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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 83/34

3:00 p.m., February 22, 1983

W. B. Dale, Acting Chairman

Executive Directors	Alternate Executive Directors
	M. K. Diallo, Temporary
	M. Hull, Temporary
	G. Ercel, Temporary
	P. D. Péroz, Temporary
	C. A. Salinas, Temporary
	C. Dallara
M. Finaish	
	I. R. Panday, Temporary
	H. Suzuki, Temporary
	D. I. S. Shaw, Temporary
	H. Arias, Temporary
	G. Grosche
	C. P. Caranicas
	A. S. Jayawardena
	S. El-Khouri, Temporary
	L. Ionescu, Temporary
A. R. G. Prowse	
G. Salehkhou	
	E. I. M. Mtei
	M. Toro, Temporary
	I. Fridriksson, Temporary
	Jiang H., Temporary

L. Van Houtven, Secretary
R. S. Franklin, Assistant

Also Present

African Department: J. B. Zulu, Director; O. B. Makalou, Deputy Director; A. Basu, N. Calika, J. M. Jimenez, G. Namakandou, S. M. Nsouli, N. E. Weerasinghe. Exchange and Trade Relations Department: W. A. Beveridge, Deputy Director; E. J. Zervoudakis. Legal Department: Ph. Lachman. Advisor to Executive Director: M. A. Janjua. Assistants to Executive Directors: H. Alaoui-Abdallaoui, M. Camara, V. K. S. Nair, J. C. Williams.

1. SOMALIA - 1982 ARTICLE IV CONSULTATION, AND REVIEW UNDER STAND-BY ARRANGEMENT

The Executive Directors continued from the previous meeting (EBM/83/33, 2/22/83) their consideration of the staff report for the 1982 Article IV consultation with Somalia, together with a review under the stand-by arrangement for Somalia and the program for 1983 (EBS/83/15, 1/19/83; and Cor. 1, 2/7/83). They also had before them a report on recent economic developments in Somalia (SM/83/27, 2/7/83).

The staff representative from the African Department, extending his remarks from the previous meeting, noted that the original program projection had indicated official capital inflows of about $25 million in 1983. During its most recent mission to Somalia, the staff had reviewed the estimates, taking into account new information that had become available on debt amortization and expected official loans. On the basis of that review, the staff had revised its projections from a net inflow of $25 million to a net official capital outflow of $25 million.

A number of references had been made to the population growth in Somalia, the staff representative recalled. The 6.7 per cent annual rate of growth over the previous decade had been taken directly from International Financial Statistics and was based on information provided by the Somali authorities. However, the figure included the inflow of refugees that had taken place during the period; the underlying rate of population growth was closer to 2.8 per cent a year. Finally, with respect to a suggestion by Mr. Prowse, the Somali authorities were anxious to develop national income accounts and had sought assistance toward that end from the United Nations Development Program (UNDP).

The Deputy Director of the Exchange and Trade Relations Department, responding to those who had wondered about the possibility of an extended arrangement with Somalia, recalled that consideration had been given to such an arrangement when the Executive Board had initially approved the stand-by program in July 1982. At that time, the staff had indicated that an extended arrangement would not be ruled out, even before the end of the stand-by arrangement, if all the necessary conditions governing the use of the extended Fund facility could be met. The current program supported by the stand-by arrangement with Somalia contained a number of features usually found in programs under the extended Fund facility, and efforts were being made to effect structural changes, a mobilization of resources, and a reform of the external sector. In that respect, the staff had asked itself whether Somalia had been put at any disadvantage because the succession of programs with the Fund--all of which had contained such elements--had not been placed in the framework of an extended arrangement. The feeling had been that, since access to Fund resources was not a problem, Somalia had in fact benefited from the periodic reviews of its programs and the frequent mid-course corrections of fundamental elements, including changes in the exchange rate. A certain amount of continuity had also been maintained under the chosen approach.

Nonetheless, the Deputy Director said, the staff was not opposed to a future extended arrangement so long as it could be developed within a strong quantified economic and financial framework. Some progress toward that end had already been made, although certain problems remained. Moreover, the staff was concerned about the fact that there was not a full meeting of the minds between the Somali authorities and the World Bank staff on the matter of the Five-Year Development Plan and the investment program. Given the prospects for the balance of payments and the external debt situation, Somalia would need assistance on highly concessional terms, and investment would need to be concentrated in projects that had a very high rate of return. The financial, technical, and other assistance that could be provided by the World Bank in those areas was of considerable importance.

The Acting Chairman observed that the Somali authorities were currently working closely with the UNDP toward developing a set of national accounts. The United Nations was normally the main source of national accounts technical assistance; however, if further assistance were to be needed, he would see no difficulty in providing it through the Fund, especially given Somalia's record of cooperation with the institution.

