programs--to limit the extent of its financial support to ensure that sufficient amounts would be available later.

Mr. Ismael remarked that it was important that price measures under the program, particularly the 50 percent increase in the cocoa price, should be implemented as planned. In general, keeping prices flexible and competitive would be essential to the success of the program and, in that regard, the role of the exchange rate could not be underestimated. The authorities should be commended for the bold measures they had taken to reform the exchange rate system with a view to maintaining the competitiveness of exports.

Some progress had been made in other areas as well, Mr. Ismael noted, and it was important that it should be continued because the external debt picture left the authorities little scope for maneuver. Despite the successes achieved thus far, growth had not been fully restored, in part because of the severe drought and the austerity program. In that regard, it was important to strike a balance between the need to restore growth and the need to overcome the serious structural imbalances in the economy; more specifically, the reduction in imports should not be allowed to disrupt Ghana's capacity for future growth. Of course, adjustment should not be postponed, but it should be carried out prudently. While external adjustment--particularly on exchange rates--was the key to the success of the whole adjustment process, the control and improvement of public finances was also essential, and he therefore welcomed the progress being made to reduce the oil subsidy and to increase real interest rates. Progress had also been made in containing inflation; however, any move at present to use that argument to increase wages would be premature.

The staff representative from the African Department agreed with those who had pointed to revisions in the projections as an example of the uncertainties about the effects of adjustment on Ghana's economy. The staff was well aware of the uncertainties and should perhaps indicate its awareness in future by incorporating projections into alternative scenarios that covered a wide range of possible outcomes. It should be remembered, of course, that all work on numbers in Ghana was difficult; moreover, the losses being experienced in trained government personnel and the problems of administrative capacity occasionally made timely monitoring of progress under the program difficult.

The bottom line in Table 7 of the staff paper was, as noted by Mr. Polak, incorrect, the staff representative continued. A continued annual 25 percent increase in GDP in nominal terms had been assumed, which was not compatible with the desirable reduction in the rate of inflation under future programs. Based on assumptions of improvements in the inflation rate, the current account deficit as a percentage of GDP in 1988 would be less favorable than shown in the present version of Table 7. If, for example, one assumed that inflation fell from 30 percent in 1984 to 15 percent by 1988, the ratio of the current account deficit to GDP would be about 4.9 percent rather than the 3 percent shown in the table.

The staff had addressed the matter of interest rates with the authorities, the staff representative recalled. While accepting the staff's arguments and maintaining the objective of moving toward real positive interest rates in the medium term, the authorities differed with the staff on the appropriate pace for the change. When the matter had been discussed in January 1983, the staff had accepted the authorities' argument that it would have been difficult to move quickly on the interest rate question because of their involvement in the very tough negotiations on wage settlements with the trade unions. In passing, he noted that the authorities had adopted an interesting approach in the effort to reduce the pressure for wage increases. They had scheduled a seminar for all parties concerned in which they had pointed out the various implications of the wage claims made by the unions for the budget; those points had then been widely published in the newspapers on the following day. The approach had apparently helped the authorities and the trade unions in reaching a compromise, which was reflected in the budget.

While accepting that it might have been difficult for the authorities to implement further changes in interest rates in the midst of wage negotiations, the staff had insisted that action be taken later in the year, the staff representative remarked. If their past record was any indication, it could be expected that the authorities would live up to their commitment to adjust interest rates in due course. However, it was difficult in the Ghanaian context to give meaning to the concept of positive real interest rates. For example, the use of the consumer price index tended to align changes in interest rates much too strongly with changes in food prices, which weighed very heavily in the index; and developments in 1983, including the effects of the drought and the impact of the return of one million Ghanaians from Nigeria, had placed tremendous pressure on the consumer price index. In the circumstances, the authorities and staff would have to work hard to find a meaningful concept of real positive interest rates.

In response to calls for an assessment of the current exchange rate in Ghana, the staff representative observed that the existing rate could hardly be said to be an equilibrium rate. What could be said was that, after resisting appropriate exchange rate changes for many years, the authorities had taken difficult and important action on the exchange rate front, although more would have to be done in future. For traditional exports, he was confident that the existing rate was appropriate; however, given Ghana's relatively weak balance of payments position and uncertain prospects, the exchange rate would need to be kept under review.

