INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 83/29

10:00 a.m., February 14, 1983

J. de Larosière, Chairman
W. B. Dale, Deputy Managing Director

Executive Directors	Alternate Executive Directors
	J. K. Orleans-Lindsay, Temporary
	C. Taylor
	L. E. J. Coene, Temporary
B. de Maulde	
A. Donoso	
	C. Dallara
	M. A. Janjua, Temporary
	I. R. Panday, Temporary
	T. Yamashita
	D. I. S. Shaw, Temporary
A. Kafka	
G. Laske	P. Kohnert, Temporary
	C. P. Caranicas
	A. S. Jayawardena
Y. A. Nimatallah	S. El-Khouri, Temporary
	A. Halevi, Temporary
A. R. G. Prowse	
G. Salehkhou	O. Kabbaj
F. Sangare	E. I. M. Mtei
	S. E. Conrado, Temporary
	L. Vidvei
Zhang Z.	Wang E.

L. Van Houtven, Secretary
B. J. Owen, Assistant

Also Present

African Department: J. B. Zulu, Director; O. B. Makalou, Deputy Director; E. A. Calamitsis, F. d'A. Collings, C. Enweze, S. M. Nsouli. Asian Department: M. Z. Khan. Exchange and Trade Relations Department: W. A. Beveridge, Deputy Director; S. Mookerjee, Deputy Director; S. Kanesa-Thasan. Fiscal Affairs Department: E.-A. Conrad. Legal Department: Ph. Lachman, J. V. Surr. Research Department: W. C. Hood, Economic Counsellor and Director; K.-Y. Chu, N. M. Kaibni, P. R. Menon. Secretary's Department: A. P. Bhagwat. Western Hemisphere Department: E. Wiesner, Director. Personal Assistant to the Managing Director: N. Carter. Advisors to Executive Directors: A. A. Agah, E. A. Ajayi, J. R. N. Almeida. Assistants to Executive Directors: J. Bulloch, T. A. Connors, R. J. J. Costa, J. A. K. Munthali, J. G. Pedersen, P. Verly, J. C. Williams, A. Yasseri, Zhang X.

1. WORK PROGRAM

The Chairman noted that in paragraph 6 of its press communiqué issued on February 11, 1983, the Interim Committee had requested the Executive Board to adopt the necessary decisions and other actions before the end of February 1983, to implement the consensus reached in the Committee. The management and staff would do everything possible to provide the Executive Board with the necessary documents in good time so that the consideration by Executive Directors of the Eighth General Review of Quotas and of the revision of the General Arrangements to Borrow could be completed by February 28, 1983. Those documents would include material on the new quotas stemming from the agreement reached in the Interim Committee, a paper on a possible special adjustment of very small quotas, namely, those that were currently below SDR 10 million; the draft Report by the Executive Board to the Board of Governors and the draft Resolution on the Eighth General Review of Quotas; and, finally, the draft decision on the revision and expansion of the General Arrangements to Borrow, together with a commentary on that decision. He proposed to place those matters on the agenda of a meeting to be called on Thursday, February 24, for a final decision on that day if possible, or--if not--shortly thereafter.

The Deputy Managing Director remarked that Executive Directors might wish to give some thought to the participation requirement that would have to be met before the eighth quota increase could come into effect. For that purpose, in the past it had been necessary for members having at least 75 per cent of total quotas to consent to the increase in their quotas under the Seventh General Review. In addition, individual members then had to make the necessary subscription payments for their new quotas to become effective. It would be necessary for the Executive Board to decide whether a similar percentage or, as on one previous occasion, a two-thirds participation requirement, should apply to the eighth general quota increase.

The Chairman noted that Executive Directors should be ready to state their views on those and other matters on February 24. Meanwhile, he extended his thanks to the Executive Board for the work that had paved the way for the agreement in the Interim Committee.

Mr. Kafka asked that the 1982 Article IV consultation with Brazil, together with Brazil's request for an extended arrangement and use of Fund resources, should be considered by the Executive Board on February 28, 1983, somewhat earlier than the appropriate date under the Board's usual procedures.

After a brief discussion, the Executive Directors suggested that the Secretary should rearrange the items scheduled at present for discussion on February 25 and 28 as necessary.

2. SIERRA LEONE - PURCHASE TRANSACTION - COMPENSATORY FINANCING FACILITY

The Executive Directors considered a staff paper on a request by Sierra Leone for a purchase equivalent to SDR 20.7 million under the compensatory financing facility (EBS/83/14, 1/18/83; Sup. 1, 2/14/83).

Mr. Sangare made the following statement:

I should like to express the appreciation of my Sierra Leonean authorities to the staff for the manner in which it has approached the request for a drawing under the compensatory financing facility in an amount equivalent to SDR 20.7 million. The staff has been forthright in their approach to the problems confronting Sierra Leone, and the paper before the Executive Board today is clear and concise.

