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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 84/129

10:00 a.m., August 29, 1984

R. D. Erb, Acting Chairman

Executive Directors	Alternate Executive Directors
	W. B. Tshishimbi
	T. Ramtoolah, Temporary
	H. G. Schneider
	G. E. L. Nguyen, Temporary
A. Donoso	
	D. C. Templeman, Temporary
	M. B. Chatah, Temporary
H. Fujino	T. Yamashita
G. Grosche	D. Hammann, Temporary
J. E. Ismael	Jaafar A.
	L. Leonard
	H. A. Arias, Temporary
	G. Gomel, Temporary
R. N. Malhotra	A. S. Jayawardena
Y. A. Nimatallah	
	T. de Vries
	K. G. Morrell
G. Salehkhou	O. Kabbaj
F. Sangare	
	J. L. Feito
	E. Olsen, Temporary
	T. A. Clark
	D. J. Robinson, Temporary
	Shao Z., Temporary

L. Van Houtven, Secretary
S. L. Yeager, Assistant

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Also Present

African Department: J. B. Zulu, Director; O. B. Makalou, Deputy Director; C. V. Callender, J. Kakoza, T. Oyama, M. Reichardt, M. Sidibé, E. S. Williams. Asian Department: Tun Thin, Director; P. R. Narvekar, Deputy Director; I.-S. Kim, K. Saito. European Department: A. M. Mansoor. Exchange and Trade Relations Department: S. Kanesa-Thasan, P. J. Quirk. Legal Department: G. F. Rea, Deputy General Counsel; Ph. Lachman, S. A. Silard. Research Department: L. Alexander. Treasurer's Department: W. O. Habermeier, Counsellor and Treasurer; D. Williams, Deputy Treasurer; D. Berthet, T. B. C. Leddy, D. Gupta, W. E. Hermann. Bureau of Statistics: G. Khatchadourian. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: A. A. Agah, S. El-Khouri, L. Ionescu, W. Moerke, I. R. Panday, A. Vasudevan. Assistants to Executive Directors: J. Bulloch, Chen J., C. Flamant, H. Kobayashi, E. Landis, J. A. K. Munthali, G. W. K. Pickering, M. Rasyid, J. Reddy, J. E. Rodríguez, C. A. Salinas, S. Sornyanyontr, A. J. Tregilgas, A. Yasseri.

1. LESOTHO - 1984 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1984 Article IV consultation with Lesotho (SM/84/181, 7/23/84). They also had before them a report on recent economic developments in Lesotho (SM/84/188, 8/3/84).

Mr. Sangare made the following statement:

> The regular reviews of developments in the economy of Lesotho serve to remind us of the peculiar problems facing this small, landlocked country that is wholly surrounded by the Republic of South Africa, a country with a much stronger and diversified economy. Thus, independent policy action by Lesotho tends to be limited.
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> In the last three years the performance of the economy of Lesotho has been reasonably satisfactory, with growth of real GNP averaging over 8.0 percent a year. In 1983/84, however, GNP growth fell markedly to 1 percent, reflecting, in part, the international recession which led to the closure of the main diamond mine, and the severe drought that adversely affected agricultural production; only the increase in workers' remittances, though lower than in previous years, made it possible to offset the 5 percent decline in the real sector. The rate of inflation as measured by the consumer price index accelerated to 15 percent in 1983/84, largely the result of the higher cost of domestic agricultural commodities as well as the impact of the imposition of the 5 percent sales tax.
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> An encouraging development in 1983/84 was the further and significant progress that the authorities had made in reducing the large financial imbalances that had accumulated over the last few years. The overall fiscal deficit was reduced from M 40.8 million (11 percent of GDP) in 1982/83 to M 21.9 million (5 percent of GDP) in 1983/84. This contributed to an improvement in the balance of payments position, with the current account deficit narrowing to 1.6 percent of GDP from 14.2 percent of GDP in 1981/82. The overall balance of payments was in surplus, although the foreign assets of the Central Bank, at M 76 million, were just enough to cover imports for six weeks.
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> In the circumstances, the authorities recognized that, in order to achieve sustained economic growth under stable financial conditions, they would have to remain steadfast in containing imbalances and improving the performance of the external sector by diversifying the economic base. To this end, continued efforts are being directed at the development of agriculture and manufacturing, which offer relatively better prospects for diversification and employment creation.

In the case of agriculture, a comprehensive review of the sector has been completed with the assistance of the Food and Agriculture Organization, providing the basis for changes being made in the major development programs. Under the Food for Self-Sufficiency Program, in which maize production is being emphasized, the role of the farmer in the production process is being articulated, while the Technical Operations Unit has been reorganized to provide extension services and basic inputs, including improved seed, fertilizer, and other chemicals. Marketing of agricultural produce is being provided by Co-Op Lesotho, while credit facilities will continue to be the responsibility of the Lesotho Agricultural Development Bank. This review has led to better coordination in implementing agricultural policy. Meanwhile, provisions of the Land Tenure Act are being implemented in respect of present land allocations with a view to providing incentive for land improvement. Other priority areas include the production of fruit and vegetables and the development of livestock through the introduction of improved varieties. As regards the latter, measures have also been taken to reduce overgrazing, including the imposition of charges for the use of grazing pasture.

The Government of Lesotho, through the Lesotho National Development Corporation, has embarked upon a selective promotion campaign which includes improvement of industrial incentives together with the offer of wider market opportunities in the European Common Market and in the southern African region. The strategy has started bearing fruit, as four firms from abroad are expected to commence operations in September 1984. Overall, the development of the manufacturing sector has been hampered by the narrow resource base, the scarcity of managerial and technical skills, and, more important, the all-out efforts by South Africa to attract investment in support of its so-called homeland policies.

Fiscal policy aims at consolidating the gains made thus far. Although receipts from the South African Customs Union (SACU) were projected to increase sharply, measures were introduced in the 1984/85 budget to further strengthen domestic revenue by raising the sales tax rate from 5 percent to 6 percent, increasing the tax on liquor, and imposing user charges for technical services provided by the Government to farmers. At the same time, efforts are being made to contain expenditure growth by, among other things, restricting the expansion of the civil service and holding the line on wages in the public sector. A decision has been taken to effect small but regular adjustments to civil service wages as opposed to the previous practice whereby large wage awards were made at intervals of between four and five years. The increase in capital expenditure in the 1984/85 budget reflects the need for speedy completion of the airport, the resumption of work on government office accommodations, and the road progam which is being financed with proceeds from external aid. The authorities had hoped to achieve a budgetary surplus in the current year, but it now seems that the outcome is likely to be a budget deficit equivalent to 1 percent of GDP, which is nonetheless a substantial improvement over the previous year. For the medium term, the authorities expect SACU receipts to fall with the decline in imports. The future level of these receipts remains uncertain, particularly as the South African authorities have indicated their desire to renegotiate the SACU agreement. The authorities are, therefore, examining ways of buttressing domestic revenues, including an increase in the sales tax on luxury items. They are also investigating the possibility of imposing a tax on miners' income, although they envisage serious practical problems in implementing such a tax. In the meantime, tax administration is being improved.

Notwithstanding these revenue-raising measures, the authorities realize that greater effort would have to be exercised to contain the growth of expenditure and to ensure that state enterprises are financially self-supporting. In this connection, measures are already under way to promote efficient operations of these corporations by closing down nonprofitable ones and improving management in others. Progress in this regard has been satisfactory. The Lesotho National Bus Company, for example, has already started operating profitably and without the need for government subsidies.

Lesotho's membership in the Rand Monetary Area places severe limitations on independent monetary policy action. The monetary authorities have been reluctant to raise interest rates in view of the excess liquidity of the banks and the depressed state of demand for credit. They are aware that the existing differentials in interest rates between South Africa and Lesotho could encourage capital outflows. However, there are no indications of such capital outflows, but the authorities are monitoring developments closely with a view to taking prompt action whenever necessary.

The current account deficit of the balance of payments was expected to rise somewhat in 1984/85, mainly on account of the need for cereal imports to augment the food supply following the severe drought that affected the country, higher imports associated with the development program, as well as increased payments on external debt. However, the overall position is projected to show a surplus of M 16 million. The medium-term outlook is favorable, barring unpredictable external shocks and assuming that the authorities continue their efforts to increase domestic savings and contain import demand. External borrowing on commercial terms will be limited. The authorities hope that the international community will increase external assistance on concessional terms in support of their development efforts.

Mr. Robinson stated that he broadly endorsed the staff appraisal. The authorities had made considerable progress in reducing the imbalances in the economy, as evidenced in particular by the sharp reduction in the fiscal deficit from 17 percent of GDP in 1981/82 to 5 percent of GDP in 1983/84, with a concomitant drop in the current account deficit from 14 percent of GDP to less than 2 percent of GDP over the same period. While the authorities were to be commended for that performance, he agreed with the staff that the reduction in the fiscal deficit had owed much to an increase in receipts from the South African Customs Union (SACU), and the improvement in the current account of the balance of payments had reflected a substantial increase in workers' remittances. Those two points highlighted the constraints Lesotho faced, in addition to those arising from its geographical position and its membership in the Rand Monetary Area (RMA).

