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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 83/118

3:00 p.m., August 3, 1983

W. B. Dale, Acting Chairman

Executive Directors	Alternate Executive Directors
	N. Toe, Temporary
	G. Ercel, Temporary
	P. D. Péroz, Temporary
	J. Delgadillo, Temporary
	J. C. Williams, Temporary
	M. B. Chatah, Temporary
	Y. Okubo, Temporary
	I. R. Panday, Temporary
R. K. Joyce	M. Casey
	J. R. N. Almeida, Temporary
	G. Grosche
	C. P. Caranicas
R. N. Malhotra	A. S. Jayawardena
	J. E. Suraisry
	E. M. Ainley, Temporary
	T. de Vries
	R. Bernardo, Temporary
G. Salehkhou	O. Kabbaj
	E. I. M. Mtei
	E. Portas, Temporary
	I. Fridriksson, Temporary
	M. Hull, Temporary
	Wang E.

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

Also Present

His Excellency Erik K. Otoo, The Ambassador of Ghana. B. Legarda, Consultant. African Department: D. T. S. Ballali, R. O. Carstens, J. W. Kratz, R. P. Kronenberg. Exchange and Trade Relations Department: M. Guitian, K. M. Huh, S. Kanesa-Thasan. External Relations Department: G. P. Newman. Legal Department: P. L. Francotte, W. E. Holder. Research Department: W. C. Hood, Economic Counsellor and Director; K.-Y. Chu, E. C. Meldau-Womack, B. E. Rourke, A. Salehizadeh. Western Hemisphere Department: S. T. Beza, Associate Director; M. A. Da Costa, H. E. Khor, D. C. Ross, M. C. Spinola, J. E. Sundgren, G. L. Terrier, E. S. Williams, G. Yadav, J. E. Zeas. Advisors to Executive Directors: A. A. Agah, P. Kohnert. Assistants to Executive Directors: H. Alaoui-Abdallaoui, H. Arias, L. Barbone, M. Camara, T. A. Connors, M. Eran, G. Gomel, N. U. Haque, H. Kobayashi, M. J. Kooymans, W. Moerke, V. K. S. Nair, G. W. K. Pickering, J. Schuijer, Shao Z., M. Toro, A. Yasseri.

1. GHANA - 1983 ARTICLE IV CONSULTATION; STAND-BY ARRANGEMENT; AND PURCHASE TRANSACTION - COMPENSATORY FINANCING FACILITY

The Executive Directors continued from the previous meeting (EBM/83/117, 8/3/83) their consideration of the staff report for the 1983 Article IV consultation with Ghana and a request for a stand-by arrangement in an amount equivalent to SDR 238.5 million (EBS/83/140, 7/7/83; and Cor. 1, 7/28/83). In addition, they took up a request by Ghana for a purchase equivalent to SDR 120.5 million under the compensatory financing facility (EBS/83/146, 7/12/83; and Sup. 1, 8/1/83). They also had before them a report on recent economic developments in Ghana (SM/83/161, 7/25/83).

The staff representative from the Exchange and Trade Relations Department noted that the figures for debt service payments, which were on the high side, had included payments with respect to short-term oil import credits. Excluding those credits, the figures for service payments as a ratio of exports of goods and services, including Fund charges and repurchases, would be 21 per cent, instead of 31.4 percent, for 1984; the figures for the following five years would read 23, 25, 33, 30, and 23 percent.

The staff representative from the Research Department described how the staff determined whether a shortfall in aggregate exports was attributable to factors largely beyond the control of the member country. The staff examined the causes of the shortfall from many different angles, in terms of both volume and price for individual commodities, in order to determine the circumstances leading to the poor performance of exports. By examining the movements of broad aggregate volumes and prices on the basis of a weighted average of unit values and volumes for individual commodities, the staff could reach a conclusion as to whether the shortfall was largely beyond the control of the authorities.

From Table 3 (EBS/83/146) it was evident that more than half of the shortfall in Ghana's total exports of SDR 120 million was accounted for by a shortfall in exports of cocoa of about SDR 64 million, the staff representative explained. It could be seen from Table 4 that the cocoa shortfall was entirely accounted for by a reduction in price; in fact, the volume of cocoa exports from Ghana in 1982 exceeded the medium-term trend calculated by taking the geometric average of export volumes for five years around the shortfall year. Two other commodities--gold and wood--had also accounted for part of the shortfall in aggregate exports. Market conditions for those exports had been severely depressed in 1982 because of the recession in the world economy; prices had been extremely low and demand had been weak.

The staff had also examined the movements of broad aggregates of volume and unit values of exports, the staff representative commented. Commodities, accounting for 96.7 percent of the total value of Ghana's exports in 1982, experienced a shortfall of 22.9 percent in the shortfall year. The volume shortfall was 2.7 percent of the level of volume in 1982, while unit values experienced a shortfall of 19.6 percent of the level of unit values in that year; clearly, the aggregate export shortfall in 1982 had been largely attributable to the lower level of prices. On that basis, the staff concluded that the shortfall was due to factors largely beyond the control of the authorities.