In recent years the balance of payments position of Sierra Leone has been under considerable pressure as current account deficits have remained high. In the three years up to 1981/82 the current account deficits were well over 15 per cent of gross domestic product. The overall deficit widened from 3.9 per cent of GDP in 1979/80 to 10.4 per cent in 1981/82. This situation very largely reflects sharp reductions in export earnings and relatively high import demand at a time when long-term capital inflows were declining. The country's external reserves fell from the equivalent of 4.9 weeks of imports in 1979/80 to only 1.8 weeks of imports in 1981/82, and external payments arrears accumulated at a rapid pace. The external payments situation is expected to remain difficult in 1982/83 despite some improvement in the current account position.

As indicated in the staff report, the shortfall in export earnings has resulted from an interplay of adverse factors largely outside the control of the Sierra Leonean authorities. In the case of diamonds, the country's main export commodity, the shortfall resulted mainly from reduced output and low export prices reflecting, in particular, adverse external demand developments and domestic financial and economic conditions, which made it difficult for the mining industry to import the equipment needed to exploit the less accessible deposits. The situation was aggravated by illicit trade practices which, though difficult to quantify, have prompted strong and concerted action by the authorities. To this end, they have introduced a dual exchange rate system with a view to discouraging smuggling, encouraging exports through official channels, and more generally improving the balance of payments position.

With regard to bauxite, cocoa, coffee, and other miscellaneous exports, the shortfalls were also a result of either volume-related factors or export price developments. The prolonged recession in the world economy, particularly in the industrial countries, affected the output of most of these exports, notably bauxite. In the case of coffee, unit values declined by 14 per cent in the shortfall year.

Following the difficulties experienced with the extended arrangement in the second half of 1981, which led to its cancellation, the Sierra Leonean authorities have maintained close consultation with the Fund through the resident representative and staff missions. In the context of the last Article IV consultation, concluded in June last year, the authorities have demonstrated their desire to achieve a viable balance of payments position by implementing strong measures, including substantial increases in producer prices for coffee, cocoa, palm kernels, and ginger with a view to encouraging production. As already indicated, they have also adopted a dual exchange rate system under which over half of Sierra Leone's exchange transactions are expected to be carried out at the market rate. On the fiscal front, the authorities have also taken action to reduce the deficit for the present fiscal year ending in June 1983. The authorities are hopeful that the measures they have put in place will encourage production, expand exports, and lay the foundation for a new adjustment program for which they intend to seek Fund assistance. Discussions with the staff on such a program will be held shortly in Freetown.

In the light of the foregoing, it is clear that Sierra Leone faces a difficult balance of payments situation. The authorities have maintained cooperation with the Fund and have recently taken initiatives aimed at redressing the country's balance of payments problems. The Board may also wish to note that the staff agrees that the Sierra Leonean request meets all the requirements of the compensatory financing decision. Accordingly, I should like to urge Executive Directors to approve the draft decision on page 14 of EBS/83/14.

Mr. Dallara remarked that his authorities were satisfied that Sierra Leone had a balance of payments need, that the export shortfall was of a temporary character, and that the member had clearly met the cooperation requirement. The comprehensive treatment by the staff of developments in Sierra Leone's economic policies over the past two years had been helpful in reaching a judgment relating to the test of cooperation. The Sierra Leonean authorities were to be commended for the manner in which they had moved to introduce appropriate changes in fiscal, producer pricing, and exchange rate policies in recent months--areas in which his chair and others had previously supported action. He welcomed the maintenance of close contacts with the Fund and the effective way in which the authorities had collaborated with the staff during its visits subsequent to the Article IV consultations held in June 1982.

However, Mr. Dallara continued, the criteria that had been successfully met by Sierra Leone provided the necessary but not the sufficient conditions for a drawing under the compensatory financing decision. His authorities were not satisfied that the shortfall in export earnings was due to circumstances largely beyond the control of the member. Specifically, they had serious reservations about the impact of the smuggling of diamonds on the calculated shortfall and the extent to which the smuggling might be the result of government policies, particularly the overvalued exchange rate that had prevailed until the introduction of a dual exchange rate system in December 1982. The staff had said that because data on the amount of smuggled diamonds were not available, it was not possible to determine how much of the decline in volume of recorded diamond exports in the shortfall year was due to smuggling as opposed to a general decline in diamond production and world demand. He recognized the serious difficulties, but the staff might have been able to make quantitative judgments about the expected reduction in smuggling in the two postshortfall years due to recent exchange rate measures, as the staff had stated that the shortfall resulted partly from a projected recovery in recorded export volumes based on the recently adopted exchange measures. It was rather difficult to understand how the staff could make at least rough estimates of the reduction in the levels of smuggling in future years and yet be unable to provide even approximate estimates of the extent to which smuggling might have been a factor in the shortfall year, a period that had ended more than seven months before. He would not be so concerned were it not for the fact that 87 per cent of the total shortfall was accounted for by diamonds.