The savings rate in Ghana was quite low and was the result of an accumulation of the effects of bad policies over a long period, say, 10-15 years, the staff representative observed. On another matter, while it would be the authorities' objective to reduce further the public sector deficits and the ratio of government deficits to GDP in future, it was a bit difficult to describe in any concrete way at the present stage how it was intended to achieve those objectives.

With regard to Ghana's financing requirements, the staff representative remarked that no assumptions were being made at present about the future use of Fund resources; nor had the staff made any assumptions about the type or magnitude of financing that might become available under future consultative group meetings. It was perhaps for that reason that the projections appeared to be pessimistic; however, he was guardedly optimistic that the financing requirements would be fulfilled.

Among the questions most difficult to answer were those pertaining to supply-side responses, the staff representative considered. Directors had been correct in noting that the Fund alone could not turn the Ghanaian economy around and that very close cooperation would be required with the World Bank. Unfortunately, the speed at which World Bank projects and disbursements tended to materialize was not often synchronized with the actions of the Fund, which made coordination somewhat difficult. In Ghana's case, in particular, the potential for cooperation had been further complicated because a number of those on the World Bank staff team working on Ghana had recently been replaced. Moreover, the Fund staff had pre-empted much of the authorities' time in dealing with the short-term stabilization measures under the program. In the circumstances, the proposals put forward by Mr. Wicks for even closer coordination with the World Bank in preparing a section on supply-side measures in the

Fund's staff report were appealing; and, indeed, the Bank staff would be invited to prepare supply-side information for the next report, although the previously mentioned problem of synchronization of actions between the two institutions might make it difficult for the Bank to comply rapidly.

Mr. Polak said that he had not been fully convinced by the staff that the corrected figure for the 1988 current account deficit as a percentage of GDP (Table 7 of the staff paper) would be 4.8. It appeared there was still an assumption involved that was difficult to justify, namely, that inflation would be 15 percent a year and that the exchange rate would not be adjusted to that. If the GNP projections were calculated in dollars, and if the current exchange rate policy was followed, the inflation rate in Ghana expressed in dollars would be similar to that in the outside world, which was about 4 percent. In the circumstances, the current account deficit as a percentage of GDP in 1988 would be closer to 7 percent.

The staff representative from the African Department commented that the staff would take a second look at the figures in Table 7 and at the methodology employed in arriving at the projections.

Mr. Wicks, recalling comments on problems of administrative capacity in Ghana and the problems of gathering the sort of data that would be useful for medium-term forecasting, wondered whether Fund technical assistance to Ghana might not be desirable. He noted that, in 1981 and 1982, a panel of experts had been sent to the Bank of Ghana to look after banking operations and accounts but that no one had visited more recently. If the authorities were willing to accept further assistance, the Fund and/or the World Bank should give serious thought to providing it.

The staff representative from the African Department replied that both Mr. Salehkhou's office and the staff had raised the question of technical assistance with the authorities and had offered them suggestions for drawing up terms of reference for such assistance. The authorities had not responded as yet, perhaps because they had been busy formulating and implementing appropriate policies under the financial program. Also, at least initially, there had been some resistance to too heavy an IMF presence in Ghana. He had the feeling that that resistance had weakened and that a resumption of the discussions on technical assistance might bring about a positive response.

Mr. Salehkhou remarked that the authorities had experienced great difficulty on the administrative side in implementing the program, especially in view of the flight of experienced technocrats from the country. He was happy to note that some of his colleagues had appreciated the logic behind the recent wage increases and hoped that more could be done to improve incentives for civil servants. It was striking to observe that the level of public sector wages at present was only 12.5 percent of the level in 1975. Government salaries were so low that only dedication to service and loyalty were keeping most senior officials on the job. Without their dedication, implementation of the program would have been impossible.

In proposing the adoption of new or additional measures or the strengthening of existing ones, his colleagues should have in mind the extent to which such measures might be socially and politically acceptable, especially given the problems created by the drought, Mr. Salehkhou continued. Ghana had suffered under a drought for four consecutive seasons, and the adverse impact had been felt throughout the country, from agriculture to manufacturing. Any prolongation of the drought would make it extremely difficult to complete implementation of the adjustment program.