The question had been raised by Mr. de Vries whether the reduction in the price of cocoa had been beyond the control of the authorities; he had also questioned the relationship between the International Cocoa Agreement and the price movement, the staff representative recalled. For a long time international market prices of cocoa had fluctuated very widely, largely because of the dynamic interaction between world market demand for cocoa and world production. Cocoa prices had peaked in 1977 and a number of producers had expanded production, which in turn had caused cocoa prices to decline rapidly. In August 1977 the price of cocoa had been $1.80 a pound, but it had declined to $1.00 a pound at the end of 1981. The 1980 International Cocoa Agreement had come into operation in August 1981, and as prices declined the buffer stock manager had bought about 100,000 metric tons of cocoa beans between September 1981 and March 1982. However, the buffer stock manager had exhausted his financial resources and had stopped buying cocoa stocks. The price of cocoa had fallen further to $0.70 a pound in November 1982. Because of adverse weather conditions in some major producing areas, cocoa prices had recovered to about $1.04 a pound by June 1983, which exceeded the minimum price specified under the International Cocoa Agreement. Cocoa prices had been so low in 1982 because of worldwide overproduction as a result of the high price in 1977; the low price of cocoa in 1982 was therefore beyond the control of the authorities.

Although the establishment of a Common Fund had been agreed upon in June 1980, it had not yet been set up because the ratification process had not been completed, the staff representative explained. Ninety countries, providing about 67 per cent of the capital resources, must ratify the agreement. The deadline for ratification had been postponed until September 1983 and if the Common Fund was eventually established there was a possibility that the International Cocoa Agreement could be associated with it.

Gold prices had declined rapidly from about $675 an ounce in January 1980 to about $315 in June 1982, the staff representative from the Research Department indicated. At the time the staff had been preparing the paper on compensatory financing for South Africa, gold prices had fluctuated between $315 an ounce and $365 an ounce during the months of June, July, and August 1982. South Africa was a dominant producer of gold, and so production and export levels in that country affected the world price of gold. The staff had prepared three different scenarios based on projected gold production and exports for two postshortfall years and had come up with three different combinations of quantity and price movements. It had chosen the conservative figure for the price of gold of $315 an ounce for the two postshortfall years. However, gold prices had recovered substantially from $315 in June 1982 to $438 in May 1983. In the case of Ghana, the staff had used the actual prices that had prevailed during the first five months of 1983 since Ghana was a small producer of gold and production would not affect the world market price. In its projection, the staff had used a substantially higher price for gold in the case of Ghana than had been used for South Africa, estimating that for the two postshortfall years, the price of gold would be $437 an ounce.

The Acting Chairman recalled that Mr. Erb had asked whether it was appropriate to compensate the entire export shortfall when it was found that the shortfall was largely, but not wholly, beyond the control of the authorities. The Executive Board might at some stage wish to have a general policy discussion on that issue. However, the compensatory financing facility decision was clear in that respect; if a shortfall was largely--meaning more than half--beyond the control of the authorities, then the whole of the shortfall could be financed.

He agreed with a number of Directors who had stated that Ghana's stand-by arrangement was unusually important both to the authorities and to the Fund, given the uncertainty of the situation, the Acting Chairman remarked. Over the previous three years, the authorities had held many discussions with the staff concerning the use of the Fund resources, all of which had been aborted until the present one. He had met Dr. Botchwey, the Minister of Finance, in Toronto and in Washington when those discussions had been proceeding, and again in Washington in February 1983. He had been impressed by the extent to which Dr. Botchwey and his colleagues had been prepared to accept the need for stronger and more courageous measures. He was hopeful that the authorities would be able fully to implement the program.

A large U.K. bank had been willing to provide bridging finance to Ghana even before the letter of intent, setting forth the objectives and policies of the stand-by arrangement, had been approved by the Managing Director, the Acting Chairman stated. That U.K. bank did have historic ties with Ghana and was also knowledgeable about Ghana's economic situation, but he was most impressed that a bank had been willing to provide bridging finance at such an early stage in the negotiation of a Fund-supported program. Furthermore, the World Bank had approved a $40 million import reconstruction loan. In conclusion, there were institutions that had shown a willingness to take risks at an early stage in the very difficult, but important, adjustment program in Ghana. He hoped that other institutions would be able to provide the finance that had been projected by the staff.

Mr. Salehkhou stated, by way of analogy, that economic adjustment programs were to a country like medicine to a patient; the more severe the disease, the more bitter the medicine. He agreed with those Directors who had underscored the importance of implementing an adjustment program sooner rather than later, because prevention was better than the cure. But once an adjustment program was put in place, it was the country that would feel the resulting pains and pleasures, like the patient who would experience the bitter medicine and any adverse side effects. It was in that context that the authorities' commitment should be assessed. In view of the extremely adverse environment, their resolve and determination to tackle the causes of the economic malaise were commendable. The authorities had maintained contact with the Fund staff throughout the previous three years, even though there had been no formal discussion in the Executive Board concerning Ghana.