In reviewing the information and the reasons advanced by the staff on page 8 of EBS/83/14 as underlying its overall judgment that the shortfall was largely attributable to factors beyond the control of the member, he had difficulty agreeing with all of the staff's points and, accordingly, difficulty in reaching the same conclusion, Mr. Dallara observed. He had particular problems with the implications of the statement that the shortfall was in part the result of a projected recovery in recorded export volumes based on the recently adopted exchange measures, which were consistent with the broad policy recommendations offered by the Fund in recent years. The implication was that, as the policies that might have been contributing significantly to the shortfall had been changed for the better, the extent to which they had contributed to the shortfall should be discounted.

That line of argument, Mr. Dallara maintained, was consistent with the line of reasoning put forward in the staff paper on the general meaning of a "shortfall attributable to circumstances beyond the control of the member" (EBS/82/42, 3/12/82). The relevant passage, referring to situations in which policies had previously been somewhat inappropriate but might have been shifted in an appropriate direction, stated that even in circumstances where "part of the calculated shortfall may be directly ascribed to the implementation of corrective policies, the practice has been to consider that, upon the implementation of policy changes, the shortfall is largely attributable to circumstances beyond the control of the member." As his chair had indicated at EBM/82/39 and EBM/83/40 (4/2/82), the U.S. authorities did not support that line of argument. Where a member had corrected inappropriate policies, put into place a comprehensive adjustment program, and was seeking support from the Fund, such support should take the form of a stand-by arrangement, if the Fund was fully satisfied that the member's adjustment efforts provided a sound basis for restoring domestic and external stability. When a member had not yet fully put into place such policies, use of the Fund's resources under the compensatory financing decision was not the appropriate way to deal with the problem.

He fully supported and commended the Sierra Leonean authorities for the important and courageous policy steps that had been taken to correct the balance of payments problem, Mr. Dallara went on. He encouraged the authorities to put into place the full range of policies necessary to restore the balance of payments to a sustainable position in the medium term. His position was not one of lack of support for the important efforts of the Sierra Leonean authorities; rather he had difficulty with the specific criteria that had to be met for use of the compensatory financing facility. He recognized that Sierra Leone's case was difficult because there were a number of uncertainties. A small part of the shortfall was due to nondiamond exports, and the diamond export shortfall itself was clearly partly attributable to factors beyond the member's control, including a weakening of world demand for diamonds.

Nevertheless, Mr. Dallara concluded, his chair remained unconvinced that the shortfall was attributable to factors largely beyond the control of the member, and could not therefore support the proposed request. But in light of the uncertainties surrounding the request, and the measures that had been taken by the authorities, his authorities would reserve their position.

Mr. Taylor said there could be no doubt that Sierra Leone was in urgent need of help from the Fund. The country's situation had become critical in many respects: readily usable reserves were virtually exhausted, and important arrears had accumulated on commercial and debt service payments. The shortage of basic commodities, such as oil and other essential imports, was serious. Clearly, therefore, Sierra Leone had a pressing balance of payments need. Yet his authorities did not feel that the economic situation was beyond repair if the right policies were followed, with the advice and support of the Fund.

Relations between Sierra Leone and the Fund, Mr. Taylor continued, had not been very happy in recent years, but there were signs of a new beginning. The authorities, as Mr. Dallara had said, had shown awareness of the need to take firm measures, and had made a number of important policy changes. The introduction of the dual exchange rate system was the welcome first step toward the eventual establishment of a more realistic unified exchange rate for the leone. Having adopted that system, it would be important for the authorities to allow tenders for foreign exchange in the commercial market to be made freely; otherwise, there would be a risk of creating a parallel market or a third window, which could undermine the whole basis of the competitive tendering system.

The authorities were to be commended for implementing substantial increases in producer prices for the principal cash crops, Mr. Taylor remarked; the increases should stimulate production and contribute to the moderate recovery of export earnings projected by the staff. It was encouraging to learn that the Government had adopted a revised budget for the present fiscal year that envisaged a reduction in the overall deficit relative to GDP. He noted from Mr. Sangare's statement that action had already been taken to that end. His authorities set considerable store by the statement in the staff paper that the formulation of a comprehensive stabilization program that could be supported by a stand-by arrangement seemed within reach. His chair would watch developments in that respect very closely. In the meantime, he accepted the staff's view that the authorities were willing to cooperate with the Fund in an effort to find appropriate solutions for their balance of payments difficulties.

One aspect of Sierra Leone's situation was causing his authorities considerable concern, Mr. Taylor observed, namely, the existence of important exchange restrictions, which the staff had not recommended approving. He was thinking in particular of restrictions on current international transactions, including large external payments arrears. Those restrictions could not be dismissed as being of minor importance, as the staff had recognized. His authorities regarded it as essential that steps should be taken to reduce those restrictions as soon as the situation permitted. He was therefore glad to note that the authorities recognized that understandings along those lines would need to be included in any forthcoming arrangement with the Fund.