Lesotho's heavy dependence on SACU receipts and on the employment of more than half its male labor force in South Africa had two implications for policy, Mr. Robinson observed. First, as Mr. Sangare had noted in his opening statement, it was clear that the authorities would not be able to rely on a continued high level of SACU receipts in future, especially as the South African Government had requested the renegotiation of the SACU agreement. Strict control of expenditure, and possibly further revenue-raising measures, might therefore become necessary.

Second, workers' remittances would remain the mainstay of the economy for the foreseeable future, Mr. Robinson continued; their importance was graphically illustrated by the startling fact that gross national product was more than twice gross domestic product. The sharp increase in remittances over the past few years had meant that GNP had continued to increase, albeit at a decreasing rate, while GDP had fallen as a result of the closure of the diamond mine and the effects of the drought.

Development policy, Mr. Robinson added, would therefore have to be planned accordingly. For example, although the demand for labor in South African mines was falling, it appeared to be rising in other sectors: to meet that change in demand, there might be scope for putting more resources into education and manpower training to improve the quality of the work force. That would also help to encourage direct investment, and to offset in part the heavily subsidized investment incentive schemes in the South African "homelands."

On fiscal policy, he agreed with the authorities that expenditure control would be crucial, Mr. Robinson said. The ratio of expenditure to GDP had been cut by 4 percentage points between 1981/82 and 1983/84 through both wage restraint and a reduction in capital projects accounted for in the budget. Nevertheless, even allowing for considerable underspending on the capital budget in 1984/85, expenditure was projected to rise as a percentage of GDP, and in addition, pressures to increase wages would, after four years of restraint, become difficult to resist. He therefore agreed with the staff that efforts would have to be made to limit capital outlays to viable projects with substantial foreign concessional financing; in that connection, he welcomed the continuing efforts to improve the financial results of the parastatals.

With regard to monetary policy, the expansionary fiscal stance in South Africa had continued to put pressure on interest rate levels in the other member countries of the RMA, Mr. Robinson observed. The interest rate differential between Lesotho and the Republic of South Africa would presumably have widened following the recent increase in the South African prime interest rate to 25 percent. While he agreed with the staff that it was important to avoid capital outflows, he noted from page 15 of the staff paper (SM/84/181) that the banking system in Lesotho was very liquid, owing to the lack of suitable lending opportunities. He wondered whether it might not be preferable for the authorities to continue to monitor flows of funds carefully, and to be ready for quick action if necessary, rather than to raise interest rates immediately.

Staff projections suggesting a viable balance of payments in the medium term were encouraging, Mr. Robinson remarked. Nevertheless, further improvement depended on the absence of major shocks, especially on remittances, as reserves, although they had increased, were still modest. Continuing efforts to encourage and diversify exports, and to promote import-competing industries, would therefore be necessary. In particular, he welcomed the measures taken to reorganize the Food Self-Sufficiency Program and to improve the livestock sector. One important aspect of policy in that sector would be to encourage farmers to move away from the traditional view of livestock as financial assets--mentioned on page 4 of SM/84/188--which had resulted in a substantial oversupply of animals relative to the pasture available and an undersupply of meat, and instead to raise livestock for commercial purposes.

Finally, Mr. Robinson noted with satisfaction that the authorities had used a substantial part of the increase in SACU receipts in 1984/85 to retire short-term debt. Even though overall public sector debt was projected to remain at its 1983/84 level, that action had allowed substantial improvement in the maturity structure. Nevertheless, although debt service was comparatively low as a percentage of exports of goods and services, interest payments had quadrupled in the government budget over the past four years; the authorities should, where possible, avoid recourse to anything but concessional borrowing.

Mr. Hammann stated that he was in broad agreement with the staff appraisal and supported the proposed decision. Lesotho, despite its lack of natural resources and its peculiar geographical situation, had been successful in reducing the deficits in the current account of the balance of payments and in the public sector budget. However, the inflation rate and growth performances had fallen somewhat short of expectations. Nevertheless, Lesotho had skillfully used its room for maneuver, even though it had clearly been limited by the monetary and customs union with the Republic of South Africa and also by the fact that an overwhelming part of its import requirements were being covered by workers' remittances.

On fiscal policy, Mr. Hammann remarked, he fully concurred with the staff recommendation that the authorities should follow a policy course characterized by a cautious wages policy, further adjustments in public expenditures, and a strengthening of revenues. In that regard, he welcomed the authorities' intention to examine capital expenditures more closely with respect to their economic feasibility, their domestic resource requirement, and the operating costs involved. Moreover, he was pleased with the steps the authorities were taking to improve the performance of the parastatal sector.

With respect to structural policy, Mr. Hammann noted, more attention was currently being paid to strengthening and diversifying agricultural activities, and the modified agricultural strategy appealed to a larger extent to the self-interest and self-responsibility of the farmer. Those efforts were welcome and should, in the long run, contribute to a better balanced pattern of employment and growth in Lesotho.

On monetary policy, Mr. Hammann continued, he wished to make two remarks in the same vein as those made by Mr. Sangare and Mr. Robinson. First, his authorities were somewhat more optimistic than the staff that Lesotho could maintain an interest rate differential with respect to the Republic of South Africa slightly larger than 2-3 percentage points. Therefore, he asked the staff to comment on whether, in view of the current lending rate differential of 4.5 percentage points, sizable capital outflows had already materialized. Second, it seemed that, while lending rates were broadly positive in real terms, deposit and savings rates were negative in real terms. Given Lesotho's institutional framework, he wondered whether savings and deposit rates that were positive in real terms might not play a more powerful role in mobilizing savings.

With respect to debt management, Mr. Hammann concluded, he encouraged the authorities to continue their prudent policy. A larger part of external debt was now being contracted at concessional terms, and short-term external liabilities had been reduced. Thus, despite a sizable increase in Lesotho's external debt from 15 percent of GNP in 1982/83 to 17 percent in 1983/84, the debt service ratio had decreased and would decrease further in the years to come.

Mr. Templeman remarked that over the past several years Lesotho had faced worsening economic conditions stemming in large part from external factors, such as drought and the worldwide recession, combined with geographical limitations and structural weaknesses. While the initial reaction of the Lesotho Government to these conditions had contributed to double-digit inflation, no real growth of GDP in the past three years, and a decline in exports, the policies that were currently being followed as well as those designed for 1984/85 offered some hope for the future. In 1983/84, positive results had occurred in several areas. The government budget deficit, excluding external grants, had been lowered from 21 percent of GDP in 1981/82 to about 7 percent in 1983/84 and was projected to drop to 4 percent in the current fiscal year. The current account deficit, aided by an increase in workers' remittances--not in exports--had been reduced dramatically from 14.2 percent of GDP in 1981/82 to 1.6 percent in 1983/84. Further, the debt burden would be alleviated by the recent concentration of new borrowing in the form of concessional credit.

Although there had been some improvement in economic performance, Mr. Templeman continued, Lesotho's overall efforts to diversify and develop the economy over the longer run had not been fully effective. However, he was encouraged by the policies the authorities planned to pursue in several areas and was particularly supportive of their efforts to give the private sector, especially in agriculture, more responsibility for economic development. The steps that were being taken to increase agricultural production, to implement the land tenure act, and to improve the quality of the livestock sector were positive factors. While he appreciated the difficulties regarding the expansion of the manufacturing sector, he hoped that further incentives to cost efficiency could be found to turn it into a more productive economic sector. He also hoped that the expansion of both agriculture and manufacturing would foster the job creation required to retain skilled labor in Lesotho.

Fiscal policy would remain tight in 1984/85, Mr. Templeman noted. Given the rather steady rise in the ratio of revenue to GDP and the fact that both revenue and expenditure ratios to GDP were currently almost 50 percent, he urged the authorities to restrain future wage adjustments and to hold down budget expenditures in general. While he recognized the need for some large capital outlays in 1983/84 to complete existing projects, he agreed with the staff that cost and feasibility issues should be examined more carefully before new projects were undertaken. He supported the Government's efforts to avoid new nonconcessional financing and, in that regard, was pleased that the needed expansion of the road program would be financed largely by international aid agencies. Further, he commended the authorities' efforts to make the parastatal industries self-supporting.

He recognized the limitations placed on Lesotho's ability to pursue an independent monetary policy, Mr. Templeman went on. However, he urged the authorities to consider seriously an increase in domestic interest rates that would bring them more in line with the Republic of South Africa in order to attract and retain the savings needed for domestic investment, as well as to help dampen inflation.