Most foreign credits projected in the program were, in fact, already in the pipeline, Mr. Salehkhou said. The majority of those credits would be extended by donor countries and international organizations, including the World Bank and the European Community--STABEX. The lack of sufficient supplementary capital under a Fund-supported adjustment program was a problem that had been faced by many countries. He hoped that debtors and creditors would understand the importance of maintaining the inflow of capital, so that adjustment could be made and the spirit of international financial cooperation kept alive. The authorities had not yet considered any specific supplementary measures that they were willing to take if there was a capital shortfall.

The demonetization of 50-cedi notes had been an emergency and temporary measure, which had been relatively successful in weakening illegal activity, Mr. Salehkhou indicated. The authorities had already made arrangements to refund the owners of those notes; the owners of small amounts were being refunded in cash.

Many Executive Directors had suggested that the shortfall was not entirely due to factors beyond the control of the authorities, Mr. Salehkhou recalled, and Mr. Erb had suggested that the part of the shortfall that was due to domestic policies should not be compensated. It was undeniable that domestic price distortions had been partly responsible for the export shortfall, but the staff report clearly indicated that the major part of the shortfall was due to exogenous factors, particularly the sharp deterioration in the prices of Ghana's exports. The policy issue of whether the full amount of the shortfall should be compensable had already been considered by the Executive Board.

In Ghana, as in other newly independent developing countries, the present economic situation was determined, in part, by the socioeconomic and political conditions existing prior to independence, Mr. Salehkhou commented. The Fund should not disregard the impediments caused by external forces during the preindependence period, since the effects of that background were still manifested in the operations of the country.

In spite of the apprehension that the one million Ghanaian "returnees" might have on adverse impact on the already weak economy, they had received a warm reception from the population and the authorities, Mr. Salehkhou stated. The returnees might be regarded as a blessing in disguise, since they were relatively highly skilled and could contribute to the reconstruction of the Ghanaian economy. Finally, he thanked the staff and management on behalf of his authorities for their flexible and cooperative attitude in putting together the comprehensive adjustment program.

The Acting Chairman made the following summing up:

Directors agreed with the appraisal in the staff report on the 1983 Article IV consultation and on Ghana's request for a stand-by arrangement. They commended the Ghanaian authorities for their courage in implementing strong adjustment measures, which were nonetheless widely regarded as long overdue.

It was noted that during most of the 1970s the Ghanaian economy had suffered from severe structural imbalances due to the cumulative impact of large budgetary deficits, rapid increases in domestic bank credit and the maintenance of a fixed exchange rate despite high rates of inflation. In the late 1970s and early 1980s, the situation was compounded by a worsening of the terms of trade as well as by a rapid deterioration in capital equipment, inadequate price incentives in the agricultural and export sectors, and a broadening of parallel market activity. Intermittent attempts to contain the deteriorating economic and financial situation had been largely unsuccessful. As a result, Directors observed, there had been severe balance of payments pressure, dissavings, a steady drop in real output, widespread shortages, and a rapid shrinking of government operations in relation to GDP; in addition, the recent large influx of Ghanaians from neighboring countries posed a more immediate problem.

Directors welcomed the Government's economic and financial program aimed at a substantial restructuring of relative prices in favor of producing sectors and exports, at improving the financial position of the public sector, at increasing the volume of imports necessary for increased economic activity, and at a reduction of external payments arrears. Strong emphasis was placed on expenditure control measures and means of monitoring closely both expenditure and receipts. The measures are expected to improve the supply situation by increasing domestic production and imports as well as by encouraging reabsorption of a substantial portion of parallel market activity into normal channels. The improved supply situation and the projected reduction in credit and liquidity expansion were expected to result in a cutback in inflationary pressures and a strengthening of the balance of payments.

Directors noted the severe difficulties that still faced the Government and the pressure on the authorities to show some visible evidence of economic improvement as soon as possible. They pointed out that a favorable outcome would depend on the authorities' resolve to implement the program fully. In that regard, Directors placed strong emphasis on the need for the authorities to implement the remaining measures on schedule. In particular, they should phase out the petroleum subsidy, adjust interest rates, and manage the exchange rate in a flexible manner with the aim of unifying the multiple exchange rate system--while keeping in mind the need to assure competitiveness. Directors welcomed and emphasized the importance of the two reviews and the need to reach understandings with the Fund on these and other issues. Several Directors expressed concern about the realism and sustainability of the balance of payments financing in both the short term and the medium term.

Directors welcomed the authorities' recognition that the measures currently being implemented were only a first step in a sustained effort, extending over the medium term, to deal with the serious structural imbalances and to rehabilitate the economy. They urged the authorities to maintain the adjustment effort and to be ready to move quickly to reinforce the adjustment process if this should be necessary. In this connection, Directors observed that in many respects Ghana's medium-term economic outlook appeared quite favorable, and they welcomed the envisaged aid conference to be organized through the World Bank late in 1983. Directors said that the authorities should be looking ahead and should agree on medium-term priorities and policies.

In sum, Directors commended and approved the strength and substance of the far-reaching and comprehensive series of measures recently taken by the Government of Ghana. They stressed the need to sustain those policy measures in both the immediate future and for a number of years ahead. In this context, the unusual degree of uncertainty with respect to Ghana's particular circumstances was stressed as a challenge to be assessed and monitored in the coming reviews.