The issue of interest rates should not be dealt with in a way that might prejudge any adjustment that would be required later in the year under a new Fund arrangement with Ghana, Mr. Salehkhou considered. Besides, the theoretical justification for positive real interest rates--namely, to encourage greater savings and discourage consumption--could not be invoked in Ghana because incomes were so low that savings had no practical meaning for most of the population. It would be illusory to hope that those individuals whose earnings might be considered illegitimate would put money in the bank, whatever the rate of interest. Moreover, it was undeniable that the adjustments in the interest rate that had been effected in October 1983 had created added difficulties for most importers, who had already been faced by a severe cash flow squeeze and by an overcautious attitude on the part of the commercial banks that had not yet assessed all the implications of the reform of the exchange system, including the huge depreciation of the exchange rate in April 1983. In that regard, and with respect to the Fund's approach to adjustment programs in member countries like Ghana, it should be remembered that conditions in most of the economies concerned were far from meeting the textbook requirements for perfect competition, and that some instruments, while they might be useful in economies that were more open and that had higher per capita incomes, were not particularly helpful in countries like Ghana; indeed, in some cases, the adverse effects of such instruments were severe. That was particularly true with respect to raising interest rates to positive levels in real terms. While it was, of course, necessary for debtor countries to engage in serious adjustment policies and to reduce structural distortions, the Fund should not place too much emphasis on issues such as the level of interest rates that were relatively less crucial to the success of the program, especially when the real impact of the policy involved was, at best, debatable.

In view of the adverse environment in which performance of the Ghanaian economy and the authorities was to be judged, Mr. Salehkhou considered that it was worthwhile to enumerate those areas in which performance had exceeded expectations. The unification of the exchange rates had been accomplished nine months in advance of the target date; oil subsidies--a particularly sensitive issue in Ghana--had been eliminated ahead of schedule; and the repayment of external arrears had exceeded the end-December target by more than $9 million. Finally, he noted that detailed discussions had already been held with the authorities on the matter of technical assistance; however, the issue would be reconsidered at the next opportunity.

The Chairman said that although no formal summing up was required, as for the conclusion of an Article IV consultation, he was prompted by the importance of the review of Ghana's program to make a few concluding remarks. There had been unanimous commendation of the authorities for their firm implementation of necessary adjustment measures, particularly with respect to pricing policies, exchange rate flexibility, and fiscal action. It was fair to say, however, that external constraints--including the balance of payments and debt situations--would linger for a number of years and would demand a continuation of the major adjustment effort that had been initiated in 1983.

The Executive Board had drawn attention to a number of actions taken on the pricing front, including producer price increases for cocoa and the full pass-through to consumers of the import cost of petroleum, the Chairman continued. Directors had also noted that expenditures would only be sustainable at the budgeted level if revenues were consistent with projections, a development that hinged crucially on what was likely to happen on the import side. Moreover, some felt that interest rates had an important role to play in encouraging an increase in what at present was a very low level of savings. Without disagreeing with Mr. Salehkhou's arguments about the limited effect an increase in interest rates would have in countries with very low levels of income, he noted that Ghana did not fare well in comparison with other such countries.

It was clear that a continuation of the necessary adjustment measures would not by itself lead to buoyant production and expansion, the Chairman said. Investment-oriented assistance from donors, other multilateral institutions, and governments would be crucial. In that regard, the time had come for close coordination with the World Bank in order to develop a program that would help the Ghanaian economy take off. Improvements in the transportation network and agricultural infrastructure and other more forward-looking supply-side changes would be needed in conjunction with appropriate demand management policies, exchange rates, and interest rates. He welcomed Mr. Wicks's proposal for a fuller reporting of the Bank staff's assessment of supply-side developments in Ghana.

Another useful suggestion had been made by Mr. Joyce, who had proposed that donor countries should gear their actions toward a medium-term and forward-looking program that might be a useful follow-on to the current stand-by arrangement, the Chairman recalled. The initial generous response of those donors had not produced fully positive results; indeed, there had been some shortcomings in the area of disbursements of committed aid, and he hoped that the donors could recommit themselves to ensuring that the authorities would be supported in their efforts to put Ghana's economy on the right track.

The Executive Board then turned to the proposed decision, which it adopted.

The decision was:

1. Ghana has consulted with the Fund in accordance with paragraph 4(c) of the stand-by arrangement for Ghana (EBS/83/140, Supplement 1, August 4, 1983) and paragraph 24 of the letter of intent signed by the Secretary for Finance and Economic Planning and the Governor of the Bank of Ghana dated July 7, 1983, attached to the stand-by arrangement, in order to establish performance criteria subject to which purchases may be made by Ghana under the stand-by arrangement.