Although a projected current account deficit of 6 percent of GDP over the medium term raised some questions, Mr. Templeman continued, that outcome might be feasible, so long as import demand was curbed, miners' remittances remained strong, merchandise exports responded to the planned incentives, and foreign capital inflows could be sustained at the projected level.

Finally, Mr. Templeman remarked, Lesotho was one of the least developed countries, with a per capita GNP of about $550, and it had been hurt by declining prices for its main export commodity, by a drop in external aid, and by serious drought conditions. A strong and cohesive development program was needed to aid Lesotho in responding to those external problems as well as structural weaknesses in its economy. In that regard, he welcomed the World Bank's involvement in Lesotho's development.

Mr. Ramtoolah commented that since the 1983 Article IV consultation, Lesotho had achieved commendable progress toward reducing both its internal and external imbalances. Adjustment policies had become of great urgency in the light of developments in the early 1980s, when the fiscal and external current account deficits for 1981/82 had reached the equivalent of about 17 percent and 14 percent of GDP, respectively. In 1983/84, real GDP was estimated to have decreased by 1.5 percent. While that performance was no doubt disappointing, it had nevertheless to be viewed in the context of a severe drought, which, among other things, had resulted in a 50 percent decline in crop output between 1981/82 and 1983/84. The authorities were, under the circumstances, to be commended for the manner in which they had coped with the difficulties confronting them. For example, they had introduced grazing fees to resolve the overgrazing problem. They had also emphasized the idea that farmers had to assume a primary role in the Food Self-Sufficiency Program--a welcome development, given that program's burden on government expenditures.

In the manufacturing sector, Mr. Ramtoolah observed, given the crucial role of the Basotho Enterprises Development Corporation in fostering most Basotho-run small businesses and the fact that the Corporation had been able to approve only 13 out of 113 applications for new projects in 1983/84 because of financial constraints, an increase in the availability of funds from both internal and external sources was clearly warranted. In addition, the efforts by other parastatals, such as the Lesotho National Development Corporation, to attract foreign direct investment, despite tough competition from South Africa, were praiseworthy. Tourism could be another promising sector; the setting up of a Lesotho Tourist Board and the emphasis on building the necessary tourist infrastructure were welcome.

The significant reduction of the deficit as a percentage of GDP in 1983/84 was a positive development, Mr. Ramtoolah remarked. He welcomed the authorities' decision to increase domestic revenues and to contain expenditures rather than resort to nonconcessional foreign borrowing.

More specifically, the efforts that had been undertaken to increase the collection of income tax arrears and to improve tax administration were particularly noteworthy, as was the implementation of measures to streamline certain parastatals and to eliminate subsidies to others. Furthermore, the authorities' intention to exercise caution, contrary to past practice, in starting new programs not adequately financed by foreign concessional assistance was extremely wise and should be scrupulously observed.

Finally, Mr. Ramtoolah noted that, in the external sector, there had been a significant improvement in the current account deficit, which in 1983/84 was estimated to be equivalent to 1.6 percent of GDP compared with 6.8 percent the previous year, reflecting an increase in miners' remittances and official transfers. In addition, staff projections confirmed the viability of Lesotho's balance of payments over the medium term. Like the staff, he hoped that the authorities would continue to implement the most appropriate policies to ensure the realization of such forecasts.

Mr. Leonard said that, as Mr. Sangare had mentioned, the management of Lesotho's economy was subject to particular constraints arising out of its geographical location and its relationship with the Republic of South Africa. Fiscal policy had to be conducted with due regard for South Africa's dominant influence in the South African Customs Union. Furthermore, a large part of Lesotho's national income was generated in South Africa and the scope for direct taxation of that income by Lesotho was limited by whatever degree of prior taxation South Africa might choose to levy on it for its own purposes. Outside the sphere of fiscal policy, the level of employment of the Basotho labor force and the buoyancy of national income were dependent to a significant extent on economic conditions and policy decisions taken in South Africa. In addition, membership in the Rand Monetary Area closely circumscribed the operation of monetary policy.

Within the limits of those constraints, Mr. Leonard observed, the authorities had done well to reduce the fiscal deficit by some 12 percentage points of GDP and to reduce the current external deficit from the equivalent of 14 percent of GDP in 1981/82 to less than 2 percent in 1983/84. He was further heartened by current efforts to consolidate those favorable trends by the introduction of measures to boost domestic revenues and to restrain the growth of expenditure, especially through better management of wages in the public sector, where pressure for increases was mounting. There was additional cause for satisfaction in the prospect that a viable balance of payments position could be maintained over the medium term.

The staff papers seemed to suggest that the balanced management of the economy that was being sought by the authorities needed to be complemented by action to ease the structural constraints on the economy, Mr. Leonard commented. It was unclear from the papers, however, whether financial management was integrated with a properly worked out approach to raising and diversifying output, providing more domestic employment, and supplementing external financial assistance with domestic resources.

There seemed to be some superficial anomalies in the current policies, Mr. Leonard observed. It seemed odd, for example, that in an economy where agricultural production was failing and food imports, financed in part by external aid, had risen, the relative importance of government expenditure on agricultural services was not higher and, in fact, had fallen in 1983/84. That prompted him to ask whether it had been necessary to make agricultural spending decisions with an eye more to fiscal needs than to fully worked out ideas on the role of the agricultural sector. He also wondered what part prices were expected to play in the development of agriculture, and whether agricultural incomes could be brought to levels that would enable the sector to retain sufficient factors of production to enable it to expand in competition with other sectors in both Lesotho and South Africa.

Regarding government current expenditure in general, Mr. Leonard added, the marked decline in the percentage of expenditure devoted to economic services during the three-year period 1980/81 to 1982/83 was unexpected. The trend in capital spending had admittedly been in the opposite direction, but that trend seemed to be more related to decisions taken outside of Lesotho than to those taken by the national authorities. He therefore questioned whether much of the capital expenditure, although useful, was taking place in areas of long-term economic need.

He recognized that the developmental aspects of management of the Lesotho economy were not the immediate concern of the Fund, Mr. Leonard added. Nevertheless, considering the low level of GDP and GNP per capita and the current limited possibilities of providing employment for a growing labor force, the future could be viewed with more confidence if it were clear that financial management had been proceeding in the context of well-devised, long-term policies. He therefore hoped that Mr. Sangare or the staff would comment on those structural issues, especially on any broader and long-term policy framework that the World Bank might be providing for the specific recommendations presented in the staff report. Solid support from the international community and its institutions would help enormously to make the future of the Lesotho economy less precarious.

The staff representative from the African Department stated that there was no certain information that capital outflows had developed as a consequence of the interest rate differential between Lesotho and the Republic of South Africa. The increase in deposits with the banking system had, however, been slower in 1983/84, when the interest rate differentials had arisen, than it had been in the previous two years; that deceleration might, however, have been due to the slowing down of the economy. He reiterated that the authorities had recognized that the interest rate differentials could cause capital outflows, and that they intended to keep interest rates under review and to adjust them if there was evidence that outflows had developed or were developing.

With regard to Mr. Leonard's question concerning the management and priorities of Lesotho's investment program, the staff representative remarked that in recent years the investment program had been dominated by two or three major projects of questionable economic viability. The airport, costing roughly M 58 million, and a government office complex had received a disproportionate share of investment program funds. The third project, the Food for Self-Sufficiency Program, an agricultural project, paled in significance compared with the other two. The airport and office complex were scheduled to be completed in 1984/85, and the staff had recommended that before new projects were entertained, the authorities should discuss the formulation of an investment program with the World Bank, taking into consideration developmental priorities and giving more emphasis to agriculture. Discussions with the Bank had started, and an investment program was expected in 1985/86.

As to whether agricultural incomes could reasonably be expected to rise to the level of incomes in other sectors of the Lesotho economy or of South Africa, the staff representative from the African Department stated that the authorities believed that, while there was room for raising agricultural income by concentrating on the cultivation of high-value crops, it was not likely that the agricultural sector would be able to compete with manufacturing in Lesotho or with mining in South Africa in the near future. He noted that the authorities had decided to devote some resources to the development of those high-value crops in 1984/85.

Mr. Sangare, referring to monetary policy and the question of making the interest rate positive in real terms in the medium term, explained that the Lesotho authorities were hesitant to do so because of the current excess liquidity of the banks and the depressed demand for credit. Consequently, they were more concerned with stimulating credit demand within Lesotho. Moreover, Lesotho's ability to pursue an independent monetary policy was somewhat constrained by its physical proximity to South Africa and by its membership in the Rand Monetary Area. For those reasons, the authorities considered that the Lesotho financial market was still in a rudimentary stage and was far less sophisticated than that of South Africa; therefore it did not permit the implementation of short-term policy instruments. Consequently, the authorities intended to pursue policies that would encourage financial stability over the medium term.

