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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 83/143

10:00 a.m., September 19, 1983

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

Executive Directors	Alternate Executive Directors
A. Alfidja	W. B. Tshishimbi
	M. K. Diallo, Temporary
	G. Ercel, Temporary
	X. Blandin
	R. J. J. Costa, Temporary
R. D. Erb	C. Dallara
	J. C. Williams, Temporary
	S. R. Abiad, Temporary
T. Hirao	T. Yamashita
J. E. Ismael	Jaafar A.
	M. Casey
	G. W. K. Pickering, Temporary
	H. A. Arias, Temporary
G. Laske	G. Grosche
G. Lovato	C. P. Caranicas
R. N. Malhotra	A. S. Jayawardena
	J. E. Suraisry
J. J. Polak	T. de Vries
A. R. G. Prowse	K. G. Morrell
	O. Kabbaj
F. Sangare	M. Camara, Temporary
	M. Toro, Temporary
J. Tvedt	I. Fridriksson, Temporary
N. Wicks	C. Taylor
Zhang Z.	Wang E.

A. Wright, Acting Secretary
S. J. Fennell, Assistant

Also Present

African Department: J. B. Zulu, Director; L. M. Goreux, Deputy Director; O. B. Makalou, Deputy Director; M. W. Bell, E. L. Bornemann, F. d'A. Collings, A. B. Diao, M. Edo, C. Enweze, C. A. François, R. A. Franks, J. E. Greene, U. R. Gunjal, A. Jbili, J. W. Kratz, H. R. Lorie, R. L. Sharer, P. C. Ugolini, E. S. Williams, A. C. Woodward. Exchange and Trade Relations Department: W. A. Beveridge, Deputy Director; A. Abisourour, C. Atkinson, Y. Boutros-Ghali, L. El-Erian, S. Kanesa-Thasan, M. Watson. Fiscal Affairs Department: A. Tazi. Legal Department: W. E. Holder, J. M. Ogoola, J. V. Surr. Research Department: L. Alexander, K.-Y. Chu, N. M. Kaibni, P. R. Menon. Personal Assistant to the Managing Director: N. Carter. Advisors to Executive Directors: A. A. Agah, C. J. Batliwalla, T. A. Connors, S. El-Khouri, H. S. Lee, P. D. Péroz. Assistants to Executive Directors: E. M. Ainley, H. Alaoui-Abdallaoui, R. Bernardo, C. Flamant, V. Govindarajan, D. Hammann, N. U. Haque, C. M. Hull, W. Moerke, J. A. K. Munthali, V. K. S. Nair, J. Reddy, J. Schuijer, D. I. S. Shaw, N. Toe.

1. IVORY COAST - EXTENDED ARRANGEMENT - MID-TERM REVIEW, AND PURCHASE TRANSACTION - BUFFER STOCK FINANCING FACILITY

The Executive Directors considered the staff paper on the mid-term review under the extended arrangement for Ivory Coast (EBS/83/184, 8/26/83), together with a request by Ivory Coast for a purchase equivalent to approximately SDR 1 million under the buffer stock financing facility (EBS/83/186, 8/26/83; and Sup. 1, 9/16/83).

Mr. Alfidja stated that Ivory Coast performance under the present program was a success story. His authorities agreed with the staff appraisal; in particular, the policy emphasis could be increasingly shifted from demand-restrictive to supply-enhancing policies, which should be more propitious to the needed resumption of growth. The grounds for the request for a drawing under the buffer stock financing facility were clear-cut, and he urged Executive Directors to approve both decisions.

Mr. Blandin indicated his support for the request for buffer stock financing. With regard to the review under the extended arrangement, the program had remained on track despite the seasonal discrepancies between revenues and expenditures that had affected performance criteria for the end of March 1983. He was sure that the program would remain on track until the end of the adjustment period. The performance of the Ivorian economy was particularly commendable as a number of assumptions underlying the program had been overoptimistic. Despite the unfavorable external environment, the authorities had persevered and had continually adjusted their efforts to cope with the difficulties. The fiscal deficit was now expected to be lower by almost 1 percentage point than had been envisaged at the beginning of the program.

Undoubtedly, the economy had suffered in terms of growth, and the recent drought had contributed considerably to the reduction in real GDP for the second year in a row, Mr. Blandin observed. The courageous action taken by the authorities in the previous three years would have lasting results and would put Ivory Coast in a better position to take advantage of a world economic recovery, which he hoped would prove durable. The structural adjustment loan of $250 million granted by the World Bank to Ivory Coast was welcome. The conditionality attached by both the Fund and the World Bank to their programs complemented each other in a useful manner.

As for medium-term prospects, Mr. Blandin asked the staff to indicate its assumptions concerning future world prices for coffee and cocoa. Producer prices for those two commodities would be increased from CFAF 300 to CFAF 350 per kilo in October 1983--a much needed adjustment, as prices had remained at the same level for the previous four years. Consequently, agricultural producers had borne a great deal of the burden associated with the adjustment efforts. He was surprised to observe that the price increase was the same for both commodities; the staff had previously indicated that it would recommend a higher increase for coffee, which was more costly to produce than cocoa in terms of both labor and input. Could the staff comment on that situation?

The balance of payments position would remain difficult in future years and Ivory Coast would continue to need Fund support, Mr. Blandin observed. The authorities would need to maintain strict discipline, particularly with regard to investment outlays. Scarce resources would have to be directed to the most productive projects and not to infrastructure projects, such as the completion of the highway.

Mr. Grosche indicated his agreement with the staff appraisal. He commended the authorities for having met all the performance criteria. After five years of continuous deterioration, Ivory Coast's terms of trade would show a modest improvement in 1983. He hoped that coffee and cocoa prices would remain stable in 1984. Assuming that the public finances and the external balance would improve further in 1984, he could support the staff's suggestion to shift the emphasis from demand-restrictive to supply-enhancing policies, which would help to bring about a resumption in growth. One major element of the supply-side policy would be to improve the profitability of the public sector enterprises, in particular, the oil refinery, the multinationals, and some of the commercial banks. Ivory Coast had made some progress, but financial and monetary discipline would need to be continued. He welcomed the authorities' intention to pursue their adjustment efforts in the future, and he agreed with the staff that those efforts should be supported by Fund programs. In conclusion, he supported the proposed decision regarding the buffer stock financing facility.

Mr. Camara noted that for the previous three years there had been no economic growth in Ivory Coast. Agricultural production had been seriously affected by poor weather conditions; 1983 projections of oil production were lower than originally expected; and gross investment was expected to decline, accentuating the recession in the construction industry.

On the fiscal side, all but one of the measures regarding price and expenditures had been implemented, Mr. Camara observed. He commended the authorities for the steps taken, which included the introduction of additional taxes and an increase in the price of edible oil. He welcomed, in particular, the authorities' efforts to control expenditure on salaries, housing, and education. The fiscal targets set for 1983 had been met, although more remained to be done in the future.

On the external side, an improvement in the terms of trade and a recovery in the price of cocoa and coffee were expected in the short term, Mr. Camara noted. He was concerned, however, with the projected reduction of capital inflows, which would seriously affect the balance of payments position. More effort was needed to build confidence in public investment projects and to make them more attractive to external financing. A modest increase in real GDP was projected for 1983. Finally, he could support the request for a drawing under the buffer stock financing facility.