2. The letter dated March 25, 1984 from the Secretary for Finance and Economic Planning and the Governor of the Bank of Ghana shall be attached to the stand-by arrangement for Ghana as representing further understandings reached for the remaining period of the stand-by arrangement, and the letter dated July 7, 1983 shall be read as supplemented and modified by the letter of September 30, 1983 and by the letter of March 25, 1984. Accordingly, the ceilings on net domestic assets of the banking system and net claims on the Government by the banking system referred to in paragraph 4(c) of the arrangement for end-March and end-June 1984 shall be in accordance with paragraph 11 of the letter dated March 25, 1984.

Decision No. 7664-(84/56), adopted
April 6, 1984

3. PERU - CURRENT STATE OF DISCUSSIONS

The Chairman remarked that, after his announcement the previous evening that discussion of Peru's requests for a stand-by arrangement and for a purchase under the compensatory financing facility would be postponed until further agreement could be reached between the staff and the Ministry of Finance in Peru on certain economic measures, he had received the following cable from the President of Peru:

> Approval of Peru's economic program for 1984 scheduled for the April 6 Board meeting is essential for the safe development of our economy. Any argument for postponement would be of minor significance in relation to the severe damage it would cause to a nation that has adopted stoic measures in the face of great risks in its determination to maintain economic austerity and fiscal discipline. Grave responsibilities would be involved in such an attitude before a country that lives in democracy and practices to the extent humanly possible the counsels in favor of a sound economy.
>
> I would appreciate your acknowledgement of these considerations and your placing them before your distinguished colleagues of the Board in the scheduled meeting on Friday.

The Chairman had replied in a telex as follows:

> I acknowledge receipt of your telex on the scheduling at the Fund Board of Peru's request for a stand-by arrangement. I understand your concerns, and I shall be bringing them to the attention of the Executive Board at today's meeting. However, I do not feel it will be possible for the Board to take a decision on the stand-by arrangement under consideration in view of the fact that we have not yet reached full understanding on the measures needed to assure the success of the economic program. It is my hope that in the coming days we will be able to resolve the remaining policy issues and thus to make possible an early Board decision on Peru's request for a stand-by arrangement, and I will so inform the Executive Board.

The staff representative from the Western Hemisphere Department, commenting on the remaining differences of view between the staff and the Peruvian authorities, recalled that certain price actions and tax measures--referred to in paragraphs 7 and 8 of the memorandum on economic policy--were to have been adopted before the Executive Board's discussion of Peru's request for a stand-by arrangement. Some of the measures had not yet been implemented; others had been implemented only in part. Among the revenue-raising actions that the authorities had not yet adopted were those relating to price increases for rice and electricity tariffs, excise taxes on specific consumer goods, the elimination of exemptions to the value-added tax, and taxes on ownership of automobiles and other luxury goods.

The authorities were aware of the actions that were needed to make up the revenue shortfall and were giving consideration to substitute measures, the staff representative continued. If the originally agreed actions or similar actions were not implemented in the near term, the revenue shortfall for 1984 would be about 1 percent of GDP. Since the revenue-raising effect of all the measures contemplated had been estimated at 3 percent of GDP, the effect of those not yet implemented was significant.

Mr. Donoso recalled that, during the review of the extended arrangement with Peru in November 1983, he had attempted to illustrate the dramatic changes in both estimates and policies that had been required as a consequence of national disasters in the country. In January 1983, GDP for the year as a whole had been projected to rise by about one half a percentage point over the level in 1982. Once the disasters had occurred, the targets had been redefined, and it had been assumed that GDP in 1983 would decrease by 4.7 percent in real terms. Later, in the papers prepared for the November review, the staff had further revised its estimates to indicate a likely decrease of 7 percent. At present, the reduction in GDP in 1983 was estimated to have reached 11 percent, a development that had directly affected public financing through lower public revenues and specific expenditures related to reconstruction efforts. Moreover, the generally deteriorating economic situation had made it increasingly difficult to apply the measures contemplated in the program. Following the onset of the national disasters, the authorities had cut ordinary public expenditures in preparation for the extraordinary ones that would be required to help the economy recover from the disasters. The authorities had also tightened monetary policy and had accelerated the depreciation of the sol, thus keeping the economic program roughly on track during the first half of the year. Unfortunately, compliance with the limits established under the extended arrangement had become progressively more difficult during the year.