With regard to fiscal policy, Mr. Sangare commented that the authorities did not envisage a precipitous change in receipts from the South African Customs Union; those receipts were expected to be an important source of revenue in the near future. The authorities were, however, currently investigating the possibility of strengthening domestic revenue. In that regard, the authorities believed that the implementation of a tax on miners' incomes would necessarily involve a prior agreement with the Republic of South Africa; not only might that measure be difficult to implement, but such a tax might also be a disincentive to miners to continue their remittances.

The Acting Chairman made the following summing up:

Directors welcomed the marked reduction in the imbalances in Lesotho's public finances and external accounts that had taken place over the last two years. While it was recognized that exogenous factors, including the increase in revenues from the South African Customs Union (SACU) and the increase in workers' remittances, had played an important part in these developments, it was observed that domestic policy adjustments had also contributed to the improved performance. In particular it was mentioned that the broadening of the tax base and the containment of government outlays had worked to reduce the imbalances. Directors also commended the decision of the authorities to allocate the increase in SACU receipts from 1984/85 to the prepayment of short-term external debt, and to avoid recourse to such borrowing in the future.

Directors expressed concern about the recent and prospective decline in economic activity and the acceleration in inflation. They cautioned that, in view of the less favorable prospects for SACU receipts and external remittances, large financial imbalances could reappear in the coming few years unless the authorities continued to pursue prudent demand management policies. In this context, they welcomed the Government's intention to introduce further measures--including the possible extension of the income tax to miners' incomes--to boost domestic revenues.

Noting the high ratio of government expenditures to GDP, Directors stressed the need for continued control of government expenditures, and in that connection particularly encouraged restraint in public sector wage increases in 1984 and 1985. A careful scrutiny of capital projects to determine their economic viability, domestic resource requirements, and operating costs was also recommended before such projects were to be initiated.

In the monetary area, Directors noted that the authorities had undertaken to monitor carefully the banking sector's high level of liquidity and encouraged them to stand ready to take action to raise domestic interest rates so as to keep them in an appropriate relationship with rates prevailing in the Republic of South Africa. By encouraging savings, reducing the demand for imports, and reducing the incentives for capital outflows, such an action would also have a positive effect on the balance of payments. Directors also noted the desirability of financial management proceeding in the context of well-defined, long-term policies.

Directors urged the authorities to persevere in their efforts to diversify the economy through the expansion of the agricultural and manufacturing sectors. In this connection, Directors welcomed the involvement of the World Bank in the investment program and encouraged the authorities to continue to strengthen the role of the private sector.

Regarding the medium-term balance of payments prospects, Directors noted the staff's judgment that Lesotho's current account position was viable, provided that there were no shocks and that import growth was restrained. Although Lesotho's debt service payments seemed manageable, Directors encouraged the authorities to limit their external borrowing and stressed the importance of concessional financing.

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

The Executive Board then took the following decision:

Decision Concluding 1984 Article XIV Consultation

1. The Fund takes this decision in concluding the 1984 Article XIV consultation with Lesotho, in the light of the 1984 Article IV consultation with Lesotho conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

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

Decision No. 7790-(84/129), adopted
August 29, 1984

2. VIET NAM - OVERDUE FINANCIAL OBLIGATIONS - REPORT AND COMPLAINTS UNDER RULES K-1 AND S-1 AND NOTICE OF FAILURE TO REPAY TRUST FUND LOANS

The Executive Directors considered a staff paper providing additional information on Viet Nam's overdue financial obligations to the Fund - together with a proposed decision (EBS/84/142, Sup. 3, 8/27/84).

The Acting Chairman made the following statement:

Since the Executive Board meeting on Viet Nam's overdue obligations on July 27, 1984, no payments have been received from Viet Nam, and the overdue obligations have increased to SDR 18,146,718, compared with the amount of SDR 13,905,741 shown in EBS/84/142, Supplement 1 (7/25/84). Detailed information on Viet Nam's overdue obligations as of August 25, 1984, and an exchange of correspondence with the Honorable Nguyen Duy Gia, Governor of the Fund for Viet Nam, are being circulated for the information of Directors in EBS/84/142, Supplement 3 (8/27/84).

In the circumstances, I believe that the Executive Board should consider taking decisions to limit Viet Nam's use of the Fund's general resources until such time as Viet Nam is current in the General Department and to suspend the right of Viet Nam to use SDRs it acquires after the suspension. Although, as explained in EBS/84/142 (6/29/84), no specific remedy is provided in the Articles of Agreement or the Trust Fund Instrument relating to overdue obligations to the Trust Fund, I believe that it would also be appropriate for the Executive Board to consider giving formal notice to Viet Nam, as part of the Board's decision, that the existence of overdue obligations to the Trust Fund would be taken into account in any appraisal of Viet Nam's standing vis-à-vis the Fund for any reason, including decisions on any request by Viet Nam to use the Fund's resources.

A draft decision reflecting these points is included as Attachment III in EBS/84/142, Supplement 3.

Mr. Ismael stated that the recent emergence of overdue obligations to the Fund by several members was a manifestation of the more general debt crisis. The problem in the case of Viet Nam was even more acute in view of its social, political, and economic history: Viet Nam's experience in this century had been unique among the world family of nations. There was absolutely no doubt that the country had gone through and was still facing serious difficulties. Three examples would serve to illustrate those difficulties.

First, Viet Nam had just emerged from the bitter experience of a 30-year war which had devastated the economy, Mr. Ismael remarked. Furthermore, it was lacking in resources to reconstruct that devastated economy. Unfortunately the situation in Indochina continued to be volatile, and was adversely affecting the reconstruction efforts of the Vietnamese authorities.

Second, Viet Nam was faced with political and economic isolationism of a kind which very few countries in the world had experienced in modern times, Mr. Ismael went on. The economic isolationism had operated in three main areas--trade, foreign aid, and access to capital markets. Viet Nam had lost its traditional markets for its main export items, comprising coal and agricultural and marine products. External assistance, including humanitarian and cultural aid to Viet Nam, had sharply declined in recent years. External assistance from the convertible currency area in 1984 and 1985 was expected to fall well below that in preceding years.

In addition, Viet Nam's access to capital markets was almost nonexistent. As a result, total foreign loans and grants had declined from 2.1 percent of GDP in 1980 to 0.7 percent of GDP in 1983, and the ratio was expected to fall further in 1984 and 1985.

Third, Viet Nam had unpledged gold holdings of about 400,000 ounces, Mr. Ismael noted. His authorities believed that those gold holdings were too low for a country with a population of 60 million, particularly when the country was being isolated from credit markets and from external assistance. In addition, in view of Viet Nam's unhappy experience with frozen accounts abroad and for reasons of national security, it was a firm policy of the authorities to use gold holdings only in an emergency. Furthermore, based on the Fund staff's views on gold as a reserve asset, as stated in a paper on the control of international liquidity and reserve creation (SM/84/147, 6/28/84)--especially on page 5 concerning the arbitrariness of the convention of what to count as reserves, and on page 6 about the low liquidity of gold, with which his authorities fully agreed--any judgment on Viet Nam's ability to pay should largely focus on its foreign exchange holdings and not on its holdings of illiquid assets. Viet Nam's foreign exchange holdings of about $16 million, which had been maintained only through the accumulation of arrears, were far below the minimum level many countries would consider tolerable; on a per capita basis, they were equivalent to $0.25. If Viet Nam were to eliminate its arrears to the Fund, the country would be left without any foreign exchange holdings. Any depletion of those holdings, for a country whose per capita income in 1983 had been as low as $42, would undoubtedly have created "exceptional hardship," and it would have certainly brought external trade, and consequently economic development, to a total halt.

Given the low per capita income in Viet Nam, the immense need for development assistance to reconstruct the economy, and the meager level of foreign exchange holdings, Mr. Ismael continued, he did not believe that the Executive Board would want to force the country to give up all its foreign exchange holdings, when the purpose of the Fund was to provide reserves to countries facing exceptional difficulties. The Fund's founding fathers had perceived that fundamental difficulty and the Articles of Agreement had made provision for postponing repurchases.

On the adjustment efforts undertaken by the Vietnamese authorities and their efforts to settle outstanding obligations to the Fund, Mr. Ismael stated that since the unification of the North and the South, two five-year development plans had been implemented, but there had been major shortfalls in meeting the plan objectives due to security reasons. More recently, the authorities had introduced a number of economic reforms designed to promote a more efficient allocation of resources and to provide greater incentives to producers. Measures had been taken to improve economic management at production levels, to allow for greater flexibility in prices, and to improve incentives for exports. Measures had also been taken to reduce the budget deficit and monetary expansion. Those measures were expected to lead to some improvement in the balance of payments, which in turn would place Viet Nam in a better position to meet its obligations to the Fund. Meanwhile, on August 17, his Vietnamese authorities had instructed their bankers--Bankers Trust Company of New York--to release $11 million, constituting interest earned on their blocked accounts, to settle Viet Nam's outstanding obligations to the Fund. They hoped that the release of those funds would be a feasible solution. Those efforts, and the country's meager level of reserves, demonstrated that it was not the lack of will but the lack of ability which was holding Viet Nam back from meeting its obligations to the Fund. That was further confirmed by the fact that Viet Nam had met all its obligations to the Fund until it had experienced serious financial difficulties in early 1984.