Several Directors expressed regret that it has been more than three years since the last Article IV consultation took place with Ghana. It is expected that the next Article IV consultation with Ghana will be held on the standard 12-month cycle.

The Executive Board then took the following decisions:

Decision Concluding 1983 Article XIV Consultation

1. The Fund takes this decision relating to Ghana's exchange measures subject to Article VIII, Sections 2 and 3, and in concluding the 1983 Article XIV consultation with Ghana, in the light of the 1983 Article IV consultation with Ghana conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. Ghana maintains restrictions on payments and transfers for current international transactions and multiple currency practices as described in EBS/83/140 and in SM/83/161. The Fund notes the intention of the authorities to remove these restrictions as soon as possible and welcomes their intention to

unify the exchange rate system by July 31, 1984. In the meantime, the Fund grants approval for the maintenance of the multiple currency practices and the retention of the exchange restrictions in the form of external payments arrears until July 31, 1984 or the completion of the 1984 Article IV consultation with Ghana, whichever is the earlier. The Fund urges Ghana to terminate the remaining bilateral payments arrangements with Fund members as soon as possible.

Decision No. 7485-(83/118), adopted
August 3, 1983

Stand-By Arrangement

1. The Government of Ghana has requested a stand-by arrangement in the amount equivalent to SDR 238.5 million for a period of 12 months from August 3, 1983 to August 2, 1984.

2. The Fund approves the stand-by arrangement attached to EBS/83/140, and waives the limitation in Article V, Section 3(b)(iii).

Decision No. 7486-(83/118), adopted
August 3, 1983

Purchase Transaction - Compensatory Financing Facility

1. The Fund has received a request by the Government of Ghana for a purchase of SDR 120.5 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 Ghana and approves the purchase in accordance with the request.

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

Decision No. 7487-(83/118), adopted
August 3, 1983

2. DOMINICA - 1983 ARTICLE IV CONSULTATION, AND REVIEW UNDER EXTENDED ARRANGEMENT

The Executive Directors considered the staff report for the 1983 Article IV consultation with Dominica, a review under the extended arrangement, and the program for 1983/84 (EBS/83/142, 7/11/83). They also had before them a report on recent economic developments in Dominica (SM/83/159, 7/18/83).

Mr. Casey made the following statement:

The extended arrangement granted to Dominica some two and one-half years ago helped the authorities to restructure the economy, reduce the external constraint and lay the basis for durable, noninflationary growth. To date all but one purchase has been made on schedule. The breach of a performance test in June 1982, caused largely by a natural disaster, led to an automatic postponement of drawing rights. Despite the serious cash-flow problems that ensued, the authorities quickly brought the program back on track.

The economy has performed well under the extend Fund facility program; the real growth rate has averaged about 5 percent a year and the inflation rate has dropped into low single figures. The reduction of imbalances has been remarkable. The current balance of payments deficit has been reduced to less than 18 percent of GDP in 1983 compared with an exceptional 56 percent in 1980. This improvement is even better than was originally targeted.

The current fiscal position, which is an important control point of the program, 1/ will now approach equilibrium, compared with a deficit equivalent to 10.5 percent of GDP in 1980. Although a slight surplus was hoped for, the achievement of equilibrium in 1983 will be no mean feat. The budget for 1983/84 was announced last month and it introduced a substantial tax package. Most current expenditure items are being cut back as much as possible. The authorities were understandably reluctant to revise the existing wage contract, which provides for a 10 percent increase starting on January 1, 1984. However, they indicated that action on this front would be considered if there were slippages on the revenue side. Looking further ahead, the Government believes that a new wage strategy should be based on the need to build up public sector savings, bearing in mind that the tax burden is already high.

Central government capital spending is, however, expected to rise sharply in 1983/84, though the extent of the increase will depend in part on donor support, particularly from the U.S. Agency for International Development. The overall fiscal deficit is likely to be some 19 percent of GDP compared with 24 percent in 1980. Given the pressing need for decent infrastructure and a more diversified export base, the overall fiscal deficit is likely to remain relatively high for some time to come. However, this deficit is financed in large part by foreign grants and

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1/ Even though the main performance criterion relates to nonconcessionary financing of the overall fiscal deficit--monitored on a quarterly basis.

concessionary loans. In addition, techniques of project evaluation and implementation have been greatly improved. Consequently, there is little cause for concern about the burden of external debt. Indeed, the staff project that the debt service ration will peak at about 14 percent in 1984 and taper off to 9.5 per cent by 1987.

Regarding the rest of the public sector, strong measures are being taken to improve organizational structure and economic performance. In addition, the authorities have stipulated that wage awards in the public enterprises cannot be finalized without government approval.

Because it is a small open economy and a member of a currency union--the East Caribbean Currency Authority (ECCA)--Dominica has limited scope for autonomous monetary policy in the sense of determining the growth of the money stock. However, there is some scope for selective credit policy. In this respect, the program for 1983/84 implies minimal credit for the public sector as a whole, thus allowing room for a 15 percent increase in credit for the private sector, the bulk of which is oriented toward productive activities, especially light manufacturing. Commercial bank lending rates are probably marginally too high, while deposit rates may be marginally too low. Fine-tuning of interest rates is made difficult both by membership in the ECCA and by the fact that the commercial banks--mostly foreign owned--insist on wide spreads because of diseconomies of scale.