The deviation from the targets in the arrangement tended to obscure the authorities' efforts to limit the effects of the worsening economic situation on the public finances, Mr. Donoso continued. For example, behind the estimated overall deficit in the nonfinancial public sector--which had grown to more than twice the target in the program--there had been a reduction between 1982 and 1983 in the current and capital expenditures of the Central Government of 10 percent and 25 percent, respectively, in real terms. The increased deficit of the Central Government was explained mainly by a reduction in revenues of 30 percent in real terms between 1982 and 1983.

In the almost two years during which Peru had had the support of the Fund, important adjustments had taken place in the economy, Mr. Donoso remarked. From the end of 1981 to the present, there had been significant reductions in real terms in the minimum wage, in the level of salaries of workers in the collective bargaining sector, and in the average remuneration for civil servants in the Central Administration. The real value of the sol, in terms of the U.S. dollar, had been cut back to its level in 1979. Those changes in relative prices had facilitated the positive evolution of the extended arrangement and had provided a good basis for expecting further improvement.

The program for 1984 contemplated a substantial reduction in the internal and external imbalances through major actions in fiscal and monetary policy and continued pursuit of flexible interest rate and exchange rate policies, Mr. Donoso commented. The reduction of external deficits together with a rigorous monetary policy should bring about an additional reduction in the current account deficit and in the rate of inflation from 125 percent to 70 percent. Many measures had already been taken, including some increases in the price of petroleum derivatives. There was, of course, still a need to adjust prices and introduce new actions to ensure that the reduction in the overall public sector deficit was attained; and the authorities in Peru were strongly committed to adopting all measures necessary for a successful program. However, as noted by the President of the Republic, the postponement of the discussion could bring about negative economic consequences, and it was to be hoped that the Executive Board would agree to consider the authorities' request for an arrangement with the Fund. He understood that for the Board to take such action against the recommendations of the management would be a departure from normal practice; however, the situation in Peru was an extraordinary one. Perhaps, as a compromise, management and the Executive

Board could consider changes in the decisions on Peru's request for a stand-by arrangement and for a purchase under the compensatory financing facility that would preserve the conditionality required but would be seen in Peru as a signal that the difficulties with the Fund were not insurmountable.

The Chairman replied that, at the present stage of discussions, the differences between what the authorities in Peru had in mind and what had been agreed between the staff and the previous Minister of Finance were substantial. Indeed, the effect of the measures not yet adopted was equivalent to 1 percent of GDP; and for a fiscal program of the sort contemplated, a slippage of that magnitude constituted more than a technical problem. That was not to say that management and staff would inflexibly demand precisely the measures that had previously been agreed. Nonetheless, it was important to preserve the rationale of the program, and actions had to be taken that would convince management and staff that the program would be successful and would convince other financiers that the program could be supported by external financing. That point had not yet been reached.

If it would help Directors to understand the situation, he would ask the staff to provide more detail on the measures--and the timing of the adjustments--that were contemplated by the authorities, the Chairman continued. He hoped that a compromise could be reached so that, in a short time, he could bring the program and the requests to the Board for consideration.

The staff representative from the Western Hemisphere Department observed that, originally, the price of rice was to have been increased by 30 percent in real terms between December 1983 and March 1984. Some increases had taken place, but there still needed to be a 23 percent increase in order to bring the price of rice in line with the originally contemplated schedule. The reason the price increases were so important was because inflation in Peru was running at a triple-digit pace; hence, for any month in which prices did not increase--especially for products for which corrective price action needed to be taken in real terms--the impact on the fiscal budget became important because public sector enterprises had a monopoly to sell the products in question. The Peruvian authorities had proposed spreading the increases in the price of rice over the next three months to bring them to a level at which the rice marketing agency would no longer suffer losses. However, the delay in bringing the price of rice to such a level would itself create a deficit that would not be covered by future price increases, and that would have to be made up through other revenue measures or expenditure cuts elsewhere in the budget.