Given the long-term structural nature of the problems facing Viet Nam, his authorities did not envisage that they would be in a position to meet their obligations to the Fund in the near future, Mr. Ismael said. Therefore, their preference would have been for a longer-term postponement of repayment so as to provide adequate time to rehabilitate the export sector of the economy. Indeed, the Articles of Agreement and the Instrument establishing the Trust Fund clearly recognized the need to deal with possible predicaments of member countries; in particular, Article V, Section 7(g) provided that in case of "exceptional hardship," postponement of repurchases might be granted by a 70 percent majority of the total voting power. Article V, Section 8(e) provided that in exceptional circumstances the Fund could, by a simple majority, allow a member to pay charges in its own currency. Insofar as the Trust Fund was concerned, paragraph 4(e) of the Instrument to Establish the Trust Fund (Decision No. 5069-(76/72), adopted May 5, 1976) provided that if repayment on the due date would cause serious hardship for a member, rescheduling could be allowed, provided that it did not impair the ability of the Trust to meet its liabilities.

His Vietnamese authorities, Mr. Ismael stated, believed that the serious economic difficulties and the exceptional circumstances of their country qualified Viet Nam for relief within the legal provisions of the Fund's Articles of Agreement and the Instrument to Establish the Trust Fund. His authorities expressed their concern and regret that solutions allowed within the legal framework of the Fund had not been proposed for consideration by the Board. Furthermore, his Vietnamese authorities regretted that the proposed decision in EBS/84/142, Supplement 3, failed to recognize the extremely serious hardship and the exceptional circumstances of Viet Nam.

The staff representative from the Legal Department confirmed Mr. Ismael's understanding of the provisions in the Articles with respect to the possible postponement of obligations due to the Fund pertaining to the use of its general resources. The Executive Board had, however, recently decided, in trying to find a uniform way to deal with problems of hardship that members might encounter in making repayment to the Fund, that it did not wish to use the provisions relating to postponement in most cases because experience with its use in the few cases that had arisen since the Second Amendment had not enabled the Board to place a great deal of faith in their effectiveness.

Furthermore, the staff representative observed, there were no provisions in the Articles with respect to the postponement of any obligation to pay charges or assessments in the SDR Account; no doubt for that reason the Vietnamese authorities had not addressed themselves to that particular part of their obligations.

It was also correct to say, the staff representative added, that the Fund had the power, by a majority of the votes cast, to decide to postpone the discharge of obligations to the Trust Fund for a period not exceeding two years from the date when the obligations became due. There was a similar requirement that such a decision be taken only if serious hardship would result from repayment on the due date.

Mr. Malhotra inquired whether the Board had decided that it would never make use of the provision in the Articles allowing the rescheduling or postponement of obligations, or whether it was generally not in favor of its use but would consider it in exceptional circumstances. He believed that the Board had adopted the latter approach, and that the question was whether or not exceptional circumstances obtained in the case at hand.

The staff representative from the Legal Department responded that the decision to which Mr. Malhotra was referring had been taken by virtue of the summing up by the Managing Director at EBM/84/54 on April 5, 1984, of the Board's discussion of Fund experience with and procedures for overdue payments (EBS/84/46, 3/9/84). The relevant sentences from that summing up read: "The Executive Board clearly does not wish to open the way for rescheduling of obligations. The staff arguments on the point were clearly found convincing and were supported by the Board. This does not mean that the relevant Articles, and particularly Article V, Section 7(g) cannot be resorted to in exceptional cases if the Board so decides. But while the Board would have to satisfy itself that discharge on the due date would result in exceptional hardship, the burden of proof that such hardship would result must be on the country, and I did not sense much support in the Board for the use of this provision."

Mr. Ismael asked the staff to comment on the legality of the Board's decision not to apply certain provisions of the Articles.

The staff representative from the Legal Department replied that the Executive Board was the policymaking organ of the Fund. In using its power to apply the Articles, the Board was not obliged to make what appeared to it to be inappropriate use of provisions of the Articles, and he understood the summing up by the Managing Director as having been made accordingly. That was not to say that the provision in question would never be used, but rather that it would be used on a uniform basis, in the existing circumstances. At the time the decision was taken the Board had not considered it appropriate to use it in the kinds of situations presented to it, but that did not preclude the possibility of the Board deciding that there was adequate justification for using that provision in a particular case.

Mr. Nimatallah doubted whether Viet Nam had made a case of exceptional hardship. The country held about 400,000 ounces of unpledged gold valued at about $140 million. It had pledged more than 300,000 ounces to secure a loan of $100 million. As Viet Nam was willing to use some of its gold for emergency purposes, should it not also have been willing to pledge a few more ounces as collateral to borrow $18 million to repay the Fund? Using $18 million of its reserves would hardly halt the whole development program.

When the Executive Board had discussed the Fund's general policy on overdue payments in April, Mr. Nimatallah recalled, he had stated that overdue obligations were a potentially serious and growing problem, as recent developments confirmed. The list of countries with overdue obligations was getting longer and the amounts involved were getting larger. He had hoped that the Fund would have been able to formulate a clear policy that would leave no doubt about what would happen to those members who could, but did not, honor their obligations to the Fund. In the case of Viet Nam, it was clear that the authorities faced serious economic problems, but so did other developing countries that were meeting their Fund obligations. It was disappointing that Viet Nam, despite having been given ample opportunity to repay, had shown no serious intention of doing so, particularly since it had sufficient reserves.

Although he would have liked the Fund to take a tougher approach, Mr. Nimatallah concluded, he could support the proposed decision. If, however, Viet Nam had not repaid the Fund within three months, or at least had not taken specific steps in that direction, the Fund should consider further sanctions. He was certain that the Vietnamese authorities understood the serious consequences of not repaying the Fund, including the possible loss of other sources of finance. All members should cooperate to preserve the revolving character of the Fund's resources.

Mr. Fujino stated that it was unfortunate that no payments had been received from Viet Nam since the end of the previous month when the Board had discussed the problem of Viet Nam's overdue obligations, and that the authorities continued to feel that they would not be able to discharge their obligations to the Fund. Under the circumstances, the Fund had no alternative but to take the action stipulated in the Articles to limit the member's use of the Fund's general resources, as had been done on previous similar occasions. He supported the proposed decision.

Mr. Clark reiterated his authorities' concern about arrears to the Fund. Like Mr. Nimatallah, he attached a good deal of importance to the points made in the Acting Managing Director's telex to the Vietnamese authorities concerning Viet Nam's foreign assets, including gold, and

Viet Nam's inability to fulfill its financial obligations to the Fund. He had not found the response of the Vietnamese authorities satisfactory and in that light he supported the proposed decision. The Articles and Rules allowed the Board either to limit a member's use of resources or to declare it ineligible to do so. He wondered in what circumstances the Board would adopt the more formal alternative.

He welcomed the determination of the Vietnamese authorities to pursue a program of adjustment, Mr. Clark remarked; but he suggested that they might consider whether that end might not be better served by regularizing their position with the Fund.

Mr. Morrell stated that he could support the proposed decision; in the circumstances, any other course of action would have been inappropriate.

The staff had presented no information in EBS/84/142, Supplement 3 concerning the adjustment measures that might have been taken by Viet Nam, Mr. Morrell noted. Yet the Governor of the Fund for Viet Nam had referred in his telex to the Managing Director to a series of comprehensive economic management measures taken the previous June. He wondered whether the staff or Mr. Ismael could enlighten the Board concerning the nature of those adjustment measures; portions of that information might assist in resolving the problem.

Like Mr. Clark, Mr. Morrell considered that the best course for Viet Nam would be to regularize its position with the Fund; it must be made clear to the Vietnamese officials that they could not expect to make further use of Fund resources until that regularization had taken place.

Mr. Grosche said that his views were identical with those expressed by Mr. Nimatallah, Mr. Fujino, and Mr. Clark. He supported the proposed course of action.

Mr. Malhotra stated that his chair had always taken the position that it was important to maintain the revolving character of the Fund's resources. It had also held that rescheduling of members' obligations to the Fund could only be allowed in exceptional circumstances and that in general the Fund should not encourage an environment in which rescheduling became common. The Articles had, however, provided that, in exceptional cases, a member could submit its case to the Fund for consideration. It was essential that the staff discuss the matter with the member and then make a detailed report to the Board in which all the issues raised by the authorities would be examined and the merits of the case evaluated. That approach had not been followed in the case of Viet Nam.