As for the export shortfall, Mr. Taylor expressed agreement with Mr. Dallara that how far it could, in all conscience, be attributed to circumstances beyond the control of the authorities was open to question. The bulk of the shortfall was apparently associated with a reduction in receipts from diamond exports, due surely in part to a falling off of world demand but also in some part to the authorities' persistence in maintaining until recently an unrealistic official exchange rate. The staff had said that an element in the shortfall had been the exceptional growth of smuggling, encouraged in recent years by the deterioration in Sierra Leone's general economic situation; yet the staff's conclusion implied that variations in the extent of smuggling were essentially beyond the control of the authorities. That conclusion was at least arguable. The exceptional degree of smuggling might be associated with an unrealistic exchange rate. Certainly, the relative contribution of those various factors was difficult to decide, and a more explicit or at any rate more straightforward treatment of those issues in the staff paper would have been welcome.

Bearing in mind all the circumstances, most of all the determined efforts that the authorities were currently undertaking to tackle their problems, and not forgetting that the proposed purchase was below 50 per cent of quota, he would, on balance, support the decision, Mr. Taylor stated, but he did so with some misgivings relating in particular to the causality of the shortfall. He could only hope that, with the support of firm domestic measures, the new exchange arrangements would remove the incentive for the exceptional degree of illicit diamond trading and begin to set the export situation right. He also hoped very much that progress could be made toward agreement on a stand-by arrangement.

Mr. Kohnert observed that a significant element of judgment had to be exercised in order to reach a conclusion whether Sierra Leone's request for a compensatory drawing was justified. He also had doubts whether the shortfall, the major part of which was accounted for by diamonds, was largely attributable to factors beyond the control of the authorities. The staff obviously shared those doubts, having devoted considerable attention to the matter in its paper. Besides weak world demand for diamonds and the depletion of easily accessible deposits, smuggling also seemed to be a cause of the shortfall. It could be argued that the export shortfall was not affected by smuggling, if illicit trade was a permanent feature in Sierra Leone and had not taken on added importance in the period in question. But the increase in smuggling had certainly been triggered by an unrealistic exchange rate, which had led some producers at least to seek a better return. The exchange rate had clearly become progressively unrealistic over time; otherwise, the authorities' sudden expectation that a new dual exchange rate system would promote diamond exports through official channels would be groundless. It was evident that the authorities had to be held responsible for the impact of misguided policies relating to the exchange rate and export development; but he realized how difficult it was to distinguish between the impact on exports of weak world demand and of smuggling, and indeed he had not found a satisfying answer in the staff paper in that respect.

Another interrelated aspect of smuggling was the existence of an unknown number of illicit diggers, Mr. Kohnert observed. The authorities intended to remove incentives to smuggling by conducting a more realistic exchange rate policy, and the recently established commercial rate should be a first step in the right direction. It was not clear to him whether illicit trade should be channeled through the official market; in fact, how could unauthorized diggers be expected to bid for foreign exchange in the commercial market? He invited the staff to elaborate on the matter.

On cooperation, Mr. Kohnert commented, the Sierra Leonean authorities seemed to be in close touch with the staff, and to be trying to find appropriate answers to their serious external problems. The staff had indicated that it would be possible to conclude a stand-by arrangement in the foreseeable future. He wondered why an agreement had not been reached with the Sierra Leonean authorities following the three missions to the member country in 1982. Perhaps the staff could provide further information about various problems, including especially how external payments arrears that were not covered by the announced rescheduling would be treated. Should the staff bring a program before the Executive Board, he hoped that it would include a major reform of the present exchange rate system.

Finally, Mr. Kohnert said that he could support the proposed decision, but with some hesitation because Sierra Leone had delayed the implementation of adjustment measures that would strengthen the performance of the economy;

to a certain extent, that delay had affected exports, the shortfall of which the Executive Board was being asked to compensate. Nevertheless, on balance, he would give Sierra Leone the benefit of the doubt.

Mr. Kafka commended the staff for the clarity with which it had tackled the basic question of the extent to which the export shortfall was within or without the control of the authorities. He would defer to the staff's expertise and take the view that on balance the shortfall was beyond the control of the country. There was always a degree of uncertainty surrounding problems of compensatory financing, and it seemed advisable to accept the considered judgment of the staff and, whenever there was any doubt, to give the benefit of it to the member.

Mr. Prowse joined others in noting that it was certain that Sierra Leone had a balance of payments need. In addition, it was hard not to agree with the staff that on balance the export shortfall had been outside the control of the authorities.

The need for a comprehensive adjustment program was quite evident, Mr. Prowse considered, and he wondered whether it would be possible for the staff to go beyond the statement in its appraisal that "based on these major policy initiatives and on the discussions already held between the authorities and the staff, formulation of a comprehensive stabilization program which could be supported by a stand-by arrangement now seems within reach." Although the prospect of a closer relationship with the Fund did not bear on the proposed decision, because all that was required of the authorities for the compensatory drawing was that they had been cooperating, it would be helpful to have some idea of the nature and possible timing of a program.

It would also be of interest to him, from a more technical point of view, to hear the staff's views on the case for and against a dual exchange rate system, Mr. Prowse added. Would it have been better simply to unify the rate at the present time?

He had noticed that the shortfall related to the period ended June 30, 1982, Mr. Prowse went on. As he understood it, however, under the compensatory financing decision, requests for drawings were to be made within six months of the shortfall period. For his own guidance, he would find it useful to know whether the lag had any significance.