Mr. Pickering commented that Ivory Coast's experience under the extended arrangement reflected many successes as well as some disappointments. Among the successes was the major fiscal improvement that had been made in spite of the less hospitable than envisaged external environment. In addition, the authorities had succeeded in meeting virtually all of the performance criteria, and he had no reason to doubt that they would continue to adhere to the program's performance criteria. However, it was a major disappointment that economic performance had remained weak during the previous few years and that it was unlikely that a sustainable balance of payments position would be achieved by the end of the current program.

Commenting on the performance under the 1983 program, Mr. Pickering said, first, that it was commendable that most of the discretionary fiscal policy measures had been implemented as planned. He encouraged the authorities to implement the proposed measures to reform the education system. Any further information on the status of those measures would be appreciated. Second, he welcomed the overall improvement in the public enterprise sector in 1981, although greater progress might have been made in that area. Both the current and the overall deficits of the consolidated public enterprise sector--based on nine enterprises--would be larger in 1983 than they had been in 1980. Furthermore, the staff had indicated that the performance of two multinational parastatals--the railway company (RAN) and the cement clinker enterprise (CIMEO)--had been poor. Could Mr. Alfidja or the staff comment on the adequacy of any proposals that were intended to remedy the situation?

Third, on the external side, the continued improvement of the trade balance and the reduction in the current account deficit were encouraging, although progress was more modest than he would have hoped, Mr. Pickering indicated. He welcomed the staff's efforts to organize statistics on short-term external debt and encouraged the authorities to make further progress in that area, perhaps with the benefit of some technical advice from the Fund.

On prospects for 1984, he had hoped that greater progress would have been made toward external payment sustainability under the current program, since Ivory Coast's request would take it to the maximum access limits for Fund resources, Mr. Pickering stated. In view of the already high level of access, there would be little room for maneuver with regard to use of Fund resources under a follow-on program. There was, therefore, not much scope for relaxing the adjustment efforts. In conclusion, he fully supported the proposed decisions.

Mr. Kabbaj indicated his support for the proposed decisions. It was encouraging to note that the adjustment program was back on track and that the program targets would be met. The success was due mainly to the authorities' implementation of the fiscal, monetary, and external policies announced under the program and to the introduction of additional measures whenever necessary. The Ivorian economy had also benefited from the recovery in coffee and cocoa prices in 1983.

The public sector and external current account deficits were projected to be below revised program targets as a result of the lower than expected public expenditures, Mr. Kabbaj observed. However, it was discouraging to note that real economic growth would be slightly negative in 1983, after a reduction of 3.3 percent in 1982 and an insignificant rate of real growth in the first year of the program. Although that poor performance was largely due to exogenous factors and technical difficulties--including adverse weather conditions and bush fires--it was also attributable to three years of tight demand management policies. Such policies had been successful in reducing the public sector deficits; in streamlining ailing public enterprises and bringing their finances under control; and in reducing external imbalances and the large foreign debt. However, the resumption of significant real economic growth was necessary to sustain that improvement, particularly given the high rate of population growth. He, therefore, supported the staff's view that it would be desirable to shift the emphasis from demand-restrictive to supply-enhancing policies.

The request for a purchase under the buffer stock financing facility met all the requirements, particularly with respect to balance of payments need and cooperation with the Fund, Mr. Kabbaj considered. Finally, he hoped that Fund assistance would extend beyond the period of the extended arrangement, especially as the external deficit and the outstanding foreign debt remained at unsustainable levels in the medium term in spite of the commendable progress achieved in the previous three years.

Mr. de Vries stated that he could support the proposed decisions. The authorities had introduced a number of important measures, and the economy had performed well over the previous three years. Like other Directors, he believed that it would be appropriate to shift emphasis from demand-restrictive to supply-enhancing policies. The first step in that respect would be to improve the profitability of the public sector enterprises.

Many problems remained and the authorities should consider entering a further Fund-supported program in order to bring about the desired increase in economic growth, Mr. de Vries went on. However, as Mr. Pickering had noted, the authorities had already used Fund resources totaling 450 percent of quota. The Fund was not a development institution such as the World Bank, which provided long-term assistance; it was a provider of short-term credit. While Ivory Coast had performed well under the program, he was concerned that the Fund had not required adjustment in line with the level of resources provided to the authorities. Ivory Coast clearly needed more assistance, but the amount of resources that the Fund could provide was limited. The Executive Board should have a more general discussion on that issue.

Mr. Suraisry indicated his support for the proposed decisions. The case of Ivory Coast was a successful one. After several years of decline there had been an improvement in the terms of trade. That improvement would alleviate some of the hardship caused by three successive years of no real GDP growth. The end-June 1983 performance criteria had been met as a result of the authorities' commendable efforts, and he encouraged them to continue implementing adjustment measures. It was appropriate to shift the emphasis from demand-restrictive to supply-enhancing policies. Finally, he supported the authorities' intention to request a follow-up program with the Fund.

Mr. Williams said that he was in general agreement with the staff appraisal and could support the proposed decisions. The revised projections for 1983 indicated that the expected public sector and current account deficits would be better than had been anticipated in June 1983. However, he was particularly concerned that the projected improvement in the external current account over the period of the arrangement was still less than had been called for under the original program.

He could accept the staff's explanation regarding the authorities' inability to meet the end-March 1983 performance criteria, Mr. Williams continued. On a related point, he noted that Ivory Coast had recently borrowed $75 million, two thirds of which had been disbursed prior to June 30, 1983. Would the performance criteria have been met if that borrowing had not taken place before the end of June?

The authorities intended to request a follow-on arrangement with the Fund, Mr. Williams noted. There was no doubt that the external environment had been more difficult than expected and that, therefore, the authorities had been unable to meet the original targets. Although his chair was prepared to keep an open mind with regard to Ivory Coast's request, it would examine such requests closely and in a medium-term context. In particular, his authorities would want the staff to justify why Fund resources, as opposed to other types of resources, should be committed.

The Deputy Director of the African Department said that even if the $50 million of the short-term loan--totaling $75 million--had not been disbursed on June 30, 1983, the subceiling on net credit to the Government would have been met with some margin. The overall ceiling on net domestic assets would have been exceeded by CFAF 1 billion, a relatively small amount that was due entirely to an increase in crop credit.

The staff assumption regarding export prices in the medium term was more conservative than the one used in the world economic outlook paper, the Deputy Director explained. The staff had been cautious because, in practice, prices might be lower than those quoted in the market. As Mr. Blandin had noted, the staff had mentioned previously that the producer price for coffee should be raised more than that for cocoa. However, in the present year there had been a drought and cocoa prices had increased substantially, while the output had declined. The authorities had decided provisionally to increase the prices for coffee and cocoa by the same amount. It would be wise for them to announce the price increases in the immediate future, because producers were withholding cocoa.

Some improvement had already been made in the operations of the public enterprises and the structural adjustment loan from the World Bank was essentially geared to improving those enterprises further, the Deputy Director indicated. After the various measures introduced during the previous three years, the greatest scope for increasing economic performance would be to reduce the deficit or increase the profit of the public sector enterprises. Two of those enterprises--the railroad company and cement factory--were jointly operated by several countries. Although, in principle, such multinational companies were a good idea, in practice they presented a number of problems. Ivory Coast was considered more creditworthy than the other partners--Upper Volta for the railroad, and Togo and Ghana for the cement company. It had therefore to bear the financial burden of any problems that arose. The President had taken the matter personally in hand, but it was difficult to arrive at an immediate solution.