On another matter, the Acting Chairman continued, he had been impressed by the resoluteness with which the Somali authorities had pursued the stand-by program with the Fund's help. He drew the attention of Executive Directors to page 95 of SM/83/27, which showed the rate of growth of GDP at 1978 factor cost prices. The staff had been cautious in making statements about the accuracy and adequacy of the statistical base underlying the table; however, even with all the necessary qualifications, the table showed clearly the impressive progress a member could make in achieving real growth when it took a wholly new view about macroeconomic policy.

With regard to questions on the possibility of an extended arrangement with Somalia, the Acting Chairman recalled that the Managing Director and the President of Somalia had discussed the matter at some length one year previously. At that time, management had indicated that a number of criteria would need to be met, including a development program that could be endorsed by the World Bank and an adequate track record in arrangements with the Fund. The authorities had certainly established a good track record with the Fund, although there remained differences of view between the authorities and the World Bank on the matter of the development program. While he was not entirely clear about the nature of the difficulty with the World Bank, he believed that it would be desirable for the Fund to do all within its power to bring about a meeting of the minds between the World Bank and the Somali authorities to see whether a basis could be established for an extended arrangement in the Fund.

Mr. Finaish observed that the impressive economic performance in Somalia had taken place in a relatively short time and with limited resources in a harsh environment, both within and outside the country. The staff had made reference to a number of exogenous developments, including the drought, the border conflict, the influx of refugees, and the severance of relations with the Soviet Union, which, until 1977, had been the major source of financial and technical assistance to Somalia. Executive Directors had emphasized that, if the investment effort was to continue, external assistance would be necessary; Somalia was a poor country with a limited resource base, and aid on concessional terms was a prerequisite for continued adjustment. Most of the aid at present was provided by Saudi Arabia and by countries in his own constituency, and he hoped that aid would be forthcoming from other sources in the future.

Like a number of his colleagues, he had difficulty understanding the position of the World Bank with respect to Somalia's Development Plan, Mr. Finaish continued. The authorities considered that all the basic ingredients of an appropriate development plan were in place, including a macroeconomic framework that would enable the planners to evaluate the impact of the implementation of the Plan on internal and external balances. The Plan contained sectoral priority, it properly emphasized agriculture and infrastructure--a traditional Bank requirement--and the projects included met the requirements of the feasibility studies and investment criteria.

As he understood it, the Bank had not taken a different position on any of those points, Mr. Finaish went on. Questions had of course been raised about how to implement and finance the Plan, but the authorities had indicated a willingness to be flexible. It should be borne in mind that the plan had been prepared with the help of the UNDP and other UN agencies, and that the Somali authorities were willing to listen to advice from any source to ensure that the Plan would be internally consistent and effective. They were continuing to cooperate with the Bank on that matter, which would be discussed in March when representatives from Somalia visited Washington in preparation for the meeting of the Consultative Group. The World Bank's basis for judging the Plan was not clear to him: he was uncertain whether the Bank was relying on experience with Somali plans in the past or comparing the Plan to those in countries in a similar stage of development; it might even be comparing the Plan with those in more advanced countries or with some ideal textbook case. He was not sure precisely what the Bank expected; he had no difficulty observing that the basic ingredients of a good plan existed, an observation that was reinforced by the fact that the Plan had been prepared with technical assistance from outsiders who did have expertise in the planning field.

As a practical matter, the Fund staff had two options in approaching the question of a development plan, Mr. Finaish said. The first was to look beyond the plan itself and to make judgments about the productivity of investment; the other was to plead ignorance and accept the judgment of the World Bank. If the Fund staff was not in a position to answer questions on matters like development plans, it might very well consider changing the procedure and bringing a Bank staff member into the Board discussion to answer relevant questions in greater detail.

The desire of the Somali authorities for an extended arrangement with the Fund had been discussed on a previous occasion in the Executive Board, Mr. Finaish recalled, and the response of the staff had been similar to the latest explanation by the Deputy Director of the Exchange and Trade Relations Department. The authorities continued to believe that an extended arrangement would have been more helpful than a series of stand-by arrangements.

Regarding questions on the exchange rate, the staff had indicated that there had been two massive devaluations in a relatively short period, and it was to be expected that the authorities would need some time to study the impact of those devaluations on the economy as a whole, Mr. Finaish remarked. Substantial changes had also been made in the interest rate structure, and he saw no reason for the authorities to focus on further changes in the near future, particularly given the impressive performance registered on the inflation front. The authorities were aware of the debt burden problem and had been in touch with some of their creditors with the view to rescheduling. However, as had been repeatedly stressed by a number of Directors, Somalia would continue to need high levels of grants and concessional assistance to maintain its adjustment effort and economic development.

On another matter, Mr. Finaish recalled from a previous discussion on Somalia a comment by Mr. Kharmawan to the effect that the Fund should not penalize those countries that had achieved an impressive performance in spite of a limited capacity to adjust. When countries failed to perform well, the Fund seemed willing to reduce its conditionality to meet their ability to adjust; paradoxically, however, the Fund seemed to tighten its conditionality when countries performed well. If a country's record was a good one and it had adopted painful adjustment measures, the Fund should take account of the sacrifices that had been made and understand that the requirements of a further sharp adjustment effort could interrupt the very process that the authorities had worked so hard to set in motion. That was not to say, of course, that the resources of the Fund should be provided in exchange for no adjustment; but a reasonable balance should be struck. The Somali authorities intended to continue with their adjustment efforts because they recognized the benefits that could be yielded by them, but there were limits to what they could be asked to do.

