NOT FOR PUBLIC USE

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 83/179

3:00 p.m., December 21, 1983

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

Executive Directors	Alternate Executive Directors
	w. B. Tshishimbi
	L. E. J. M. Coene, Temporary
B. de Maulde	X. Blandin
A. Donoso	
R. D. Erb	
M. Finaish	T. Alhaimus
T. Hirao	T. Yamashita
J. E. Ismael	Jaafar A.
R. K. Joyce	D. I. S. Shaw, Temporary
	C. Robalino
	G. Grosche
	C. P. Caranicas
R. N. Malhotra	A. S. Jayawardena
Y. A. Nimatallah	J. E. Suraisry
J. J. Polak	
A. R. G. Prowse	
	O. Kabbaj
	E. I. M. Mtei
	J. L. Feito
J. Tvedt	A. Lindø
N. Wicks	T. A. Clark
	Wang E.

A. Wright, Acting Secretary
J. A. Kay, Assistant

Also Present

African Department: R. J. Bhatia, Deputy Director; O. B. Makalou, Deputy Director; N. Abu-zobaa, E. L. Bornemann, Buu Hoan, C. Enweze, M. G. Gilman, S. Schiavo-Campo, M. Sidibé, R. T. Stillson, A. Tahari, A. C. Woodward. Asian Department: R. H. Nord. Central Banking Department: P. Duvaux, L. E. Molho. Exchange and Trade Relations Department: C. D. Finch, Director; D. K. Palmer, Associate Director; W. A. Beveridge, Deputy Director; S. Mookerjee, Deputy Director; S. Kanesa-Thasan, M. O. Tyler. Legal Department: G. P. Nicoletopoulos, Director; J. G. Evans, Jr., Deputy General Counsel; M. Ogoola. Middle Eastern Department: A. S. Shaalan, Director. Secretary's Department: R. S. Franklin. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: S. R. Abiad, E. A. Ajayi, H. A. Arias, C. J. Batliwalla, J. Delgadillo, L. K. Doe, K. A. Hansen, W. Moerke, J.-C. Obame, Y. Okubo, D. I. S. Shaw. Assistants to Executive Directors: E. M. Ainley, H. Alaoui-Abdallaoui, J. Bulloch, M. Camara, M. B. Chatah, M. Eran, C. Flamant, I. Fridriksson, G. Gomel, V. Govindarajan, D. Hammann, C. M. Hull, A. K. Juusela, H. Kobayashi, M. J. Kooymans, G. W. K. Pickering, T. Ramtoolah, M. Rasyid, A. A. Scholten, Shao Z., J. C. Williams.

1. MADAGASCAR - 1983 ARTICLE IV CONSULTATION, AND STAND-BY ARRANGEMENT

The Executive Directors continued from their previous meeting (EBM/83/178, 12/21/83) their consideration of the staff report for the 1983 Article IV consultation with Madagascar (EBS/83/235, 11/2/83; and Cor. 1, 12/19/83), together with a proposed decision concluding the 1983 Article XIV consultation with Madagascar and a request by Madagascar for a stand-by arrangement equivalent to SDR 33 million for a period of 15 months ending March 31, 1985 (EBS/83/255, 11/30/83; and Cor. 1, 12/20/83). They also had before them a staff report on recent economic developments in Madagascar (SM/83/245, 12/2/83; and Cor. 1, 12/19/83).

Mr. Wang stated that he favored an increase in the amount to be made available by the Fund to Madagascar under the stand-by arrangement.

The Chairman, replying to a question raised by Mr. Malhotra at the end of the morning meeting (see EBM/83/178), explained that he could not accede to Mr. Malhotra's suggestion that, if after the donor conference a gap still remained in the external financing of Madagascar, the Fund would make good the difference. The last thing that the Fund ought to do was to indicate to donor countries and creditors that the Fund would act as a residual supplier of resources if others did not provide adequate amounts. The Executive Directors would have to decide, on the evidence before them, whether they wished the Fund to make available to Madagascar 50 percent of its proposed quota or some higher figure. The staff had well explained the reasons for suggesting that 50 percent was appropriate. If the decision by the Executive Directors left an unfinanced gap, it would have to be filled from other sources. It would be most unwise to leave the Fund in a position of having to take up any slack left by creditors.

The Deputy Managing Director commented that, omitting Mr. Polak and Mr. Ismael, 12 Directors with 40.79 percent of the voting power would favor making a larger amount of resources available to Madagascar, within the ceiling mentioned by the Chairman at EBM/83/178. Five Executive Directors with 39.47 percent of the vote would approve the decision as it stood.

Mr. Malhotra recalled that he had not suggested that the Fund should, as a general rule, adopt procedures that would make it a financier of residual gaps. If the Fund raised the proportion of its financing from 50 percent of Madagascar's proposed quota of SDR 66.4 million to, say, 62.5 percent, a substantial part of the likely gap would be covered. The Fund was after all determining the gap when it decided how much of it the Fund would provide. He therefore suggested that the Executive Board should act with some flexibility in the matter; if it did not provide sufficient resources at the present time, it might have to do so later.

Mr. Tvedt remarked that during the morning meeting he had had some doubts about the appropriateness of the proposed decision. However, after hearing the staff's explanation and the Chairman's remarks, he leaned toward supporting the proposed decision as it stood.