Economic growth performance in Ivory Coast had been disappointing, the Deputy Director commented. Although the fiscal targets under the adjustment program had been met, economic growth had been much lower than expected. In fact, GDP in nominal terms and fiscal receipts were both about 15 percent lower than the staff had projected. Furthermore, gross borrowing would be considerably lower than had been foreseen in 1980, and would be even lower than indicated in the staff paper because it had become more difficult to finance a number of projects. Although reduced borrowing would improve the debt service burden in the medium term, the short-term effect on GDP and revenues would be negative as a result of a lower level of investment.

A number of Directors had expressed disappointment that after three years of adjustment the improvement in the external balance and the current account deficit had not been as great as foreseen, the Deputy Director recalled. However, Directors should realize that it would take several years before the impact of expenditure cuts would be felt, since many of the investment programs under way would have to be completed.

He agreed with the view of most Directors that it would be necessary for Ivory Coast to pursue a further Fund-supported adjustment program, the Deputy Director said. The amount of resources that would be available to the authorities would depend on access policy. In any event, the amount would not be very large and, in view of the repurchases, there would be a net outflow of resources from Ivory Coast to the Fund. A further purchase would only minimize that outflow.

As for the status of the educational reforms, all measures had been taken with the exception of the one dealing with scholarship modification, the Deputy Director of the African Department indicated. The Council of Ministers had approved the decree regarding the scholarship modification, but the President was waiting until he was present in the country before announcing the measure. The staff would be raising that issue with the President at a meeting on September 21, 1983.

Mr. Alfidja observed that the Deputy Director had suggested that the Fund might be involved with an adjustment program for Ivory Coast in 1984 and 1985, and some Executive Directors had mentioned Fund involvement on a medium-term basis. The question of the form of further use of Fund resources should be kept open because of the structural nature of the problems facing Ivory Coast. He assumed that the staff had not completely excluded the possiblity of a new extended arrangement.

The Executive Board should reconsider the Fund's access policy, Mr. Alfidja remarked. It would be inappropriate to limit a country's involvement with the Fund at a time when a turnaround could be achieved rapidly if a further adjustment program was adopted. There was justification for some exceptions to the policy of enlarged access.

The Executive Board then took the following decisions:

Extended Arrangement - Mid-Term Review

Ivory Coast has consulted the Fund in accordance with paragraph 3 of the extended arrangement for Ivory Coast (EBS/81/34, Supplement 2, March 5, 1981) and paragraph 3 of the letter of January 19, 1981, annexed thereto, from the Minister of Economy and Finance, and paragraphs 19 and 20 of his letter of March 1, 1983, annexed thereto. The Fund finds that no new understandings are necessary at this time.

Decision No. 7533-(83/143), adopted
September 19, 1983

Purchase Transaction - Buffer Stock Financing Facility - International Natural Rubber Agreement

1. The Fund has received a request by the Government of Ivory Coast for a purchase of approximately SDR 1 million under the Decision on Buffer Stock Financing: The Problem of Stabilization of Prices of Primary Products, Decision No. 2772-(69/47), adopted June 25, 1969, as amended by Decision No. 4913-(75/207), adopted December 24, 1975, and the Decision on Buffer Stock Financing: International Natural Rubber Agreement, Decision No. 7246-(82/147), adopted November 12, 1982.

2. The Fund determines that this purchase would be consistent with the decisions referred to in paragraph 1 above, notes the representations of Ivory Coast, and approves the purchase in accordance with the request.

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

Decision No. 7534-(83/143), adopted
September 19, 1983

2. MALAWI - EXTENDED ARRANGEMENT

The Executive Directors considered a request by Malawi for an extended arrangement equivalent to SDR 100 million (EBS/83/183, 8/26/83).

The staff representative from the African Department made the following statement:

> According to a communication received from Malawi over the weekend, the Malawi kwacha was devalued on September 17, 1983 by 5 percent and Malawi adopted, in place of the SDR, a new currency basket more representative of the direction of external trade flows.
>
> The authorities have adopted an administrative reform that limits to 60 days the period in which the Government must respond to applications for price increases.
>
> The World Bank staff believes that Malawi's public sector investment program is appropriate in its overall objectives, including the provision of support to agriculture and agro-based or import-substituting industries, and the improvement of internal and external transportation routes. Agreements have been reached between the Malawian authorities and Bank staff on the broad framework for restructuring Press Holdings Limited and the major parastatals, and the Bank staff is satisfied that the decisions that have been taken by the Government so far are in accord with these agreements. Completion of the examination of these programs is expected during the formal negotiations of the second World Bank structural adjustment loan, which is scheduled to take place in October 1983.

Extending his remarks, the staff representative stated that although the Malawian authorities had agreed to carry out an exchange rate devaluation of 5 percent immediately prior to the Executive Board meeting, to adopt a new trade-weighted currency basket in place of the SDR, and to further devalue the currency by 7 percent over a period following the Annual Meeting, they had in fact carried out the entire devaluation of 12 percent in one step on September 17, 1983. The authorities had not yet adopted a new currency basket, but would do so in the near future.

Mr. Sangare made the following statement:

> I should like to start by thanking the staff and management for the understanding shown in evaluating the problems facing the economy of Malawi; I wish to compliment them for the clear and concise paper prepared for the Board's consideration today. The Malawian authorities are indeed grateful for the manner in which the staff conducted the discussions.

Background

Following the weak economic performance and increasing financial imbalances that emerged in the Malawian economy since 1978, the authorities embarked upon a stabilization program in 1980/81 that was supported by a two-year stand-by arrangement. Despite some initial successes, however, the difficulties persisted. The stabilization efforts were therefore continued in 1982/83 with the understanding that continued efforts would be required over the medium term aimed at bringing the economy back on the path of rapid and sustained growth. The growth of GDP at 2.7 percent in 1982/83, though negligibly above the rate of population growth, was an improvement over the previous year, while consumer price increases slowed. The overall budget deficit was reduced from 10.6 percent of GDP in the previous fiscal year to 7.1 percent in 1982/83, although it remains high. The balance of payments position, however, remained worrisome as the overall deficit widened in 1982 by about SDR 30 million. This was due, in part, to a substantial decline in long-term capital inflows.

With the successful implementation of the program, the authorities considered that the stage had been set to initiate policy measures that would address the longer-term problems of the economy. In this connection, a comprehensive set of measures, including a three-year investment program, have been worked out and are being used as the basis for securing a structural adjustment loan from the World Bank and as a means of increasing bilateral assistance from donor countries and other multilateral financial institutions. The discussions with the World Bank have reached an advanced stage and preparations for a donors' conference to mobilize external assistance are well under way. The authorities consider that the Fund has an important role to play in this regard, perhaps as a catalyst in mobilizing external resources, including debt rescheduling.

The medium-term strategy

The authorities are seeking to expand and diversify output, placing greater emphasis on export production in order to reduce the economy's vulnerability to adverse developments in the world economy. Public sector investment, which has been prepared in close consultation with the World Bank, is expected to increase from 15 percent of GDP in 1982 to 19 percent in 1986, with sectoral allocation being made in favor of directly productive projects in agriculture and industry. This will be supported by appropriate producer price incentives. Consequently, real GDP growth is projected to rise from 2.7 percent in 1983 to 4.5 percent by 1986.