The Sierra Leonean authorities had been receiving technical assistance in the central banking area since 1979, Mr. Prowse observed. The quality of the data presented in the staff paper suggested that a case could also be made for technical assistance in the statistical area, with specific reference to the development of the balance of payments statistics.

Mr. El-Khouri said that he supported Sierra Leone's request for a purchase under the compensatory financing decision. He agreed with the staff that the request met all the requirements of that decision. Furthermore, it was based on actual data for the whole shortfall year so that there was no risk of overcompensation.

An important element in the test of cooperation, where the proposed purchase was for 50 per cent of quota or less, Mr. El-Khouri considered, was that regular Article IV consultations were conducted. Executive Directors then had a chance to express their opinion about the type of adjustment that might be needed, thereby laying the basis on which cooperation should be pursued. The most recent Article IV consultation with Sierra Leone had been considered by the Executive Board as recently as mid-1982. In addition, the authorities had kept up a dialogue with the Fund through its resident representative, stationed in Freetown, as well as through numerous staff visits for discussions on a possible adjustment program. Therefore, the test of cooperation had been fully met.

Mr. Orleans-Lindsay recalled that it had been about two years since the economy of Sierra Leone had encountered structural problems and imbalances and the authorities had adopted a medium-term program of economic and financial adjustment early in 1981. In support of the program, the Fund had approved an extended arrangement, which should have ended in February 1984. But weaknesses in the implementation of the policies and measures accompanying the program, as well as adverse external developments, had created serious difficulties that had made it necessary for the Sierra Leonean authorities to cancel the program in 1982.

As in many other developing countries, Mr. Orleans-Lindsay continued, the recession in the industrial world had had an adverse impact on the volume of exports of Sierra Leone, and had caused a deterioration in the terms of trade. The balance of payments position had been under severe pressure for the past five years and, as the staff had pointed out, the size of the current account deficit had been growing. Capital inflows had not been adequate to offset the current account deficits. Consequently, the overall balance of payments deficit had grown from roughly 4 per cent of GDP in 1979/80 to about 13 per cent of GDP in 1980/81, before declining slightly to about 10 per cent of GDP in 1981/82. Foreign exchange reserves had fallen from SDR 29 million at the end of June 1980 to SDR 10 million--or less than two weeks' imports--at the end of June 1982. Sierra Leone had also accumulated a large amount of external payments arrears.

A smaller current account deficit had been projected by the staff for 1982/83, Mr. Orleans-Lindsay remarked, after which Sierra Leone's balance of payments position would continue to be weak. The proposed compensatory drawing was justified by the member's balance of payments need. Moreover, the authorities had been maintaining close contacts with the Fund in their endeavors to attain a viable balance of payments position in an environment of price stability. The major policy initiatives that the authorities had taken were also commendable. He hoped that they would complete the formulation of a comprehensive stabilization program, which could be supported by the Fund.

In conclusion, Mr. Orleans-Lindsay expressed his support for Sierra Leone's request to draw SDR 20.7 million under the compensatory financing decision.

Mr. Jayawardena considered that Sierra Leone's request for a drawing, which amounted to only 45 per cent of its quota, fully satisfied all the requirements of the compensatory financing decision.

Referring to the question of the appropriateness of the exchange rate policy in relation to the problem of diamond smuggling and the extent to which the export shortfall had been largely beyond the control of the authorities, Mr. Jayawardena declared that smuggling was certainly not a function of the exchange rate alone. In fact, smuggling was also a function of the domestic control of production--particularly necessary in the case of small items of high value--and of demand; the purchasers of the illicitly traded diamonds, especially when they were concentrated in the upper income segments, wished to remain anonymous for tax and other purposes. Hence, whatever the exchange rate, smuggling would continue.

Thus, there was no possibility of finding an "optimum" exchange rate that would clear the market as far as diamonds were concerned, Mr. Jayawardena observed. The exchange rate policy recently adopted in Sierra Leone should contribute to minimizing smuggling. It might be disastrous for a country relying so heavily on diamonds as a source of export income to depend entirely on the exchange rate to tackle the smuggling problem.

In any case, Mr. Jayawardena considered, the member had to be given the benefit of the doubt on that question, and he would therefore support the proposed decision.

Mr. Coene considered that Sierra Leone's request for a compensatory drawing was justified. The country clearly had a balance of payments need. As to the causes of the shortfall, he acknowledged that it was difficult to quantify the effects of smuggling. But because other major diamond producers in the world had witnessed a drop in their exports, he was able to support fully the staff's view that the export shortfall was largely beyond the control of the authorities. In addition, the test of cooperation had been fully met.

Mr. Caranicas remarked that he found Sierra Leone's request amply justified. He agreed with the staff that, on the whole, the main causes of the shortfall had been outside the control of the authorities. The many visits to Sierra Leone by the staff, and the consequent findings and analysis in the staff's appraisal, made it clear that the member was cooperating fully with the Fund. Finally, the staff's indication that a comprehensive stabilization program was at hand argued in favor of support by the Executive Board for Sierra Leone's request.