The policy-constrained nature of the economy also extends to the external sector. The real effective appreciation of the exchange rate has probably caused difficulties in the export sector, particularly with regard to bananas and tourism. For the time being, the most that can be said is that all members of the ECCA are, collectively, studying the exchange rate regime.

In conclusion, even though adjustment is seen as an ongoing process, Dominica will continue to rely on grants, concessional loans, and external direct investment for several years to come. The authorities would also greatly value continued advice and financial assistance from the Fund. Even though Fund money is "expensive" in accounting terms, it carries with it the benefit of policy guidance and the Fund's imprimatur. These aspects are greatly valued by my authorities, who also wish to thank the staff for the excellent manner in which they conducted the review under the extended arrangement and the Article IV consultation.

Mr. Hull stated that he was in broad agreement with the staff appraisal and could support the proposed decision. The authorities should be commended for their vigorous response to the effects of the hurricanes in 1979 and 1980, particularly given the difficult world economic conditions at the time. Noting that so much of the program under the extended arrangement was related to recovery from those hurricanes, he wondered about the frequency of such disasters in Dominica and whether the authorities had any short-term economic contingency plans to deal with them. For the medium term, the best approach was probably a diversification of the productive sectors; in that regard, he welcomed the attempts being made to promote foreign investment, which should assist in the diversification effort. Perhaps the authorities should consider ways of encouraging the banks to overcome their reluctance to lend to the fledgling manufacturing sector. In passing, he noted that the major constraint to the expansion of the manufacturing base was the lack of suitable factory space; indeed, it was estimated in the staff report that the demand for factory space was twice the area currently under construction. It would be helpful to know the basis on which that estimate had been calculated. He added that, despite the need to encourage credit to the manufacturing sector, it would be desirable to maintain restrictions on consumer credit.

In the area of fiscal policy, Mr. Hull remarked, the welcome decline in the government deficit had been brought about, inter alia, by the elimination of transfers to state enterprises. It was essential that fiscal equilibrium on the current account should be achieved in 1983. The rationalization of the tax structure and more efficient collection of duties should complement the new revenue measures without further increasing the direct tax burden, particularly since tax revenues in 1982/83 had fallen below the levels projected in the program, mainly because of "shortfalls in import and consumption duties related to the low level of taxable imports." In that regard, he noted that imports were in fact generally on track, and he wondered whether the authorities should not have foreseen the revenue shortfall.

On the expenditure side, Mr. Hull observed that a sharp decline in the rate of inflation had reinforced the necessity for wage restraint, particularly in the public sector. Also important was the reorganization of certain public sector enterprises--particularly the vital banana industry--on a sounder financial footing, and the authorities' efforts toward that end were encouraging. In that context, he would appreciate hearing from the staff or Mr. Casey whether the 10 per cent increase in water rates--which had been scheduled to go into effect in the previous month--had in fact become effective.

Commenting on external policies, Mr. Hull welcomed the current review of the appropriateness of the exchange rate, a review that his chair had been urging for some time for several members of the East Caribbean Currency Authority. Dominica, in particular, had suffered severely from the general appreciation of the East Caribbean dollar because a large proportion of its exports were denominated in sterling, which had fallen vis-à-vis the U.S. dollar. The appreciation of Dominica's currency must have inhibited efforts to reduce the current account deficit, which would remain at more than 15 per cent of GDP in 1984. An inflexible exchange rate could easily provide less than positive signals for resource allocation and could place most of the burden of adjustment on domestic policies, particularly fiscal policy. Unfortunately, in very small island economies, overhead fiscal costs could be relatively high, so that the room for discretionary fiscal action was even more limited than in larger economies.

His chair had in the past raised the issue of possible joint consultations with the East Caribbean Currency Authority (ECCA), Mr. Hull recalled. In the recent discussion of currency unions in general, the staff had reported that no substantial progress toward joint consultations had been made, although, during the Executive Board discussion on St. Lucia, it had indicated that the question of a devaluation would be taken up at a joint Fund-ECCA consultation that the Fund was attempting to schedule for later in 1983. He would appreciate a status report on the matter.

While considerable progress toward stabilization had been made in Dominica, further adjustments were necessary, Mr. Hull considered. The program for 1983/84 seemed reasonably well balanced, and the criteria appeared to be attainable. However, it was always important in the third year of an extended arrangement to assess the problems that were likely to remain at the end of the current program. An overall balance of payments deficit was projected for 1983 and only a marginal surplus was projected for 1984; given that the current account deficit was not expected to fall below 10 percent of GDP before 1986, it would seem, prima facie, that Dominica's balance of payments position was not sustainable. In the circumstances, it would be disappointing, although not altogether surprising, if Dominica was to seek a follow-on program with the Fund. Ideally, an extended arrangement should be entirely adequate for the purposes of adjustment, although a follow-on stand-by arrangement might be justified for Dominica. On the assumption that the staff continued to view the exchange rate as inappropriate, and given the requirement of unanimity among the currency unions members in making exchange rate decisions, he would appreciate comment from the staff on the relationship between any possible follow-on stand-by arrangement and an exchange rate change in Dominica. Would it be possible to give some incentive to set the exchange rate at a more appropriate level?