An important element of the investment program is the construction of roads that will serve as alternative routes to seaports in order to minimize the impact of congestion and constant disruptions on railway lines to ports in Mozambique. The Fifth Highway Project, which is to commence in the current fiscal year, and the purchase of a tanker boat are initial steps to provide access to outlets in Tanzania.

The medium-term strategy also involves further rationalization of public sector enterprises, including Press Holdings Limited, in order to make them self-supporting. To this end, a number of detailed studies involving individual enterprises are either under way or have been completed in connection with the World Bank structural adjustment loan. Furthermore, the authorities intend to steadily reduce subsidies, particularly those on fertilizers which will be eventually eliminated by 1984/85. In the area of consumer prices, steps have been taken to reduce administrative controls to enable industrial enterprises to make timely adjustments with increases in costs.

The 1983/84 program

In the near term, the authorities are pressing ahead with the reduction in financial imbalances in the economy, while continuing to lay the basis for sustained growth. As regards the latter, new prices were announced on September 11, 1983, well before the beginning of the growing season. These increases are in addition to those granted in 1982/83, which included a 40 percent increase in smallholder tobacco prices and a 50-80 percent rise in the prices of groundnuts, peas, and pulses. The increase in the price of cotton is aimed at encouraging production to meet domestic requirements.

The authorities intend to continue their policy of containing the growth in expenditure, while implementing a number of new revenue measures. No increases in salary have been allowed in the 1983/84 budget and appropriations have been reduced in real terms for a number of sectors. Those sectoral increases that have been allowed, such as for rural agriculture, education, and road maintenance, have been kept in line with the recommendations of the World Bank. With regard to revenue, the measures that have been implemented are expected to yield a total of MK 16.1 million in additional tax revenue. These include increasing excise duties on soft drinks, malt, beer, and tobacco; expanding the surtax to include some of the local manufactures and imports that were originally exempt; and introducing a temporary levey on imports. As a result of the revenue and expenditure measures, the budget deficit is expected to drop further from the equivalent of 7.1 percent of GDP in 1982/83 to 6.4 percent in 1983/84. The target over the medium term is to reduce the deficit to the equivalent of 4.8 percent by 1985/86.

Efforts to improve the financial position of public enterprises are continuing. Following the increase in charges for public utilities and Air Malawi early in 1983, the authorities intend to make further reviews during the course of the year to ascertain whether further increases are necessary. In the meantime, a number of institutional changes are under way involving the rationalization of assets among the main holding companies. In the particular case of Press Holdings Limited, such rationalization will involve, among other things, the closing down or sale of unprofitable subsidiaries.

Monetary and credit targets have been formulated in line with anticipated fiscal developments as well as the balance of payments objective while ensuring adequate availability of credit for productive projects in the private sector. On June 1, 1983 the authorities increased savings and deposit rates by 2 percentage points making them positive in real terms. On the other hand, the maximum lending rate was considered to be too high and was reduced from 18.5 percent to 16.5 percent. This still provides adequate operating margins to the banking sector.

The medium-term objective is to further reduce the deficit to 5.6 percent of GDP by 1985 by containing the growth in imports and diversifying exports into coffee, groundnuts, and manufactures. As the balance of payments progressively strengthens, and assuming that projections for capital inflows are realized, the need for debt relief could be eliminated after 1983/84. In the meantime, the Malawian authorities will be seeking further relief in 1983/84 from both the Paris and London Club members, including a possible separate agreement with the Commonwealth Development Corporation. In view of the high debt service burden, the authorities are committed to avoid further borrowing on commercial terms.

On exchange rate policy, the authorities have adopted a more represntative basket of currencies as the peg for the Malawi kwacha in order to avoid loss of competitiveness arising from the higher weight of the U.S. dollar in the SDR. They will continue to maintain a flexible policy in order to avoid erosion of competitiveness.

In conclusion, it might be noted that the staff agrees that adequate measures have been taken to achieve the stated objectives of the program. The World Bank has evaluated the investment program and the restructuring exercises going on in the parastatal sector and has indicated that they contain the necessary elements to achieve rapid and sustainable growth. Accordingly, I should like to request Directors to approve the decision appearing on page 38 of the staff paper (EBS/83/183).

Mr. Wicks said that he questioned whether the extended Fund facility was the most appropriate facility to help Malawi at the present stage of its development, but nothing he said should be taken as a criticism of the Malawian authorities. For many years, the Malawian economy had been a shining example of successful development in Africa. Indeed, the adjustment program being considered by the Executive Board and the authorities' policies had many positive features. Furthermore, he did not want anyone to conclude from his remarks that his chair believed that countries such as Malawi should not be eligible for purchases under the extended Fund facility, as that would be a denial of the principle of uniformity of treatment. Indeed, at the Executive Board meeting on September 16, 1983 (EBM/83/141), his chair had raised the possibility of an extended arrangement for Uganda.

Nevertheless, Mr. Wicks went on, he did have some doubts concerning the staff proposal. Following the economic deterioration in 1979, Malawi had adopted a succession of stand-by arrangements that had slowed but not halted that deterioration. The economy still remained fragile and required further adjustment over a period of several years if economic growth and financial stability were to be assured. Yet, even with the adoption of an extended arrangement, the Malawian economy might not achieve a sustainable position by the end of the program period. The fiscal deficit was anticipated to decline from 6.4 percent of GDP to 4.8 percent of GDP, a modest improvement considering that the extended Fund facility was the Fund's most comprehensive facility. The turnaround in the balance of payments position was not striking; the overall balance would only just record a surplus in 1985. Furthermore, the balance of payments projections appeared to rely heavily on concessional aid flows, not all of which were assured. On a more detailed point, there were still critical gaps in the data on investment projects to be undertaken by the parastatal enterprises outside the government budget.

In short, in Malawi's case it would have been more appropriate to rely on a series of stand-by arrangements, Mr. Wicks considered. However, as the staff had proposed an extended arrangement, he would have preferred the adjustment measures to have been more front-loaded. A clearer timetable for the implementation of each adjustment measure should have been established.

Furthermore, on a matter of principle, he did not believe that a Paris Club rescheduling arrangement would require a debtor to have implemented an extended arrangement with the Fund, Mr. Wicks remarked. The Paris Club members would want the debtor country to be pursuing sound policies, and for that purpose a Fund stand-by arrangement was just as appropriate as an extended arrangement. At the Executive Board discussion on Grenada, a number of Directors had also been concerned about whether the extended Fund facility was the appropriate instrument in that country's case. Perhaps the Executive Board should have a general policy discussion at a later date on the extended Fund facility.

As for the main components of the adjustment program, Mr. Wicks continued, he welcomed the reduction in the fiscal deficit to 7 percent of GDP. However, the projections did appear rather modest and he wondered whether the staff thought that there was greater scope in restraining expenditure at an earlier stage in the program to give some margin of safety. On monetary policy, the raising of interest rates in June 1983 was welcome. Given the ambitious projections for domestic savings, it would be important to maintain positive interest rates on deposits. He supported the authorities' intention to make more credit available to the private sector, but it should be done in a way that would contain the growth in the money supply. The staff and the authorities should keep in mind the need to prevent an expansion of bank liquidity, particularly if the special local registered stock to be issued was allowed to meet the banks' liquidity ratio requirements.