Because the procedure followed so far had been unsatisfactory, he would reserve his position, Mr. Malhotra stated. He urged that, first, the Fund not decline to discuss the matter with the authorities, either in Hanoi or when the Vietnamese authorities came to Washington for the Annual Meetings. Such a refusal would not be in accord with either the letter or the spirit of the Articles of Agreement. Second, while management was free to form a judgment, a substantive report to the Board should have been made, in which the merits of the arguments put forward by the authorities were examined. The point was procedural, but it touched on the serious matter of the Fund's relationship with its members and the treatment of sovereign authorities.

Mr. Leonard stated that his chair supported the proposed decision.

Mr. de Vries said that the significance of Viet Nam's case was, first, that it reflected a serious problem. The list of countries with overdue obligations was lengthening, with serious implications perhaps not only for the Fund as an institution, but also for its borrowing members. After all, the Fund was able to grant members the use of its resources because other members exchanged their currencies for claims on the Fund.

Second, it was that concern for the revolving nature of the Fund's resources, Mr. de Vries recalled, that had led the Board to decide not to apply, as a first and general policy line, the provision of Article V, Section 7(g). According to that provision, the Fund could decide in certain circumstances, by a 70 percent majority, whether or not to postpone a repurchase obligation. The Executive Board had decided in April 1984 that it was not appropriate to apply that provision dealing with countries with overdue obligations.

Third, the Vietnamese authorities' argument that their gold holdings were illiquid might be relevant to the solution in their case, Mr. de Vries considered. Article V, Section 12(d) stated that "the Fund may accept payments from a member in gold instead of special drawing rights or currency in any operations or transactions under this Agreement. Payments to the Fund under this provision shall be at a price agreed for each operation or transaction on the basis of prices in the market." However, he understood from the statements made by the Vietnamese authorities and by Mr. Ismael on their behalf that that was not the main difficulty and that it was not their intention to repay the Fund in the near future.

The need to find ways to resolve the problem of the persistent failure of member countries to meet their obligations to the Fund was regrettable, Mr. de Vries observed. He asked whether the staff could prepare a study of the options available to the Fund if the problem continued.

Finally, Mr. de Vries stated, he supported the proposed decision.

Mr. Feito said that he also supported the proposed decision. However, the decision was unnecessarily narrow in scope; it concentrated on accounting details and ignored the country's economic circumstances.

If, as the nature of the decision suggested, the country's failure to settle its obligations stemmed from a lack of will on its part, the course of action proposed was not the correct one; but that was not the case, according to Mr. Ismael. Therefore, it would have been proper to take account in the decision of the economic difficulties the country was facing.

Mr. Templeman stated that he supported the proposed decision. As others had noted, many countries were currently experiencing international debt problems. Moreover, the Fund had always been considered a preferred creditor because its relationship with its members had widespread implications for the international economic community; thus, countries should assign very high priority to meeting their financial obligations to the Fund. He was not entirely convinced that that had been the case with Viet Nam.

With reference to the blocked accounts mentioned in the staff paper and by Mr. Ismael, Mr. Templeman confirmed the existence of blocked accounts of the Government of Viet Nam in the United States. The Board had been notified in 1975 that the accounts were being blocked, under the provision set forth in Decision No. 144-(52/51), for reasons related to the preservation of national and international security. That rationale still applied. Moreover, the United States had counterclaims against Viet Nam in excess of $500 million. Although the final amount had not yet been adjudicated, it was possible that no balances would remain after the claims had been settled.

Mr. Salehkhou said that he agreed with Mr. Malhotra that the staff report should have been more detailed. Moreover, he considered that the case of hardship was well established: Viet Nam had been at war for 30 years and was facing economic and political sanctions; the gold holdings and foreign exchange holdings available to the country as reserves were a matter of national security; Viet Nam had shown willingness and made all possible efforts to settle its outstanding obligations; and it was thus its inability to meet the obligations that prevented repayment. In the circumstances, he felt that by its nature, the Fund was required to cooperate.

Mr. Schneider remarked that he, like other Directors, was aware that the number of cases of overdue obligations was increasing and that the amounts were becoming larger. Therefore, as a matter of principle, and to safeguard both the Fund's credibility as an international institution and its borrowing capability, he supported the proposed decision.

Considering the economic situation of Viet Nam, Mr. Schneider added, he supported the request of Mr. Malhotra and Mr. Salehkhou for a further staff study in the next three months of whether the recent measures taken by Viet Nam would lead to an improvement of the balance of payments situation in due time. He also hoped that the Vietnamese authorities would respond positively; their adjustment efforts would be greatly helped by Fund assistance.

Mr. Nimatallah inquired whether the study proposed by Mr. Malhotra was the same as that proposed by Mr. Schneider.

Mr. Malhotra responded that he believed his request differed from that of Mr. Schneider. His concern was essentially procedural: the Vietnamese authorities had made several requests to management that it discuss with them the possibility of renegotiating their obligations; according to the staff papers, management had turned down those requests. He believed that a request from a member for exceptional treatment should be considered very seriously. Furthermore, he was of the opinion that the Board was entitled to a much more detailed assessment of that request in terms of Article V, Section 7, and also in terms of the recent decision to which the staff had referred.

He was not advocating that the Board should make it easy for countries to secure rescheduling, but rather that some provisions of the Articles should not be rendered nugatory, Mr. Malhotra said. The Board and management should not refuse to consider such requests, because in doing so they would fail to discharge their obligations and responsibilities under the Articles. He therefore suggested that it might be useful, if the Vietnamese authorities so wished, for them to discuss the matter further with management at the time of the Annual Meetings three weeks hence. A more detailed report could then be submitted to the Board. He was not prejudging the merits of the case but considered that additional clarification was required.

Mr. Schneider stated that, because he supported the decision as drafted, his proposal differed. Nevertheless, he invited the staff to look at the measures mentioned in Mr. Ismael's opening remarks to determine whether there had been a major improvement in Viet Nam's economic situation since the last Article IV consultation.

The staff representative from the Legal Department, responding to the procedural points raised by Mr. Malhotra, stated that the staff had acted under very carefully defined procedures. The Executive Board had decided on July 27, 1984 that it would discuss the matter of Viet Nam's overdue obligations to the Fund at the present meeting. The Vietnamese authorities had been notified of that decision and had been invited to present their views either through a specially appointed representative or their Executive Director. Those views had been conveyed to the Board by Mr. Ismael. There had been, of course, several discussions with the Vietnamese authorities during which the issues Mr. Malhotra had referred to had been considered in great detail. At the current stage, however, it was no longer a matter for discussion between management and the Vietnamese authorities, but a matter that the Vietnamese authorities, acting through their representative, had to present to the Board.

The staff had acted in light of the Board decision taken in April, which had placed emphasis on the uniform treatment of members, the staff representative observed. Exceptional cases had not been precluded, but in the present case the staff had acted under the Board's guidance, and in good faith.

The staff representative from the Treasurer's Department recalled that the original staff paper on Viet Nam's overdue obligations to the Fund had discussed the question of rescheduling and had described the discussions that had been held between the Fund mission and the Vietnamese authorities, as well as those held between management and the Vietnamese authorities. The decision under consideration was based in part on those discussions.

Furthermore, the staff representative remarked, in its communications with the Vietnamese authorities over the previous few weeks, the staff had been careful to explain both the Board's views on the matter and the guidelines under which it had been operating, and had quoted in its entirety the provision set out in the Chairman's summing up and quoted earlier in the meeting by the staff representative from the Legal Department. The staff had stressed the Board's view that the Fund should not encourage requests for rescheduling, that the burden of proof to establish the case for rescheduling did not rest with the Fund, and that the Board would have to react to a proposal for rescheduling if there were some substantiation of a case. The staff had tried to be fair and comprehensive in its explanation of the guidelines under which it was operating.

Mr. Donoso stated that he supported the proposed decision. He was, however, concerned about the procedures which had been followed, and he asked whether any attempt had been made to negotiate possible reschedulings prior to the present Board meeting.

The staff representative from the Legal Department responded that management had acted in accordance with the sense of the meeting held on April 5, 1984. The Executive Board had been reluctant to proceed in the direction of rescheduling, and management had taken its views into account.

Discussions on a more general basis had taken place and would continue at the Annual Meetings, the staff representative stated. The matter could not be resolved by a decision taken at the present meeting because Viet Nam had the continuing obligation to discharge its overdue financial obligations to the Fund; both the Vietnamese authorities and the Fund would persist in seeking ways and means to deal with the problem, and the staff and the management would appreciate the Board's guidance in formulating a suitable approach.