Also, originally it had been agreed to increase electricity rates by 20 percent in real terms, the staff representative continued. The authorities were currently 6.5 percentage points short of that goal, and they were suggesting that electricity rates should be increased by 10 percent a month which, given estimated inflation, would bring the rates to the originally promised level in three months. It should be noted, however, that the target of a 20 percent increase in real terms had been only a first step toward bringing electricity rates up to levels that were considered by the World Bank to be adequate. At present, the World Bank had stopped disbursements on loans to projects in the electricity sector because it was felt that rates should be approximately 100 percent on average above present rates; hence, there remained significant differences of view between the World Bank and the Peruvian authorities on what electricity prices should be. In the Fund program, the staff had built in revenue measures based on a 20 percent increase in electricity rates. That did not mean that the Fund staff was not supporting the World Bank's effort to move the rates to a higher level; it was only that the Fund staff considered the 20 percent increase sufficient for the revenue program, but even that target had not been met.

On other controlled prices, the differences between what had been done and what was necessary were not great, in part because no corrective price adjustments had been needed for the relevant products, the staff representative commented. Still, their prices should be increased at least in line with inflation; and the staff understood that such increases had not taken place consistently over the past four months. The effect on revenues of price increases for those items was not as large as for increases in rice and electricity, but the increases were considered necessary.

With regard to tax measures, the authorities had not eliminated exemptions to the value-added tax, the staff representative noted. Authority had been given to the Government to eliminate exemptions, but that authority had expired on March 15 without any action having been taken. Congress had reconvened in Peru, and it was the intention of the authorities to request an extension of 60 days of the authority to remove exemptions. The elimination of the exemptions would have made a difference of 0.2 percent of GDP for all of 1984.

Authority had also been given for increases on excise taxes on consumer items, the staff representative remarked. Taxes on tobacco products had been increased, but taxes on soft drinks, beer, and alcoholic beverages had not. The authorities were looking for alternatives to the excise tax increases, without which the shortfall in revenue for 1984 would be equivalent to 0.3 percent of GDP. The third action that had not yet been implemented, despite the fact that authorization existed, was a tax on ownership of automobiles and other luxury goods. The authorities had indicated that they might implement that tax in the near future.

Mr. Malhotra noted from Mr. Donoso's statement that GDP had declined in 1983 at a pace much faster than originally expected. Mr. Donoso had also indicated that the 1984 fiscal deficit would decline from 10 percent of GDP to 3.8 percent of GDP, that the current account deficit might also fall substantially, and that inflation was expected to decline from 140 percent to 70 percent. Considering the very steep decline in GDP, how much weight should be attached to the 1 percent of GDP decline in the fiscal situation because of the measures the authorities had not yet adopted?

The fiscal deficit was expected to decline from 10 percent to 3.8 percent on the assumption that all the measures originally contemplated were taken, Mr. Malhotra continued. If all the measures were not fully taken, he wondered what the fiscal deficit would be and whether it would still be seen as declining considerably. The question was whether or not the Fund should insist that the fiscal deficit must necessarily fall to 3.8 percent of GDP or whether a ratio somewhat higher was acceptable.

The Executive Directors agreed to continue their discussion on Peru in the afternoon.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/84/55 (4/5/84) and EBM/84/56 (4/6/84).

4. ST. CHRISTOPHER AND NEVIS - GOVERNORS' VOTE

The Executive Board approves the report of the Secretary (EBD/84/111, 4/5/84) on the canvass of votes of the Governors on Resolution No. 39-1, with respect to membership for St. Christopher and Nevis, approved by the Executive Board for submission to the Board of Governors (EBM/84/36, 3/5/84). The Governors' vote on the Resolution is recorded as follows:

Total affirmative votes		848,418
Total negative votes		0
Total votes cast		848,418
Abstensions recorded	0	
Other replies	0	
Total replies		848,418
Votes of members that did not reply		78,090
Total votes of members		926,508

Decision No. 7665-(84/56), adopted
April 5, 1984

5. ASSISTANT TO EXECUTIVE DIRECTOR

The Executive Board approves the proposal set forth in EBAP/84/68 (4/3/84).

Adopted April 5, 1984

6. ASSISTANT TO EXECUTIVE DIRECTOR

The Executive Board approves the proposal set forth in EBAP/84/69 (4/3/84).

Adopted April 5, 1984

7. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 83/170 and 83/171 are approved. (EBD/84/106, 3/30/84)

Adopted April 5, 1984

8. EXECUTIVE BOARD TRAVEL

Travel by an Executive Director as set forth in EBAP/84/70 (4/4/84) and by an Advisor to Executive Director as set forth in EBAP/84/70 (4/4/84) is approved.

APPROVED: September 19, 1984

LEO VAN HOUTVEN
Secretary