On the supply side, the strong and profitable agricultural sector would be the main engine of growth in the medium and long term, as in the 1970s, Mr. Wicks observed. In addition, that sector offered the best prospects for increasing the Government's revenue base. The procedure introduced by the World Bank relating producer prices to "farmgate" prices was welcome, and the authorities' commitment to maintain real rates of return for smallholders was encouraging. The establishment of a revolving fund to cover the early import of fertilizer and the proposal to establish medium-term guarantees were commendable. Could the staff indicate whether those measures would enhance the profitability of the estates as well as smallholders?

Commenting on the parastatal enterprises, Mr. Wicks remarked that he welcomed the recovery of Air Malawi. Steps taken to improve the performance of the Agricultural Development and Marketing Corporation (ADMARC) and to restructure Press Holdings Limited, whose poor performance in recent years had made Malawi's economic and financial problems worse, were appropriate. But the staff paper indicated that serious problems remained with regard to other parastatals, such as the Electricity Supply Company of Malawi (ESCOM), the Malawi Development Corporation (MDC), and the Malawi Housing Corporation (MHC); he hoped their financial performance could be improved.

On the external side, the 12 percent devaluation of the kwacha was a move in the right direction, Mr. Wicks indicated. The debt service burden was heavy, and the program ceiling on new nonconcessional borrowing of 1-12 years maturity and the authorities' intention to attract more foreign capital were appropriate. The debt reschedulings would ease the burden on the balance of payments until 1984, but the debt service ratio would remain above 30 percent in 1987. It was rather disturbing that no significant buildup in foreign reserves was expected until after that year.

The length at which he had spoken was evidence of his authorities' interest in Malawi, Mr. Wicks continued. He would have preferred the structural adjustment to be achieved in a step-by-step process, and his chair might wish to press that approach in future cases. He noted that the disbursements were concentrated toward the end of the program period and he was, therefore, prepared to support the proposed decision.

Mr. Casey indicated his agreement with the staff appraisal. It was difficult to assess whether the authorities' intention to make improvements in the different sectors would improve the economy as a whole. The staff had attempted to put the adjustment measures in a medium-term context but its assumptions could not be taken too literally. Most developed countries spent at least a year designing a medium-term plan; not only good national accounts, but also such information as flow of fund statements, input-output matrices, and behavioral relationships were required. Developing countries did not have that kind of data base. Moreover, they were more vulnerable to external conditions.

Although the staff paper did indicate the policy measures to be taken in the first year of the program, very little information was given on policy measures to be implemented in the remaining years, Mr. Casey observed. Like most adjustment programs, Malawi's extended arrangement would require policy corrections as events unfolded. Such an ad hoc approach was usually employed by developed countries where policies were adjusted each year in light of recent developments. He was not criticizing the adjustment programs of Malawi; rather, he was explaining that it was difficult to specify the details of any program at the beginning of the adjustment period.

On another general point, although the World Bank was heavily involved in Malawi, it would be naive to assume that there was not a significant developmental aspect to the proposed extended arrangement, Mr. Casey considered. The achievement of a sustainable balance of payments position in the medium term very often depended on economic development. It was a question of whether development was a means of achieving balance of payments sustainability. As he believed that the adjustment measures would bring about export-led growth, he could support the program.

Nevertheless, he did have a number of concerns, Mr. Casey remarked. With regard to fiscal policy, the reduction in the overall fiscal deficit to 6.4 percent of GDP in the first year and the reductions planned for future years were not substantial. In fact, the degree of fiscal adjustment over the three-year program period was no greater than the adjustment that Senegal was expecting to accomplish in one year. It was surprising that no increase in the ratio of revenue to GDP was planned.

On the expenditure side, in the light of World Bank advice, emphasis was being given to education, railroad projects, and roads, Mr. Casey continued. As a result, other expenditures would have to be reduced in real terms over the program period. Was it realistic to reduce wage increases and to eliminate subsidies? After insistence by the World Bank, the authorities were considering a reduction in personal allowances and the imposition of fees for attending the national university. Other aspects of expenditure cuts would be studied, but it was difficult to determine what the outcome would be, in particular with regard to the parastatals.

On monetary policy, the staff had stated that targets for monetary aggregates would be formulated annually in light of balance of payments developments, which suggested an ad hoc approach that was probably inevitable in any medium-term program, Mr. Casey noted. The staff projections did seem reasonable, however, and he welcomed the emphasis on increasing credit to the private sector and the authorities' intention to keep interest rates at least equal to the underlying rate of inflation, which he presumed was the best indicator of the expected rate of inflation.

On the external side, the decline in the current account deficit from 9 percent of GDP in 1982 to 5.4 percent of GDP in 1986 was not a very fast-paced adjustment, Mr. Casey stated. The staff considered the 1986 ratio to be sustainable in light of continuing capital inflows, even without further debt relief. He hoped that the staff was right, although it did seem a rather optimistic view; much depended on whether there would be a resumption of export-led growth within three years.

He welcomed the decisions to peg the currency to a more appropriate basket of currencies rather than to the SDR and to follow a flexible exchange rate policy, Mr. Casey commented. Furthermore, the one-step devaluation of 12 percent was appropriate.

Like Mr. Wicks, he was concerned about the lack of information on a number of aspects of the adjustment program, Mr. Casey continued. As the staff had stated, "Current data do not provide a full indication of investment projects to be undertaken by parastatals outside the central government budget." Furthermore, there was no information on price controls, although the authorities had agreed to conduct a comprehensive review of those controls. In addition, there was a lack of information on the donors' conference to be held in 1984. In spite of the information gaps, he accepted the authorities' intention to take compensating action as required. The choice between an extended and a stand-by arrangement was never easy to make. He supported Mr. Wicks's proposal to review the guidelines in that area in the future. In sum, an extended arrangement was justified in Malawi's case as the authorities had not only improved existing policies, but had also developed a new policy instrument, namely, the exchange rate.

Mr. Laske remarked that Malawi's request for a purchase under the extended arrangement amounted to 350 percent of present quota. Although it was substantially below maximum access, that amount required a firm commitment by the authorities to sustain their efforts in policies of demand management and structural adjustment. He shared Mr. Wicks's and Mr. Casey's reservations regarding the adjustment program. However, giving the benefit of the doubt to the authorities, he could, with some reluctance, go along with the proposed decision.

Malawi's economic performance, which had been satisfactory for an extended period, had been affected by exogenous factors and policy shortcomings, Mr. Laske observed. Some of the events that were beyond the authorities' control might continue to exert their influence, such as the transportation disruption in neighboring countries. The difficulties caused by misdirected policies--such as the overexpansionary investment program, which had had little immediate positive impact on domestic production and the balance of payments--called for early corrections in policy.

The staff's projection that a sustainable balance of payments position would be reached by the end of the program period was based on the assumption that Malawi would benefit from enlarged inflows of concessional aid, Mr. Laske noted. The staff had even assumed that Malawi would not have to apply for further debt rescheduling after the 1983/84 rescheduling arrangements. The projected debt service ratio, which would remain at about 30 percent over the whole program period, was high. Moreover, the export projections appeared to be on the optimistic side and measures might have to be taken to reduce imports further.