Mr. Sangare said that his chair supported, at least in principle, the proposed decision; the revolving character of the Fund's finances should be respected by all members, and the Fund should observe the principle of uniform treatment of all members. The fact that Viet Nam had gold holdings that could be used to repay the Fund had also persuaded him to support the decision.

However, Mr. Sangare continued, after listening to the opening statement of Mr. Ismael and the interventions of Mr. Malhotra and Mr. Donoso, he wondered whether it would be appropriate to take an immediate decision. Mr. Ismael had indicated that Viet Nam wished to fulfill its obligations to the Fund and had requested further discussions with the staff. He could go along with Mr. Ismael's request, and proposed that the Board postpone the decision until it had received detailed information from Viet Nam.

Mr. Nimatallah considered that the proper procedure had been followed. First, management had not accepted Viet Nam's suggestion that a Fund mission visit Hanoi to discuss a rescheduling because the Executive Board had rejected that approach in July. Second, Viet Nam had been informed that management could not discuss the possible use of resources by the member because it was in arrears to the Fund.

The Acting Chairman, commenting on the issue of procedure, re-emphasized that a great deal of time and care was being spent by the staff and management on what was, as Directors had stated, a growing problem. In each case, management and staff had acted within the guidelines laid down by the Board during its discussion in April of the general policy issue and also in the course of its consideration of individual cases. Every effort had been made to apply the agreed principles in a uniform way. If those procedures were now being questioned, the Executive Board could, if it so desired, reconsider them as a separate issue.

Mr. Templeman considered that the staff had acted in keeping with the guidance which it believed it had received. He would have been very disturbed had the Fund staff gone to Viet Nam to negotiate a postponement because that had clearly not been what the Board had had in mind when it had discussed the issue earlier. Similarly, the Board had had an opportunity to review Viet Nam's arguments for making an exception in its case, as the documents under discussion and Mr. Ismael's statement showed. The Board had also recently concluded the 1984 Article IV consultation with Viet Nam. Therefore, if the Executive Board wished, it could decide whether or not exceptional treatment for Viet Nam was justified. As he had not discerned widespread agreement in favor of such treatment, he considered that there was no need for postponing the decision or for further study.

Mr. de Vries said that he had reached the same understanding as Mr. Nimatallah about the decision adopted by the Board in July. He therefore considered that the staff had followed the proper course of action.

Mr. Tshishimbi said that he agreed with Mr. Malhotra that it would be imprudent for the Board to decide, as a general rule, to ignore certain provisions in the Articles of Agreement. With regard to the general problem of arrears, if special cases of hardship arose, the Board should consider them on their merits, based case by case on an in-depth analysis by the staff. If the Executive Board determined that hardship existed, it might be willing to be more lenient than if it considered that the member had not made a case of hardship at all.

Mr. Nimatallah remarked that while he agreed that management had acted properly so far, he could also agree with Mr. Malhotra on the appropriate course to be followed in future. It might be useful to determine, in the light of Article V, Section 7(g), whether or not Viet Nam was actually suffering from exceptional hardship. The Executive Board could then take up the matter squarely when it reviewed the decision it was being asked to adopt at the present meeting.

Mr. de Vries noted that on July 27, the Board had taken a decision that had subsequently been implemented. On rereading the communications between the Fund and the authorities in EBS/84/142, Supplement 3, he had noticed that exceptional hardship had been mentioned for the first time in a communication dated August 21, received in the Fund on August 22. Since the Board had taken a decision in principle that it would not, as a matter of policy, apply the hardship provision, how did the staff propose to handle that issue?

Mr. Malhotra remarked that the Board had taken the position that it did not favor resorting to the rescheduling provision as a general rule. However, if exceptional circumstances were found to exist, a request for rescheduling would have to be considered; whatever the Board had decided on July 27, the provision existed, and when it was invoked by a member, it would only be fair to examine the merits of the case. He reiterated that a further examination of Viet Nam's situation was necessary, preferably in consultation with the authorities.

The Acting Chairman said that he wished to underscore the Managing Director's statement, in his summing up of the discussion in the Board on April 5 regarding the rescheduling or postponement of obligations. The statement read: "The Executive Board clearly does not wish to open the way for rescheduling of obligations. The staff arguments on the point were clearly found convincing and were supported by the Board. This does not mean that the relevant Articles, particularly Article V, Section 7(g) cannot be resorted to in exceptional cases if the Board so decides. But while the Board would have to satisfy itself that discharge on the due date would result in exceptional hardship, the burden of proof that such hardship would result must be on the country, and I did not sense much support in the Board for the use of this provision." As he understood it, Mr. Malhotra was suggesting a special Fund mission to Viet Nam to explore with the authorities whether or not a case of exceptional hardship could be made. That was one of the issues before the Board on which he looked for guidance from Executive Directors.

Mr. Fujino stated that on such a basic question as arrears, the Executive Board would set an important precedent if it deviated from the agreed guidelines. In his view, enough consideration had been given to Viet Nam's situation, and the Board should adhere to the procedures followed on previous occasions.

Mr. Templeman remarked that the Board would surely want to act reasonably quickly to deal with cases of overdue obligations as they arose. The possibility of a mission to Viet Nam had been raised; would the Board be expected to wait several weeks before taking any action? If so, would it be treating Viet Nam more favorably than other members in similar situations?

Mr. Nimatallah suggested that the proposed decision be adopted and that, within the three months provided for its review, the staff should examine whether Viet Nam was a case of exceptional hardship.

Mr. de Vries observed that the Board generally took two types of decisions: general policy decisions and decisions implementing those policies. The Board was currently concerned with the implementation of a policy decision; its previous decision that the burden of proof was on the country to demonstrate exceptional hardship still stood, and he had heard little to substantiate its existence in Viet Nam.

The other issue before the Board was whether its April decision had been appropriate, Mr. de Vries noted. He suggested that, if some Executive Directors so desired, the Board could review its policy decision before the Annual Meetings and, in the light of the discussion, reconsider the case of Viet Nam.

Mr. Grosche stated that he would be very hesitant to deviate from the procedures agreed in April the first time a case of hardship came before the Board. Viet Nam had had sufficient time to explain the hardships it would face in meeting its obligations, most recently on the occasion of the 1984 Article IV consultation. In his view, its situation did not compare unfavorably with that of other member countries in arrears to the Fund.

Mr. Clark said that he agreed with Mr. Grosche and would be happy to maintain the existing procedural arrangements.

The staff representative from the Legal Department observed that the discussion had led to a feeling on the part of several Directors that the case of Viet Nam had not been adequately considered by the staff and management before a conclusion had been reached. He wished to point out, however, that the proposed draft decision implied a finding by management and the staff that the case for a postponement of Viet Nam's repurchase obligations in the present instance had not been made. Account had been taken of the Board's decision that it would be reluctant to accept exceptional hardship as justification for postponement, although it might overcome its reluctance in some justified cases. The management and staff were of the view that the case of Viet Nam did not meet the standard set by the Board, based upon careful consideration of the evidence. The discussions with the Vietnamese authorities had taken place over a long period of time, and the Board had recently had the opportunity to express its views when it had considered the staff report for the 1984 Article IV consultation.

The Director of the Asian Department said that he wished to draw the attention of Executive Directors to the first sentence of the Acting Chairman's summing up at the conclusion of the Board's discussion of the 1984 Article IV consultation with Viet Nam on June 18, 1984: "Executive Directors noted the relatively favorable trend in output in recent years as well as the significant reduction in inflation, in the budget deficit, and in the external accounts in 1983." Viet Nam of course had been current in discharging its obligations to the Fund in 1983. Gross international reserves were rather low in terms of imports, but many other members in a similar situation had discharged obligations to the Fund on time.

As for the measures taken by Viet Nam in June, the Director recalled that the Acting Chairman had mentioned in his summing up that Executive Directors had suggested a number of adjustment measures that would affect the exchange rate, the budget, monetary conditions, and economic management. The Vietnamese authorities had not informed management of the precise nature and scope of the measures adopted in June, and the staff has therefore been unable to assess the likely adjustment they would entail.

Finally, the Director of the Asian Department remarked, the staff had been constantly in touch with the Vietnamese authorities and had been outlining in detail the steps they should be taking and the steps that the Executive Board would be taking if they did not meet their obligations.

Mr. Nimatallah recalled that he had asked whether the staff had reached a conclusion concerning whether or not Viet Nam faced exceptional hardship. Although it had not been explicitly stated in the staff paper--and he agreed with Mr. Malhotra that it should have been--it was apparent that the staff had found that Viet Nam faced no greater hardship than other countries in a similar position that had met their obligations to the Fund. Therefore, he joined those Directors who considered that Viet Nam should not be accorded special treatment.