Mr. Williams said that he too was in broad agreement with the staff appraisal and could support the proposed decision. The economy of Dominica had performed satisfactorily for the most part since the previous review, and the authorities should be commended for their role in that performance, particularly with respect to the better than projected improvement in the deficit of the current account of the balance of payments. In the area of fiscal policy, he had been encouraged by the plans to rationalize and diversify fiscal revenues, and he welcomed the authorities' success in containing current expenditures in 1982/83. He had been further encouraged by Mr. Casey's remark that most current expenditure items would be cut back in the 1983/84 budget.

With regard to wage policies, Mr. Williams remarked that it would be essential to keep labor costs under control. The authorities had indicated that action to revise the existing wage contract would be considered if slippages in revenue were to develop. Over the longer term, the 1984 labor negotiations--under an appropriate wage strategy to take effect when the current contract expired--should go some way toward reducing inflationary pressures in the economy. Wage policy could have important ramifications in a small and open economy like that of Dominica, and he therefore commended the authorities for their flexible approach to wages thus far.

Commenting on exchange rate policy, Mr. Williams noted the authorities' concern that the appreciation of the East Caribbean dollar had compounded the difficulties of Dominica's export sector. He joined the staff in urging the authorities to press their regional partners for an early and comprehensive re-examination of exchange rate policy in the East Caribbean area.

Interest rates in Dominica were also a source of concern, particularly given the large spread between interest rates charged and paid by commercial banks, Mr. Williams said. He would appreciate hearing from the staff or Mr. Casey what actions were envisaged to stimulate more active competition among the commercial banks. Finally, he noted with satisfaction the role of the World Bank in designing a program of capital investment; so far, progress toward that end had improved the medium-term balance of payments and growth outlook. A capital investment program should be an integral part of Dominica's overall adjustment strategy.

Given the authorities' intention to request additional use of Fund resources following the completion of the current extended arrangement, he had been disappointed that the staff paper had not provided a more comprehensive analysis of Dominica's medium-term balance of payments prospects, Mr. Williams remarked. Such an analysis should have discussed why temporary resources from the Fund were necessary and appropriate. As his chair had noted during the previous discussion of the extended arrangement with Dominica, the country's balance of payments financing needs could more appropriately be met by longer-term development financing. In various Board discussions on enlarged access and other issues related to the use of Fund resources, the United States had stressed the importance of the Fund giving priority to helping members with temporary and short-term maladjustments in their balance of payments; Fund resources should not become a substitute means of financing a country's investment program. Greater emphasis should in the future be placed on restoring Dominica's financial position in the Fund and on providing Fund resources only when there was a clear-cut need for temporary assistance. The Fund could of course continue to play an important advisory role for the Government and could continue to facilitate arrangements with bilateral and multilateral donors and creditors.

Mr. de Vries said that it was clear from Mr. Casey's opening statement that the extended arrangement with Dominica had been successful so far. Confidence had been restored, growth had been maintained, public investment outlays had increased markedly, inflation had been reduced, and prospects for the future were good. The budget was the main adjustment instrument available to the authorities because the currency union made it almost impossible to use monetary and exchange rate policy; however, the authorities had used the budget instrument well, in particular, by establishing equilibrium in the current account in order to make room for needed investment, especially in infrastructure. The budget was also a useful instrument in influencing wage levels, not only because government wages were important in the economy, but also because expenditures on wages affected budget equilibrium and thus set a limit to the amount of wages that could be paid. Despite the efforts of the authorities, wages were still somewhat excessive--for example, in the Port Authority--especially given the exchange rates. In other areas, producer prices should be raised in order to make more room for investment and domestic savings.

Commenting on monetary policy, Mr. de Vries observed that while the authorities had no opportunity to establish or use monetary policy independently from the currency union, they were able to steer available credit to various sectors. By limiting public recourse to credit, they had freed more credit for the private sector, thus stimulating diversification of the economy.

The exchange rate had appreciated sharply in both nominal and real terms, Mr. de Vries observed. Unfortunately, the scope for action by the authorities for checking that appreciation was limited; in the circumstances, the currency union itself should address the problem of the exchange rate. In passing, he noted that, while currency unions generally provided some benefits, the economic costs involved in membership were often substantial. Perhaps the members of the East Caribbean Currency Authority could learn from the members of the European Community, who agreed to fix the exchange rate when the pressures became too great. By acting in that way, the members of the European Community were able to maintain some of the benefits of belonging to the union while limiting the costs.

For the longer term, the authorities should strive to maintain investment, especially in infrastructure, and to encourage diversification, Mr. de Vries considered. Their success would depend upon the availability of external financing as well as on domestic savings. In that regard, one way to improve domestic savings was to increase the profitability of the public enterprises.

Finally, on a technical matter, Mr. de Vries said, he had noted an apparent inconsistency between Tables 17 and 27 of SM/83/159. One table showed a decline in GDP originating in construction, while the other suggested that construction activity had risen quite rapidly. He would appreciate some clarification from the staff on that matter.