Major distortions in the public finances had developed in recent years, largely because of a severe deterioration in the operations of public enterprises, Mr. Laske continued. That deterioration had been a large burden on the budget and had also led to a weakening of the banking system. Although some action had already been taken to remedy the situation, progress should be closely monitored to prevent further deterioration. The investment program for the parastatals assumed that about 40 percent of the investment expenditure would be self-financed; however, the staff had indicated that it was doubtful whether more than half of that amount would be available because of the weak financial position of a number of enterprises. Such a situation was not satisfactory, and he hoped that the authorities would reconsider their investment objectives in case those enterprises failed to improve their profitability.

Mr. Erb reminded Directors that in February 1983, when the Board had reviewed Malawi's performance under the stand-by arrangement and considered the 1982 Article IV consultation (EBM/83/33, 2/22/83), he had stated that he was not convinced that an extended arrangement would be appropriate. Although he agreed with the staff that the proposed adjustment program would contribute to an improvement in economic growth prospects and to a restoration of the balance of payments position in the medium term, he continued to question whether an extended arrangement was the appropriate form of Fund involvement. In Malawi's case he would have preferred a one- or two-year stand-by arrangement.

He was not sure whether Malawi would meet the general criteria of the extended Fund facility, Mr. Erb indicated. The first criterion was that assistance should be given to support a comprehensive program that included policies to correct structural imbalances when those policies were feasible only over an extended period. That criterion seemed to be satisfied. The other two criteria of the facility--that the set of policies and measures to be introduced during the first 12-month period constituted a program that was considered substantial, and that the facility be reserved for exceptional problems, rather than normal development problems facing most members--raised some questions when applied to Malawi.

Although some improvement was projected in all of the key macroeconomic variables over the period of the program, he was not convinced that the adjustment program was substantial enough to justify a drawing under the extended Fund facility, Mr. Erb explained. Furthermore, he was not sure that the problems were really substantial. He wondered whether, by approving Malawi's request, the Executive Board would not be establishing a precedent that would lead to a large increase in the number of extended arrangements. However, Executive Directors' doubts about whether the extended Fund facility was appropriate should in no way detract from the efforts of the Malawian authorities and the staff of the Fund and the World Bank to put together a comprehensive adjustment program.

Commenting on Malawi's present and future policies, Mr. Erb noted that the authorities had taken effective steps to bring the financial situation under control and to put the economy back on course toward economic growth while achieving a sustainable external position. A number of the policy measures being contemplated were appropriate to address Malawi's major structural problems, including the government subsidies of public sector enterprises, the depressed private savings and investment levels, the inefficient production levels, and the unreliable trade and export routes through neighboring countries.

On the supply side, agriculture would remain the primary support of the economy, Mr. Erb observed. Thus, Malawi's plans appropriately emphasized the need to strengthen agricultural production and exports. He welcomed the emphasis on developing alternative transportation routes and on raising savings and investment levels. Although desirable, those policy adjustments would be more appropriately financed through the World Bank.

Many of the adjustment measures that could be easily introduced and that would have a positive impact in the short term on Malawi's balance of payments position and domestic production would require additional temporary Fund financing, Mr. Erb stated. Nevertheless, financing from the Fund or the World Bank was not necessary in order to induce those policy changes; it would be in the short-term and long-term interests of the country itself to adopt such policies. The traditional fiscal and monetary policies proposed for the first year of the program constituted an appropriate, if modest, extension of the recently completed stand-by arrangement. Revenues were projected to be 16.7 percent of GDP in 1985/86, a much lower level than in the period 1978/79-1981/82. Was it not feasible or necessary for the authorities to take further action on the fiscal side?

As for the external sector, he welcomed recent modifications to the exchange system and encouraged the authorities to pursue a flexible exchange rate policy, Mr. Erb went on. Although formal debt relief would not be required beyond 1983/84, the proposed purchases under the extended arrangement roughly equaled scheduled repurchases to the Fund over the same period.

In sum, he did not believe that the structural adjustment called for in the proposed program should be financed under the extended Fund facility, Mr. Erb commented. A further stand-by arrangement would have been more appropriate. It was difficult to take a position in light of the efforts made by the authorities in the previous two years and the successful implementation of the previous stand-by arrangement. He did not have a problem with the position taken by other Directors in which they had, in effect, given the authorities the benefit of the doubt. But he did not want Malawi's case to set a precedent and, in that regard, he supported Mr. Wicks's suggestion that the Executive Board should discuss the more general question of the appropriate role of the extended Fund facility in financing structural adjustment.

Mr. Lovato indicated his support for the request. The program outlined in detail the nature of the structural adjustment and the supply-oriented policies designed to effect those changes. On the demand-management side, the staff had recommended the introduction of more standard measures.

With regard to the supply side, the public sector investment program submitted by the authorities and endorsed by the World Bank in connection with its structural adjustment loan appeared reasonable, Mr. Lovato considered. That program emphasized agricultural, civil, and industrial development, which was in line with the basic requirements of Malawi. The initial steps had been undertaken to streamline and improve the financial and managerial performance of the parastatal enterprises.

On the demand side, the proposed budget target appeared attainable, Mr. Lovato remarked. Revenue was already equal to current spending, leaving only the budget deficit to be financed. A large proportion of that financing was expected to come from external concessional assistance. Did the figures in Table 6, on page 20 of EBS/83/183, represent projections or merely targets? What contingency plans had been envisaged if such foreign assistance did not materialize? He welcomed the pricing and interest rate policies; in particular, the increases in public utility charges, the schedule of price deregulation, and the level of deposits and lending rates seemed appropriate.

On the external front, performance was constrained by prevailing trends in world demand and prices for Malawi's major export commodities, Mr. Lovato stated. In view of Malawi's limited ability to bring about import substitution, the authorities intended to diversify exports as much as possible. The exchange rate policy seemed well geared toward that purpose, and he welcomed the recent decision to adopt a trade-weighted currency basket to improve the country's competitive position. The staff estimated that the external position would be roughly in equilibrium by 1986. The authorities intended to seek a second year of debt rescheduling in 1983/84. In late 1984, capital inflows would exceed the current account deficit. He hoped that those inflows would be of a concessional nature so that the debt service ratio would not become excessively high.

Mr. de Vries said that he could support the proposed decision, although he shared some of the doubts expressed by other Executive Directors. One of the requirements of the extended Fund facility decision was that the economy should be suffering from serious balance of payments problems arising from structural maladjustment in production, trade, and prices, and from cost distortions. The Malawian economy met that requirement. The decision also stated that Fund assistance would be made available if it was required to correct those structural imbalances in production, trade, and prices. The staff paper gave the impression that Malawi's structural maladjustments would not improve substantially over the program period. There was some doubt as to how the increase in gross fixed capital formation would be financed. The ratio between government revenue and GDP was projected to remain the same and it therefore appeared that investment would be financed by an increase in domestic savings. In view of the information provided in the staff paper, he was not confident that there would be an increase in savings; in particular, he was concerned that the parastatal enterprises would not be able to increase investment levels as projected.

The staff had projected that favorable developments in the terms of trade would bring about an improvement in the trade balance, Mr. de Vries observed. However, the terms of trade were dependent on external factors and not on the Malawian authorities. Some slight improvement was projected for the current account deficit, but the external debt service ratio would remain at a very high level. His main objection to the proposed program was that not enough action would be taken to deal with the very substantial structural maladjustments. The authorities had taken a great number of painful and well-designed measures to improve the situation, however, and he could support the proposed decision.