Mr. Salehkhou associated himself with the comments made by Mr. Prowse, Mr. Jayawardena, Mr. Kafka, and others, and expressed his support for the request by the Sierra Leonean authorities for a purchase under the compensatory financing decision. He asked Mr. Sangare to convey the best wishes of his chair to the Sierra Leonean authorities.

Mr. de Maulde added his support to the request from Sierra Leone for a compensatory drawing.

The staff representative from the African Department recalled that, as had been clear from the discussion in the Executive Board of the 1982 Article IV consultation with Sierra Leone (EBM/82/83, 6/16/82), exchange rate policy had been a major reason for the failure in mid-1981 to conclude the first review of the program under the extended arrangement that had been approved effective March 30, 1981 and subsequently canceled. The Fund and Sierra Leone had maintained contact, but it was not until February 1982, during the Article IV consultation discussions, that a constructive dialogue had been resumed. Following the national elections and the appointment of a new Cabinet in May 1982, the staff had discerned a greater willingness on the part of the authorities to change various policies. The staff visit to Sierra Leone in June 1982 had taken place at the request of the new Minister of Finance, who had wished to inform himself of the history of the relationship between Sierra Leone and the Fund, as well as of the staff's views on the basic issues. A brief visit of that nature, though useful, could not lead to major detailed discussions of the situation or prospects for future cooperation.

During further discussions with the Minister at the time of the Annual Meeting, the exchange rate issue still being the major impediment to a more constructive approach, the staff had considered it advisable not to foreclose any possibilities for improving Sierra Leone's exchange arrangements, the staff representative went on. The possibility of establishing a temporary dual exchange rate system had been explored. Such a system had been mentioned in the Executive Board discussion of the 1982 Article IV consultation, and had been adopted with some success in other countries, including Uganda. The mission to Sierra Leone in October 1982 had therefore been devoted almost exclusively to reaching understandings on the basic framework and operational features of such an arrangement. The authorities had felt that allowing the market to determine through foreign exchange auctions certain aspects of exchange rate policy was an impersonal way of neutralizing the difficult social and political problems that sometimes arose when major exchange rate changes had to be made.

An interesting feature of the dual exchange rate system that had been put in place, the staff representative noted, was that it would ensure a considerable strengthening of the export sector. The full output of the Alluvial Diamond Mining Scheme, which accounted for about 50 per cent of total diamond exports, would go through the commercial market, as would one third of the exports of the rest of the diamond and mining sector, including iron ore, together with 50 per cent of export crops. The staff had emphasized, however, and the authorities had agreed, that the new system was a transitional arrangement, or a first step toward unification of the two exchange rates at an appropriate level within a reasonable time period.

Because a breakthrough in exchange rate policy had been made, the staff representative commented, agreement was more likely to be reached with the authorities on other measures. Certainly, over the past few months, experience had shown that whatever the Minister of Finance had undertaken to do had resulted in specific action. In particular, considerable progress had been made with respect to producer prices. Steps had also been taken to revise the budget. It might perhaps be noted that more recent information suggested that the targeted reduction in the budget deficit in 1982/83 might not be achieved mainly because of a shortfall in government revenue. In addition, the authorities had begun to liquidate domestic arrears, which obviously had an adverse influence on the overall cash position of the Government. Nevertheless, there was some movement in the right direction and, on a commitment basis, the budget should be more satisfactory. Thus, in the view of the staff, several basic pillars of policy had been set in place on which a full-fledged stabilization program could be constructed in due course.

The restrictive system was also of great concern to the staff, but it was to be noted that, coincident with the adoption of the new exchange arrangements, there had been some liberalization of the import licensing system, the staff representative remarked. Imports of certain necessities and other priority goods were currently covered by open general licenses, whereas other imports still required specific licenses.

Any program that might be supported by use of the Fund's resources would call for a progressive reduction of the restrictiveness of the exchange system, the staff representative stated. For that purpose, a schedule would be established for the settlement of outstanding external payments arrears. It had to be admitted, however, that the liquidation of arrears would be a difficult task. The arrears of debt service payments to non-Paris Club creditors were expected to be consolidated shortly, and there would eventually have to be some rescheduling of debts to the Paris Club creditors. By contrast, the "commercial pipeline" would have to be dealt with by the authorities themselves, and it would probably take considerable time to reopen it through cash payments.

Efforts were being made to improve the institutional arrangements in the diamond sector, including those relating to dealer operations, the staff representative said, but it was not easy to control the diamond trade. The expectation was that, given an adequately market-oriented rate at the foreign exchange auctions, diamond dealers would channel the bulk of their foreign exchange earnings through the domestic banking system.

On technical assistance, the staff representative from the African Department observed, the Fund resident representative in Freetown was assisting the authorities in a number of areas. The member's balance of payments statistics could stand improvement, but the authorities had not hesitated in the past to seek Fund assistance and should they do so again, they would surely receive a positive response.

The staff representative from the Research Department explained that the compensatory financing decision required only that "the existence and amount of an export shortfall for the purpose of any drawing...shall be determined with respect to the latest 12-month period preceding the drawing request for which the Fund has sufficient statistical data...."