Mr. Ainley considered that the authorities of Dominica were to be commended for their successful management of the economy within the framework of the extended arrangement. As noted by Mr. de Vries, performance with respect to growth, inflation, and the public finances had been encouraging; indeed, the authorities were well on their way toward meeting the main objectives of the extended arrangement.

The program for 1983/84 deserved continued Fund support, Mr. Ainley remarked. As in the past, the bulk of the adjustment would be on the fiscal side, and the measures introduced in the new budget should lead to a strengthening of the public finances and set the stage for further improvements in the medium term. He was happy to note that the authorities were well aware of the need for wage restraint in the public sector, and he encouraged them to build on the progress already made in streamlining the operations of the public enterprises.

On the external side, Mr. Ainley observed that there was a general consensus among the staff and the authorities that the appreciation of the exchange rate was causing difficulties in the export sector. He was aware of the policy constraints in the exchange rate area and thus looked forward to the results of the study currently being undertaken by the East Caribbean Currency Authority on the matter. He would appreciate hearing from the staff or Mr. Casey how that study was progressing.

The success achieved under the extended arrangement was encouraging for both Dominica and the Fund, Mr. Ainley considered. It was clear that the extended Fund facility could be useful for small as well as large members, even in periods of considerable uncertainty in the world economy. In the case of Dominica, the two ingredients essential to success appeared to have been a program specifically designed to fit the circumstances of the economy and a firm commitment on the part of the authorities to follow that program. He hoped the example of Dominica would be followed by other countries.

The staff representative from the Western Hemisphere Department, responding to questions, observed that hurricanes in the Caribbean were quite frequent, although those in 1979 and 1980 had been particularly disastrous. Relief programs had been organized in the region, but he knew of no program specifically designed to minimize the damage caused by the hurricanes.

The demand for factory space in Dominica had been estimated on the basis of the applications for fiscal incentives, the staff representative continued. In many cases, those applications arose long before investors were prepared actually to begin operations. As to whether the fall in import duties could have been anticipated, he noted that the import level was currently estimated to be much lower than projected in the original program for 1982/83, in part because during 1982 smuggling had increased. The lower outcome for the import level helped to explain the reduction in import duties. The 10 per cent increase in water rates had taken effect in early July 1983.

In response to a question by Mr. Williams about what action was envisaged to stimulate more active competition among the banks so as to reduce the interest rate spread, the staff representative from the Western Hemisphere Department remarked that the authorities had been attempting to use the National Commercial Bank to stimulate that competition. However, for historical reasons, Dominicans tended to continue to prefer to use the branches of the international banks. Perhaps in time, when there was more confidence in the local banks, greater interest rate competition could be expected. Finally, the apparent inconsistency between Tables 17 and 27 of SM/83/159 was probably due to a reclassification of government workers employed in the public investment program, the bulk of which was construction oriented.

The staff representative from the Exchange and Trade Relations Department remarked that the staff continued to believe that a joint consultation with members of the East Caribbean Currency Authority would serve a useful purpose so long as it was not used as a substitute for individual consultations. Thus far, no concrete progress had been made toward the implementation of a joint consultation.

With regard to questions on the possibility of a follow-on program with Dominica in the context of an exchange rate that was inappropriate, *the staff representative from the Exchange and Trade Relations Department* agreed that, because it was a member of the currency union, Dominica had little freedom to adjust its exchange rate. Any discussion of a follow-on program would have to take that fact into account. The implication was that domestic financial policies under a follow-on program would probably need to be tighter than otherwise. As Mr. de Vries had noted, Dominica might be in a position where the costs of being in the currency union outweighed the benefits, but that was a matter that should be raised with the currency authority.

Mr. Casey noted that, because Dominica was a small and open economy and a member of a currency union, the main performance criterion had to be on the fiscal side, where diseconomies of scale made for rather stringent conditionality. Monetary ceilings, for example, did not strike quite so close to the heart of the political process as fiscal ceilings. Nonetheless, the authorities had such a high regard for the Fund that they were prepared to take political risks to further the adjustment process. Indeed, in the 1983/84 budget, they had pushed even further than expected or required to boost revenues by action on previously exempted categories. On the matter of interest rates, it was difficult for the authorities to dictate interest rate spreads in Dominica, where most of the banks were foreign owned. The authorities could only use moral suasion to reduce the gap.

Expanding on a point by Mr. Williams, Mr. Casey considered that it would be of great benefit to Dominica if aid donors could provide additional resources; the leverage effect would be enormous in the sense that a very small amount of money could make a great difference to the economy. Moreover, given the extremely well-intentioned Government, he could guarantee that the resources would be put to productive use.

On other matters, Mr. Casey noted, first, that the estimates of the demand for factory space in Dominica came mainly from the Industrial Development Corporation of Dominica, which handled the applications for licenses to manufacture. With respect to questions on hurricanes, he observed that, at one time, the meteorologists had felt that the pattern of weather in the entire Caribbean region might be changing for the worse, although those fears had not materialized so far. There had been some thoughts about a possible collective insurance scheme for the region. An organization of banana growers in the Windward Islands was working on a collective insurance scheme for its members. The best solution to the problem of hurricane disasters was probably diversification of the productive base in Dominica; in extreme cases, the East Caribbean Currency Authority could probably disburse more reserves to countries afflicted by financial disasters, but that could only be done with the unanimous agreement of members. Perhaps the idea of a special disaster facility in the Fund should be re-examined.