Miss Diallo commented that few developing countries, particularly in Africa, had been as successful as Malawi in managing their economies. Despite the world economic turmoil and an internal situation that was not always conducive to stable economic development, the Malawian authorities had achieved relatively rapid economic growth in the 1970s. More important, they had achieved self-sufficiency in terms of food production. The authorities were to be congratulated for their successes.

The world economic situation was difficult, and for the developing countries--in particular, the non-oil developing countries--externalities played a critical role in the management of their economies, Miss Diallo stated. Malawi's economic and financial situation had deteriorated considerably as a result of the combined effects of the decline in the prices of Malawi's primary commodity exports with the consequent sharp deterioration in the terms of trade, the high international interest rates, political instability, and the 1979/80 drought. Nevertheless, beginning in 1980 the authorities had adopted a series of relatively successful Fund-supported stabilization programs. The 1980-82 stand-by arrangement had failed to achieve all of the targets and the authorities had adopted a further one-year stand-by arrangement. Those three years of constant adjustment had permitted the authorities to prepare the ground for a more extensive adjustment program aimed at restructuring the country's economy.

She welcomed the staff statement that "the proposed program, in drawing on the experience of the earlier arrangements, recognizes that demand management and financial policies are inadequate unless supported by action directed toward supply," Miss Diallo said. Such an approach was crucial to any meaningful adjustment program and it assumed that the developed countries would cooperate by avoiding the introduction of protectionist measures. To achieve an average annual growth rate of 3.5 percent and to restore the external account to a sustainable position, the authorities would have to receive appropriate debt relief during 1983/84. The close cooperation between the Fund and the World Bank in preparing the program was highly commendable and she encouraged the two institutions to maintain their cooperation throughout the implementation of the extended arrangement. The adjustment program was sound and, if implemented appropriately, would help to put the Malawian economy on the right track toward a sustainable and balanced economic position.

The staff representative from the African Department stated that the staff had taken a number of factors into account when formulating the medium-term program. Malawi's performance until the late 1960s had been generally satisfactory. In fact, in a review prepared by the World Bank in 1978, Malawi had been singled out as one of the countries that had followed appropriate policies, and in a recent World Bank report, Malawi was mentioned as one of the few countries that had generally used pricing policies and incentives to encourage development. Since independence, the Malawian authorities had emphasized agricultural development. Possibilities for development were limited by Malawi's lack of mineral resources, its landlocked position, and the small size of the domestic economy. In that context, the pragmatic policies followed by the authorities had been relatively impressive. Between 1979 and 1982 the Fund had assisted Malawi in overcoming those difficulties.

In formulating the proposed adjustment program, the staff had taken into account the fact that the authorities were preparing a medium-term public sector investment program, the staff representative explained. The staff of the Fund and the World Bank had agreed that a resource-based, consumer-oriented, high-employment policy would be the most appropriate growth strategy for Malawi to pursue. Such a strategy would have the advantages of utilizing domestic resources to produce goods for the domestic market, of providing a framework for improving the operations of the parastatals, and of improving the fiscal and external positions.

As for the specifics of the program, real expenditure had declined between 1981/82 and 1982/83 by approximately 10 percent, the staff representative indicated. It was not projected to increase over the period of the extended arrangement, which would mean that by the end of the program period expenditure would be less than it had been in 1981/82. In fact, the World Bank staff viewed that degree of adjustment as being very stringent.

On the fiscal side, the major difficulty was the limited scope for revenue increases, the staff representative continued. Most revenues were derived from imports, and corporate and personal incomes. Imports would be restrained through the demand measures recommended by the staff and by the transportation difficulties. Corporate incomes had been stagnant for some years, and it would take time before they recovered. Furthermore, personal incomes would be restrained over the program period as the authorities were committed to maintaining an appropriate incomes policy. Measures had already been taken on the revenue side to increase excise taxes and temporary levies on imports and fuel. The staff had discussed with the authorities a number of areas in which new measures could be taken during 1983/84. The staff was also looking at the possibility of increasing the rents paid by estate owners on public lands, of linking excise duties to the rate of inflation, and of increasing taxes on various consumer goods.

Given the limitations for increasing revenue, the emphasis of fiscal policy had to be on the expenditure side, the staff representative commented. Expenditures would therefore have to be dependent on the prospects for revenues. In formulating the program, the staff had considered the expenditure requirements of the World Bank program. Within the context of overall restraint, expenditures had been shifted to areas of high priority regarding development, such as transportation, agriculture, and education.

Both the staff and the authorities would take great care that the local registered stock would not form a disruptive part of the monetary base, the staff representative went on. If all of the stock was made part of the monetary base, the possibility of credit expansion would be greatly enlarged--a factor that was being considered closely by the staff.

A number of measures to improve the operations of the agricultural estates would be introduced, the staff representative continued. First, there would be more training for managers of the estates; courses would be introduced at the University of Malawi and at the Tobacco Institute. Second, extension services to the estates would be improved. Previously, extension services had been supplied primarily to smallholdings as it had generally been assumed that the estates had been able to provide their own services. Third, the authorities were considering the possibility of creating a medium-term credit institution that would facilitate the financing of the operations of the larger estates. Fourth, the estates were now permitted to cultivate a number of crops--in particular, groundnuts and cotton--which had in the past been reserved for smallholders.

The staff had assumed a decline in the terms of trade during the period 1983-85 when making balance of payments projections, the staff representative explained. If anything, the staff had been pessimistic in its projections of capital inflows. The Malawian authorities were considering a donors' conference. Both the Bank and the Fund staff had agreed to assist the authorities in approaching donors if the conference was properly organized and if the proposed adjustment measures were in line with both the extended arrangement of the Fund and the structural adjustment loan of the Bank.

As for the parastatals, Air Malawi was now operating at a profit, the staff representative indicated. It was difficult to improve the operations of Malawi Railways because of its dependence on the railways through Mozambique to the ports; external disruptions had had adverse effects on the operations of the domestic railways. Furthermore, domestic tariff increases tended to be matched by increases in neighboring countries; the return to Malawi Railways was therefore not always commensurate with the tariff increases. Nevertheless, the authorities had closed unprofitable routes. Some steps had also been taken to improve the performance of the MHC. Rents had been imposed on government properties and would be increased in future years. Both the MHC and the Capital City Development Corporation would be operating on profitable terms in the near future.

A major objective of the extended arrangement would be to mobilize domestic savings to increase GDP growth, the staff representative commented. The adjustment program therefore included measures to improve the investment strategies and the management of Press Holdings Limited, MDC, and ADMARC, which would lead to increased productive activity.

Finally, on the question of foreign financing of the budget, the staff had explained in its paper that the available foreign financing was below the level necessary to support the projected expenditures, the staff representative from the African Department noted. There was a clear understanding that the authorities would modify expenditures according to the availability of financing. Given the limited scope for increasing revenues, expenditures would have to be modified should foreign assistance be less than projected.

The staff representative from the Exchange and Trade Relations Department stated that there were three aspects to the question of whether an extended arrangement was appropriate in the case of Malawi. First, it was clear that Malawi's request fell within the framework of the extended Fund facility decision; namely, that it was "an economy suffering serious payments imbalance relating to structural maladjustments in production and trade and where prices and cost distortions have been widespread."