The practice, however, had been to limit the lag between the end of the shortfall year and the request to roughly 6 months. The data up to June 1982, which had been used to calculate Sierra Leone's export shortfall, were the latest available data. However, those data had been received toward the end of 1982, and by the time the paper had been issued, the lag was more than 6 months.

As for the way in which the staff had handled the requirement that the Fund be satisfied that the shortfall in Sierra Leone's exports was largely attributable to circumstances beyond the control of the member, a difficult judgment had had to be made, the staff representative observed. The staff had had to take into account the fact that shortfalls of several products other than diamonds--notably, bauxite, coffee, and cocoa--could clearly be attributed to factors outside the control of the member, as indeed could the shortfall in diamond exports itself, to a minor extent, due to price factors. But the difficulty with respect to the diamond export shortfall, insofar as it was due to volume, was that it could be attributed to many factors that were at work at the same time. Easily accessible diamond reserves had been depleted in recent years; production costs had been rising because of the lack of adequate equipment to exploit less accessible diamond reserves; and above all, world demand had fallen.

Regarding the manner in which unrecorded trade in diamonds was treated, the staff representative from the Research Department continued, the projections made by the staff were based on the assumption of a recovery in demand and a positive response of diamond exports through official channels to the exchange rate and other measures taken by the authorities. The volume of official diamond exports was estimated to recover by approximately 15 per cent in the first postshortfall year and by 17 per cent in the second year ending June 1984. Perhaps more than half of the recovery could be expected to result from an improvement in demand. The official projections provided by the authorities envisaged a much sharper increase in volume for the two postshortfall years than the projections made by the staff for the purpose of calculating the export shortfall. Viewed in a different perspective, and even without full knowledge of the value of unrecorded trade for the five-year period under review--the shortfall year, as well as the two preceding years and the two years after it--a reasonable case could be made that developments in the world diamond market were such that an export shortfall reflecting the fluctuation in world demand would be as large or larger than the estimate given in the staff paper. Information was available indicating that other diamond exporting countries had been affected by the decline in world demand for diamonds. But quite apart from the fact that Sierra Leone would in all probability have had a large export shortfall, based on the total volume of diamond exports, official and illicit, it would be undesirable for the Fund to base its calculations on unreliable data.

Mr. Dallara said that he recognized the great difficulties associated with estimating unrecorded trade. However, he understood that the staff had estimated an increase in the volume of diamond exports between June 1982 and June 1983 of 15 per cent. In making that assumption, the staff had implicitly had to estimate how much of the projected increase would result from the exchange rate change, which would seem by definition to be an indirect estimate of the extent to which smuggling might be reduced and the level of recorded transactions increased. Thus, it remained difficult for him to understand how an estimate of the projected increase in unrecorded diamond exports could be made for the first postshortfall year but not for the shortfall year.

The staff representative from the Research Department mentioned that a conservative estimate had deliberately been made of the likely impact of the exchange rate measures in the two postshortfall years, largely because of the difficulty of estimating the unrecorded trade. What was known was that the volume of official diamond exports had declined by 30 per cent in the shortfall year, a rate that was slightly smaller than the fall of 33 per cent recorded in the preceding year. Other diamond exporting countries had experienced declines of 50 per cent in their diamond exports during those two years. To have attempted to analyze the effect on exports of the decline in world demand compared with the effect of the exchange rate during the shortfall year could only have been a hypothetical exercise. The staff believed that unrecorded diamond exports by Sierra Leone were much higher than the estimated increase in the volume of recorded exports in the first postshortfall year would suggest; the anticipated increase of 15 per cent in recorded exports would represent only one third of the level of recorded exports in 1977.

In response to a question by the Chairman, the staff representative explained that in the projections made for the purpose of calculating the export shortfall, the staff had taken more account of the improvement in demand than of the likely increase in recorded exports stemming from the exchange rate measures. The authorities had envisaged a much larger increase in their projections, which obviously took more account of the beneficial effects of the exchange rate measures.

The staff representative from the African Department, replying to a further question by the Chairman, explained that there had only been three auctions so far, and to the best of the staff's knowledge, bids could be made freely. Obviously, there were administrative and operational requirements to be met, including the granting of a license, which was more easily available at present, and other documentation. Pending confirmation, it appeared that the authorities had been concerned in the first auction about the possibility of a few large trading houses having a determining influence on the market, and about the principle of equity among the various sectors. From that point of view, the authorities had wished to establish limits on the maximum amount that a successful bidder could receive, while maintaining the freedom of bidders. The exchange rate in terms of the U.S. dollar that had cleared the market in the first auction was Le 2.45 and in the second Le 2.40; the results of the third auction had not yet been received. Those rates, which were about double the official exchange rate, did not suggest any excessive intervention on the part of the authorities. The staff would look into the matter carefully because the rate on the commercial market would be an indicator of what might ultimately be an appropriate level for the unified exchange rate.

Finally, the staff representative noted, initial difficulties in administering the dual exchange rate system were not unlikely. Uganda had experienced similar difficulties, which had been reviewed with the staff and eventually overcome.