Mr. Malhotra said that in the absence of a detailed report on the hardship issue, his chair did not possess sufficient information on which to reach a conclusion, even after having heard the explanations given by the staff. He had noted from the staff report for the 1984 Article IV consultation (SM/84/114, 5/18/84) that Viet Nam's reserves were supposed to have increased slightly, but that gross reserves were minuscule; while gold holdings valued at $42 an ounce were stated to be $31 million, liabilities secured by gold were of the order of $102 million.

Besides, the Fund had to view hardship in a somewhat broader perspective, Mr. Malhotra remarked. Because no in-depth assessment had been provided, he was unable to agree with the view that there was no exceptional hardship in Viet Nam's case. Similarly, he noted that the staff had not made a comparison with other cases. A full assessment and comparative analysis would have made it possible for the Board to determine conclusively whether or not there had been uniform treatment. In the case of Chad, for example, the Board had come to the conclusion that, although foreign exchange had been available, obligations could not have been met because of budgetary problems. That example seemed to illustrate the need for a more comprehensive staff study that would show clearly whether or not Viet Nam's case was exceptional.

Mr. de Vries stated that he respectfully disagreed with Mr. Malhotra. He understood that the Board had decided that, in the application of Article V, Section 7(g), it would take the position that the burden of proof was on the member concerned; that policy decision stood until it was changed. It was therefore encumbent upon the Vietnamese authorities to document hardship, which they had not done so far.

Mr. Morrell observed that the relevant section of the Article referred only to the hardship resulting from the discharge of the obligation; it did not discuss general hardship. As Directors had noted, quite a number of developing countries were experiencing general hardship. It was not necessary for the Board to come to a judgment about the overall situation of Viet Nam but only about what would happen upon the discharge of its obligations to the Fund. As Mr. Nimatallah and Mr. de Vries had noted, those obligations could be discharged by the use of some of Viet Nam's gold; but Mr. Ismael had clearly indicated that the authorities had decided not to use their gold holdings, which were regarded as necessary for security reasons. It was therefore difficult to come to any other conclusion than that no hardship would have resulted from Viet Nam discharging the obligation.

The staff representative from the Legal Department responded that Mr. Morrell's interpretation was correct. Moreover, the concept of exceptional hardship was difficult to apply. The general condition of hardship that many countries were currently experiencing was one of the reasons for the adoption of the April decision. In that decision, the Board had made an effort to act uniformly in light of the Fund's special role in dealing with cases of hardship.

The staff had had little experience with what constituted hardship justifying postponement, the staff representative continued. A request for postponement had been considered reasonable in earlier cases that were not based on claims of exceptional hardship if a member demonstrated unusual difficulty in discharging its obligations on schedule and if there was a sound basis for expecting that the postponement would clearly contribute to the discharge of the obligation at some later time that would be consistent with the temporary use of the Fund's resources as provided specifically in the Articles. In the few cases in which the Fund had taken a decision since the Second Amendment to permit the later discharge of an obligation, the expectations of later settlement had not been realized; that experience had contributed to the decision in April establishing the position for postponement both within the original period for repurchase and beyond that period in case exceptional hardship would result from the discharge of the obligations on the due date.

In the case of Viet Nam, the staff representative continued, staff and management had found no justification for postponement in that sense. In fact, the Vietnamese authorities had made no promise whatsoever to pay on specific dates; they had made a general statement about a medium-term postponement being necessitated by conditions, but it had not seemed clear to the staff that the postponement of the discharge of the obligations would have contributed in any way to their meeting the obligations in the future. As the Director of the Asian Department had explained, not much economic improvement was expected unless some important policy changes were made.

The Acting Chairman noted first that it was his view that the Board was ready to approve the decision proposed in the staff paper. Second, he had not seen general support for a change in the procedure outlined by the Board in April for dealing with overdue obligations. In that connection, he observed that the procedure provided the opportunity for the country involved to make the case to the staff and management, and ultimately to the Executive Board, that it qualified on the ground of exceptional hardship for treatment different from that outlined in the general principles laid down in April. Third, the decision called for a review within three months, during which time it would be up to Viet Nam to make its case of exceptional hardship to the staff, management, and the Board, and then it would be up to the Board to decide.

If management and staff had reached a judgment that exceptional hardship existed, and that there was a case for postponement, then it would have presented that conclusion to the Executive Board, the Acting Chairman said. According to the procedures, however, it would not be appropriate for management to make the case to the Board that the hardship criterion had not been satisfied; that determination would be up to the Board, based on the presentation of the government involved. If in any case the staff and management determined that a country had presented sufficient justification for exceptional treatment on the basis of exceptional hardship, it would present the case to the Board. On the other hand, if the case for exceptional hardship had been asserted but had not been substantiated, as in the present case, staff and management could only forward an appropriate draft decision to the Board and leave it to the representative of the government to present a case to the Executive Board at the time the decision was considered.

In concluding, the Acting Chairman mentioned that there had also been Directors who had felt that more decisive action should have been taken than had been proposed in the draft decision.

Mr. Nimatallah inquired whether any special meaning was attached to the wording of paragraph 4(b) in which it was stated that the right of Viet Nam to use SDRs would be suspended until such time "as Viet Nam is fulfilling its obligations," rather than "has fulfilled its obligations."

The staff representative from the Legal Department explained that it would be possible to use the formulation, "until such time as Viet Nam is current on its obligations," which would be analogous to paragraph 4(a) of the decision with respect to use of the general resources. The staff had tried to maintain the language in Rule S-1. No special technical meaning was attached to the formulation used.

Mr. Nimatallah considered that the verb "is fulfilling" suggested the country could utilize the SDR.

The staff representative from the Legal Department responded that continuous action connoted that a country had not only come into compliance after being out of compliance but also was continuing in compliance. That might be a difficult concept to apply, but there was a logical point, namely, that the country should not merely have been acting on a timely basis in meeting a particular obligation but that it should have been acting on a continuing basis to meet its obligations. He was not troubled by the formulation as it appeared in the draft. However, in light of the ambiguity which Mr. Nimatallah had detected, the staff would be willing to take another look at the language and consider for the future whether to use the formulation employed with respect to the General Department, namely, that the country was "current on its obligations."

The decision was:

1. The Managing Director has reported under Rule K-1 and Rule S-1 of the Fund's Rules and Regulations to the Executive Board the facts on the basis of which it appeared to him at the dates of these reports that Viet Nam was not fulfilling its obligations under the Articles of Agreement and submitted complaints on July 25, 1984 (EBS/84/142, Sup. 1) in accordance with those rules. The complaint under Rule K-1 was that as of July 24, 1984 Viet Nam was not fulfilling its obligations relating to repurchases and the payment of charges in the General Department in the total amount of SDR 8,032,771. The complaint under Rule S-1 was that as of July 24, 1984 Viet Nam was not fulfilling its obligation to pay charges in the SDR Department in the total amount of SDR 3,152,581. Furthermore, the Managing Director added to his complaints a notice of the facts on the basis of which it appeared to him that as of July 24, 1984 Viet Nam was not fulfilling its obligations under Decision No. 5069-(76/72) on the Trust Fund to repay a disbursement and to pay interest in the total amount of SDR 2,720,389. These facts, and the complaints and notice of the Managing Director have been communicated to the authorities of Viet Nam.

2. Taking into account the further obligations of Viet Nam that have become overdue since July 24, 1984, Viet Nam's overdue obligations to the Fund have increased to SDR 8,532,399 in the General Department, SDR 4,324,189 in the SDR Department, and SDR 5,290,130 under the Trust Fund.

3. Having considered the reports of the Managing Director, the complaints and the notice, and the views of Viet Nam, the Fund finds that Viet Nam has failed to fulfill its obligations under the Articles of Agreement and the Trust Fund as stated in 1 and 2 above.

4. The Fund regrets the nonobservance by Viet Nam of its obligations and urges Viet Nam to resume their observance forthwith. The Fund decides

(a) pursuant to Rule K-2 of the Fund's Rules and Regulations that Viet Nam shall not make use of the general resources of the Fund until such time as Viet Nam is current on its obligations under the Articles of Agreement relating to repurchases and the payment of charges in the General Department,

(b) pursuant to Article XXIII, Section 2(b) of the Articles of Agreement to suspend the right of Viet Nam to use SDRs it acquires after the suspension until such time as Viet Nam is fulfilling its obligations to which that provision applies, and

(c) if Viet Nam were otherwise eligible to make use of the general resources of the Fund, to take into account the existence of any overdue obligation to the Trust Fund in considering any request by Viet Nam for the use of the general resources.

5. The Fund shall review this decision within a period of three months from the date of the decision.

Decision No. 7791-(84/129), adopted
August 29, 1984

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/84/128 (8/27/84) and EBM/84/129 (8/29/84).

3. EXECUTIVE BOARD TRAVEL

Travel by an Advisor to Executive Director as set forth in EBAP/84/132, Supplement 1 (8/27/84) is approved.

APPROVED: May 30, 1985

JOSEPH W. LANG, JR.
Acting Secretary