The Dominican authorities were making an effort to encourage banks to lend to manufacturing, Mr. Casey remarked. However, moral suasion was the only form of encouragement that they could employ because most of the banks were foreign owned. The Industrial Development Corporation should help in the long run in developing the private sector, which would perhaps then attract the attention of the banks. The recently established Agricultural and Industrial Development Bank should also be helpful in that area.

As the staff had observed, there had been some slippage in tax revenues in 1982/83, mainly because of the lower than expected level of imports, Mr. Casey continued. Another element in the slippage might have been the postponement of a measure to raise hospital fees and charges. While the measure had been brought in later in a different guise, the postponement might have had some marginal effect on revenue performance.

Commenting on wages in Dominica, Mr. Casey agreed that a 10 percent increase might seem excessive, given the rate of inflation currently prevailing. However, when the extended arrangement had been negotiated, the authorities had inherited a commitment to increase wages by about 60 percent all at one time. It had seemed reasonable to the staff and the authorities to spread that commitment over time, and the 10 percent a year increase that had been agreed had not seemed excessive in light of the inflation rate at that point. In any event, the 10 percent wage increase scheduled for January 1984 in the public sector would be reviewed by the Government if there was any slippage on the revenue side; and the authorities were committed to a far more modest evolution of wages over the medium term.

He had little to add to the staff's comments on the exchange rate regime and the potential for joint consultations with the East Caribbean Currency Authority, Mr. Casey said. However, he saw some practical problems to such consultations. First, a great deal of staff time would be involved; second, not all members of the East Caribbean Currency Authority were members of the Fund; and finally, the pattern of trade weights varied greatly among individual members of the East Caribbean Currency Authority, and it was not clear that a single exchange rate regime could be found to suit all members. Still, he could agree with those who felt that there was some merit in considering joint consultations.

The Acting Chairman made the following summing up:

Directors expressed broad support for the views in the staff appraisal and generally commended the authorities on their performance so far under the extended arrangement with respect to growth, inflation, and adjustment. They noted, in particular, the improvement in the public finances, although they stressed the need for further progress in raising public sector savings. Directors agreed that the finances and management of the public enterprises should be strengthened, and they welcomed plans for the restructuring of the banana industry.

Directors observed the sustained increase in public investment since 1979/80, which was based largely on the receipt of foreign concessional assistance. They remarked that Dominica would continue to require substantial external concessional assistance in the coming years to develop infrastructure and strengthen the economy. Directors noted the Government's intention to request additional use of Fund resources, following the completion of the current extended arrangement, in order to underpin further balance of payments adjustment; it was observed in that regard that it would be important to ensure an appropriate and temporary use of those resources.

Directors pointed to Dominica's success in creating a favorable environment for private investment--which was partly attributable to the marked improvement in industrial relations--and they urged further efforts toward that goal. They expressed concern over the fact that wage increases were currently in excess of the existing and projected rate of inflation and emphasized that wage restraint was needed to secure the required improvement in public finances and to preserve the competitiveness of Dominica's export sector, especially in light of the recent real appreciation of the East Caribbean dollar on a trade-weighted basis with respect to Dominica.

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

The Executive Board adopted the following decision: 1/

Review Under Extended Arrangement

1. Dominica has consulted the Fund in accordance with paragraph 3(b) of the extended arrangement for Dominica (EBS/81/12, Supplement 1, February 9, 1981) and paragraph 15 of the letter dated June 17, 1982, attached thereto, in order to reach understanding with the Fund regarding policies and measures that Dominica will pursue and to establish performance criteria subject to which purchases may be made by Dominica during the remaining period of the extended Fund facility arrangement.

1/ See EBS/83/142, Correction 1 (8/12/83).

2. The letter dated June 3, 1983 from the Prime Minister and Minister of Finance, Trade and External Affairs of Dominica shall be attached to the extended arrangement for Dominica (EBS/81/12, Supplement 1, February 9, 1981) and the letters dated December 5, 1980, July 20, 1981, and June 17, 1982 shall be read as supplemented and modified by the letter dated June 3, 1983.

3. Accordingly, Dominica will not make purchases under this extended arrangement:

(a) during any period after July 1, 1983 in which the data at the end of the preceding period indicate that the limit on the overall budget deficit specified in paragraph 14 of the attached letter dated June 17, 1982 and paragraph 15 of the attached letter dated June 3, 1983, is not observed.

4. Purchases under the extended arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 7,125,000 until August 15, 1983; the equivalent of SDR 7,597,000 until November 15, 1983; and the equivalent of SDR 8,074,000 until January 15, 1984.

Decision No. 7488-(83/118), adopted
August 3, 1983

APPROVED: February 17, 1984

JOSEPH W. LANG, Jr.
Acting Secretary