The Chairman expressed the hope that in the months to come more would be learned about the operation of the dual exchange market, permitting exchange rate developments to be evaluated before any judgment was reached on the level of the unified exchange rate. No doubt the introduction of the new budget in June 1983 would also have a bearing on the prospects for a future program.

Mr. Sangare remarked that Executive Directors had recognized that all the requirements for a purchase transaction by Sierra Leone under the compensatory financing decision had been met, including the existence of a balance of payments need, the short-term character of the export shortfall, and the fulfillment of the test of cooperation. Some doubts had been expressed whether the factors contributing to the export shortfall had been beyond the control of the authorities, and one Executive Director had expressed a reservation in that respect. Too much emphasis had probably been placed on diamond smuggling, and too little on other factors. Certainly, the overvalued currency had contributed to the increase in smuggling. For that reason, in response to the Fund's recommendation, the Sierra Leonean authorities had taken steps to correct the situation by introducing a dual exchange system, which they hoped would be effective. But as the staff had stressed in its paper, the overvalued currency had only encouraged smuggling, and had not created it; smuggling had always been part of the diamond trade in most African countries. Diamond mining activities were extremely difficult to regulate. A diamond was a small item of great value that could be taken abroad undetected. Diamond traders, particularly the small traders, wanted to avoid paying taxes not only in the country of origin but even in the country in which the diamonds were sold. It was extremely difficult to determine to what extent the overvalued currency had contributed to the increase in smuggling, even though his authorities recognized that it had in fact played a part. The main factors underlying the export shortfall, as demonstrated by the staff, were the depletion in diamond deposits and the adverse effects of the world recession on the demand for diamonds.

The proposed drawing was below 50 per cent of quota, and the export shortfall had been calculated on the basis of actual data for the 12 months ended June 1982, Mr. Sangare stressed. Thus, as Mr. Kafka had rightly said, Sierra Leone should be given the benefit of the doubt. Indeed, he hoped that the Executive Board would act on their belief in Sierra Leone's commitment to strengthen its economy, as recommended by the Fund, by giving full support to a stand-by arrangement for the member, if a request was received.

The Executive Directors approved the proposed decision, with one reservation.

The decision was:

1. The Fund has received a request from the Government of Sierra Leone for a purchase of SDR 20.7 million under the Decision on Compensatory Financing of Export Fluctuations (Executive Board Decision No. 6224-(79/135), adopted August 2, 1979).

2. The Fund notes the representation of Sierra Leone and approves the purchase in accordance with the request.

3. The Fund waives the limitation in Article V, Section 3(b)(iii).

Decision No. 7321-(83/29), adopted
February 14, 1983

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/83/28 (2/4/83) and EBM/83/29 (2/14/83).

3. MALAWI - 1982 ARTICLE IV CONSULTATION - POSTPONEMENT

Notwithstanding the period of three months specified in Procedure II of the document entitled "Surveillance over Exchange Rate Policies" attached to Decision No. 5392-(77/63), adopted April 29, 1977, the Executive Board agrees to postpone its consideration of the 1982 Article IV consultation with Malawi until not later than February 28, 1983. (EBD/83/34, 2/8/83)

Decision No. 7322-(83/29), adopted
February 10, 1983

4. EQUATORIAL GUINEA, INDIA, AND UGANDA - 1982 ARTICLE IV CONSULTATIONS - POSTPONEMENT

Notwithstanding the period of three months specified in Procedure II of the document entitled "Surveillance over Exchange Rate Policies" attached to Decision No. 5392-(77/63), adopted April 29, 1977, the Executive Board agrees to postpone its consideration of the 1982 Article IV consultations with Equatorial Guinea, India, and Uganda until not later than February 18, 1983. (EBD/83/37, 2/9/83)

Decision No. 7323-(83/29), adopted
February 11, 1983

5. FUND HISTORY, 1972-78 - CONTENTS OF VOLUME III - PUBLICATION OF DOCUMENTS

The Executive Board approves the proposal set forth in EBD/83/24 (1/26/83).

Adopted February 9, 1983

6. ANTIGUA - TECHNICAL ASSISTANCE

In response to a request from the Antiguan authorities for technical assistance, the Executive Board approves the proposal set forth in EBD/83/32 (2/7/83).

Adopted February 10, 1983

7. ASSISTANT TO EXECUTIVE DIRECTOR

The Executive Board approves the proposal set forth in EBAP/83/41 (2/7/83).

Adopted February 10, 1983

8. APPROVAL OF MINUTES

a. The minutes of Executive Board Meetings 82/102 through 82/107 are approved. (EBD/83/27, 2/2/83)

Adopted February 8, 1983

b. The minutes of Executive Board Meetings 82/108 through 82/113 are approved. (EBD/83/29, 2/3/83)

Adopted February 9, 1983

9. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/83/39 (2/3/83) and EBAP/83/40 (2/4/83) is approved.

APPROVED: July 21, 1983

JOSEPH W. LANG, JR.
Acting Secretary