Second, the decision stated that assistance would be given in support of comprehensive programs that included policies of the scope and character required to correct structural imbalances in trade and prices where it was expected that the needed improvement in the members' balance of payments could be achieved only over an extended period, the staff representative went on. The staff's most recent review of extended arrangements had classified the nature of the measures specified in adjustment programs into four broad categories: structural adjustment measures; measures related to prices and wages; public sector policies;

and financial policies. It was the staff's judgment that the program proposed for Malawi covered nearly all of the measures listed in that staff report. Third, an extended arrangement was appropriate in the case of Malawi because the adjustment program involved the utilization of new policy instruments and the introduction of institutional reforms that would only become effective in the medium term. In particular, the adjustment program emphasized the reform of the parastatal enterprises, which had been a major source of the problem over the previous years.

In his statement, Mr. de Vries had concluded that the macroeconomic targets included in Table 5 of EBS/83/183 did not provide any evidence of structural change but, rather, reflected a position of stability, the staff representative recalled. In his view, the ratios, particularly of capital formation to GDP and domestic savings to GDP, did show a movement in the right direction. Mr. de Vries had also noted that the ratio of revenue to GDP was projected to remain stable. However, that ratio did not reflect the results of the structural change in the parastatal sector, which would be a major source of savings. In addition, a significant growth in exports was projected over the program period. Moreover, the debt service ratio was expected to decline from 43 percent to 27 percent between 1983 and 1986, so there would be an underlying improvement in the balance of payments position.

A number of Directors had considered that an extended arrangement was inappropriate in the case of Malawi, because by the end of the program period Malawi would still need Fund support, the staff representative from the Exchange and Trade Relations Department observed. It was not the staff's view that an extended arrangement should only be approved if the member would cease to need Fund support by the end of the program period; in the past, there had been at least one case in which one extended arrangement had been followed by another. In conclusion, the staff considered that the adjustment program proposed for Malawi met the requirements of the decision on the extended Fund facility. However, as suggested by some Executive Directors, a review of the policy on the extended Fund facility might be opportune.

Mr. de Vries stated that after hearing the staff's comments he felt less uncomfortable about supporting the proposed decision.

The Chairman remarked that it was evident from Table XII of EBS/83/183 that there had been a dramatic increase in the recurrent account between 1979/80 and 1981/82, accompanied by a decline in the development account. Three factors explained those changes. First, the extrabudgetary expenditure on maize purchases had amounted to almost MK 37 million in 1981/82. Second, MK 20 million had been accounted for by higher interest payments, and, most important, gross consumption had increased by MK 28 million, most of which had been accounted for by wages and salaries and other goods and services. He was especially concerned that the figure for wages and salaries was continuing to increase in 1982/83 and 1983/84.

There had been an unfavorable shift from development toward recurrent expenditure, the Chairman observed. The adjustment program should therefore put greater emphasis on the need to bring down the recurrent account of the budget.

It was unclear how the 4 percentage point increase in domestic savings would be achieved, the Chairman commented. The staff representative had stated that there was not much scope for increasing revenue and that total expenditure would be reduced by only 1 percentage point. It would probably be necessary to curtail expenditures even further. The staff should outline more precisely how the parastatals would contribute to the 4 percent increase in domestic savings. At each review of the Malawian adjustment program, he would like the staff to indicate the progress made in increasing domestic savings as a percent of GDP.

The staff representative from the African Department stated that recurrent expenditure in 1983/84 provided for development of education and agriculture, and for road maintenance. The wage bill had been affected by the fact that a number of new institutions established under the adjustment program would need to be staffed; for example, a new department had been established to coordinate expenditure and new units had been set up in the agriculture department.

Mr. Jayawardena stated that he would like to introduce a slightly different perspective. In 1980/81 and 1981/82, the overall fiscal deficit had been 11.1 percent and 10.6 percent of GDP, respectively. Foreign financing had been 3.8 percent and 2.6 percent of GDP in those years. Thus, domestic financing of the budget had been 7 percent and 8 percent of GDP, respectively. Between 1982/83 and 1985/86, the overall fiscal deficit was projected to decline progressively from 7.1 percent of GDP to 4.8 percent of GDP. When foreign financing was deducted, recourse to domestic resources would decline from approximately 7 percent in 1981/82 to 1.6 percent in 1985/86. In a country using foreign resources extensively, that ratio indicated real adjustment. Hence, it was clear that strong fiscal adjustment would be taking place, reducing recourse to domestic resources to 1.6 percent of GDP by the end of the program period. Similarly, one could examine the viability of the current account by netting out foreign aid absorption from the current deficit. Whereas the current account deficit would decline from 9 percent to 5 percent of GDP during the program period, the adjusted deficit, after netting foreign aid absorption, showed a decline from 2.3 percent to 1.6 percent of GDP, which was also indicative of strong adjustment.

Mr. Sangare noted that some Executive Directors were generally of the view that the budget deficit was projected to decline modestly. However, the Executive Board should not overlook three factors. First, the ratio of revenue to GDP was estimated to reach 17 percent by 1985/86, while the rate of growth of expenditure would be contained at about 9.5 percent--equal to the expected rate of inflation. Second, being a landlocked country, Malawi could not cut back expenditures in certain areas; in particular, those related to transportation between Malawi and the ports in Mozambique. Third, the slow resumption of economic activity in industrial countries--the main export markets for Malawi's commodities--had affected economic growth.

A number of Executive Directors considered that Malawi had not met the conditions for a drawing under the extended Fund facility, which implied that Malawi's medium-term economic outlook was good, Mr. Sangare considered. However, Directors had stressed that the problems facing the Malawian economy were structural in nature. In his view, those problems could only be meaningfully dealt with in a medium-term perspective and therefore a stand-by arrangement would not be appropriate. The proposed adjustment program was adequate, and the Malawian authorities should at least be given the benefit of the doubt. He was confident that his authorities would be vigilant in implementing the program and succeed in attaining the stated objectives, given the track record established under the previous stand-by arrangement.

The Executive Board then took the following decision:

Extended Arrangement

1. The Government of Malawi has requested an extended arrangement for the period from September 19, 1983 to September 18, 1986 for an amount equivalent to SDR 100 million.

2. The Fund approves the extended arrangement set forth in EBS/83/183, Supplement 1.

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

Decision No. 7535-(83/143), adopted
September 19, 1983

3. EXECUTIVE DIRECTORS

The Chairman bade farewell to Mr. Casey, Mr. Dallara, and Mr. Taylor at the conclusion of their service as Alternate Executive Directors.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/83/142 (9/16/83) and EBM/83/143 (9/19/83).

4. 1984 STAFF COMPENSATION REVIEW - NATURE AND SCOPE

The Executive Board approves the proposal set forth in EBAP/83/183, Supplement 1 (9/13/83).

Adopted September 16, 1983

5. RULES AND REGULATIONS AMENDED SINCE 1982 ANNUAL MEETING

The Executive Board approves the letter and draft resolution as set forth in EBD/83/239 (9/14/83).

Adopted September 16, 1983

6. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 83/63 and 83/64 are approved. (EBD/83/234, 9/12/83)

Adopted September 16, 1983

APPROVED: March 15, 1984

LEO VAN HOUTVEN
Secretary