The Acting Chairman made the following summing up:

> Directors generally concurred with the thrust of the staff appraisal and they warmly commended the Somali authorities for the impressive success of the adjustment programs that had been implemented in the previous two years.
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> It was noted that, in 1982, the Somali authorities had intensified their adjustment efforts and had met or exceeded all the quantitative performance criteria under the program with the Fund. As a result of these exemplary and impressive actions, and with the help of good weather conditions, economic activity expanded further, the rate of inflation was nearly

halved, and the current account of the balance of payments improved considerably, offsetting, in large part, an unexpected large capital outflow with the result that the overall balance of payments target was estimated to have been attained.

Directors welcomed the intention of the Somali authorities to continue with their adjustment efforts in 1983 and to adopt additional measures--such as the bonus scheme, with preference in import licensing given to participants of the scheme, and the setting of attractive interest rates on external accounts--with a view to stemming the capital outflow. Directors accepted the need for the bonus scheme as a temporary measure and encouraged the authorities to adopt a unitary rate as soon as practicable.

Directors commended the Somali authorities for their intention to reduce the budget deficit in 1983 through the continued enforcement of strict expenditure controls and a reduction in the Government's net indebtedness to the banking system. They welcomed the intention of the authorities to pursue a tight monetary stance, while providing adequately for the credit needs of the nongovernment sector in order to continue to stimulate economic activity. In this regard, it was felt that the recent increases in domestic interest rates would contribute to the mobilization of savings and the enhancement of financial intermediation. The authorities were thus encouraged to exercise greater flexibility in interest rate policy.

There was praise for the steps the authorities had taken with regard to pricing and marketing policies to promote the expansion of economic activity. The recent establishment of a high-level intragovernmental commission to evaluate the viability of public enterprises was seen as a positive step, and Directors expressed the hope that prompt action would be taken once the Commission made its recommendations. Directors welcomed the efforts the authorities had made to improve the development planning process and encouraged them to formulate, with the assistance of the World Bank, a three-year public investment program. They stressed the significance of such a program in the elaboration of a medium-term adjustment strategy.

Regarding Somalia's external position over the medium term, Directors noted with some concern the projected rapid increase in the debt service burden and the country's dependence on grants and concessional loans. In this connection, they recognized the importance the authorities attached to negotiating with creditors a rescheduling or cancellation of part of Somalia's external debt. Also, Somalia's continuing need for a high level of foreign grants and concessional assistance was stressed.

The Executive Board then took the following decisions:

Decision Concluding 1982 Article XIV Consultation

1. The Fund takes this decision relating to Somalia's exchange measures subject to Article VIII, Sections 2 and 3, and in concluding the 1982 Article XIV consultation with Somalia, in the light of the 1982 Article IV consultation with Somalia conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. On January 1, 1983, Somalia introduced a bonus scheme, described in EBS/83/15, which gives rise to a multiple currency practice. In view of the comprehensive policies for balance of payments adjustment adopted by Somalia and, in particular, the intention of the authorities to eliminate that practice, the Fund grants approval for the retention of the multiple currency practice until December 31, 1983.

Decision No. 7331-(83/34), adopted
February 22, 1983

Review Under Stand-By Arrangement

1. Somalia has consulted the Fund in accordance with paragraph 4(c) of the stand-by arrangement for Somalia (EBS/82/105, Supplement 1, December 20, 1982) in order to establish performance criteria subject to which purchases may be made by Somalia under the stand-by arrangement during January 1-June 30, 1983.

2. The letter from the Minister of Finance and the Governor, Central Bank of Somalia, of December 8, 1982, shall be annexed to the stand-by arrangement for Somalia, and the letter of April 15, 1982, attached to the stand-by arrangement, shall be read as modified and supplemented by the annexed letter.

3. Accordingly, paragraphs 4(a), (b), and (d)(ii) of the stand-by arrangement shall be amended to read:

(a) during any period until June 30, 1982, in which the data at the end of the immediately preceding performance period indicate that

(i) the limit on total net domestic credit of the banking system described in paragraph 18 of the annexed December 8, 1982 letter is not observed; or

(ii) the limit on net bank credit to the Government described in paragraph 18 of the annexed December 8, 1982 letter is not observed; or

(b) (i) if Somalia fails to observe the limits on contracting of new public and publicly guaranteed external debt described in paragraph 26 of the annexed December 8, 1982 letter; or

(d) (ii) introduces new multiple currency practices, or modifies the existing multiple currency practice described in paragraph 24 of the annexed December 8, 1982 letter, or.

Decision No. 7332-(83/34), adopted
February 22, 1983

APPROVED: July 22, 1983

JOSEPH W. LANG, JR.
Acting Secretary