Mr. Hirao said that he too could go along with the decision proposed by the staff. Like Mr. Caranicas and others, he would like to have had more time to reflect on the proposal that the Fund should make a larger sum available. Nevertheless, after hearing the explanations given by staff and management, he would support the decision as it stood.

Mr. de Maulde commented that the matter was not one on which a decision should be taken by a narrow majority. There were two points at issue, the first being a problem of the fundamental philosophy of the Fund, which, although interesting, was not immediately relevant; the second was the practical matter of how to deal with Madagascar. He would like to be able to join any consensus that might be offered by the Chairman or Mr. Tshishimbi. The philosophical aspects should be left till later.

Mr. Caranicas stated that, while he had been impressed by the arguments brought forward by Mr. de Maulde, Mr. Tshishimbi, and others, the decision on such a matter of principle was the joint responsibility of members of the Executive Board and the Managing Director. Management had to act with prudence in such cases. After listening to the various arguments, particularly by the Managing Director, he would rather stick with the proposed decision, if only as a means of avoiding setting a precedent. Clearly, the general philosophical points would have to be discussed later.

Mr. Tshishimbi commented that he did not wish the Executive Board to take a decision by a narrow majority. Although the Managing Director had said that he could not consider raising the amount to be made available from SDR 33 million to the SDR 51 million originally requested by Madagascar, perhaps he could accept either a figure between the two, or agree that the program period should be 12 months rather than 15 months. That would mean that Madagascar would receive 50 percent of quota for one year.

Mr. de Maulde observed that SDR 33 million for one year fell rather short of what he would have liked to see adopted. Nevertheless, the proposal would represent an elegant compromise. Several Executive Directors had said at EBM/83/178 that, in applying the enlarged access policy, they wished to husband the Fund's resources carefully, and he believed that the message had been understood. Nevertheless, the Fund had still to make it clear to aid donors and creditors of Madagascar that it was interested in protecting the economic future of the country. In those circumstances, if there were a majority, he would accept Mr. Tshishimbi's proposal.

Mr. Erb considered that if the Executive Board followed Mr. Tshishimbi and Mr. de Maulde, it would be setting a precedent. The likelihood was that in future Executive Directors would find themselves entering a bidding process in the Executive Board as part of their approval of a proposed program. He feared that on each occasion the staff would propose one figure and an Executive Director a different one, leading the Executive Board to a compromise solution between the two. Consequently, the proposal to increase the amount would be a dangerous one. It was true that there had been cases when Executive Directors had criticized the amount proposed by the staff as being too large; even so, they had not entered into a negotiation to change the amount.

Mr. Polak noted that he had been convinced by the staff and by the Chairman that there was good reason to stay with the staff proposal. More generally, the Executive Board should not lightly change either upward or downward the proposals made by management; in the present instance, there did not seem to be any compelling reason for doing so. He also agreed with Mr. Erb that it would be unwise for the Executive Board to start negotiating changes in amounts for individual countries.

Mr. Clark expressed agreement with the staff proposal. Like Mr. Erb, he had grave doubts about establishing a precedent that might lead to haggling to try to secure small changes in the size of programs.

Mr. de Maulde remarked that he was not impressed by Mr. Erb's argument. If the Executive Board could not decide on an amount to be made available by the Fund, who could?

Mr. Tshishimbi said that naturally he trusted the work of the staff and had no reason not to believe the arguments that it put forward. But if the task of the Executive Board were limited simply to ratifying what the staff had proposed, there would be no great value in having Board meetings. Moreover, the staff had proposed a change in the decision for the stand-by arrangement, if not the arrangement itself. In other words, when papers came to the Executive Directors they were by no means immutable. The amount that the Malagasy authorities had intended to request from the Fund was clearly considerably higher than the figure that the Fund was now prepared to offer. Unfortunately, at the time that the letter of intent had been signed, circumstances had enabled the Fund to reduce the amount, since liquidity had clearly been tight. However, events since the Annual Meeting of 1983 had made it possible to treat the request by the Malagasy authorities without anxiety about what might be called the "liquidity syndrome." He did not wish to continue the discussion about the catalytic role of the Fund and similar matters; but he had hoped that the Executive Directors would see their way to making a larger amount available to the Malagasy authorities.

Continuing his remarks, Mr. Tshishimbi noted that he had listened with interest to the points made by the Executive Directors, and to the responses given by the staff. This was the second occasion on which he had had to present the case of a country in his constituency that had become heavily indebted. It was clear from the discussion at EBM/83/178 that not only the staff but Executive Directors as well felt that the external debt was at the root of Madagascar's problems. It was for that reason that in his opening remarks he had suggested that perhaps the rescheduling arrangements could go rather further than they usually did. The staff had clearly indicated that if the debt rescheduling took only its normal form, the outcome would not be satisfactory. His suggestion had been that the Board should express itself more positively, so that the present discussion might be more useful.

One of the main features of the stand-by arrangement was the structural reforms to be undertaken by the authorities, Mr. Tshishimbi went on. The measures that they had already introduced were unpopular, particularly those governing the price of rice, the main staple in the country. The price of rice had never been regulated in the whole 50-year history of Madagascar, and the present series of measures was politically highly sensitive. The authorities had agreed to work closely with the Fund and in close collaboration with the World Bank, and they were trying to implement all the Fund's recommendations on producer prices. They also intended to offer incentives in connection with industrial prices. As for the exchange rate, the staff had dealt with the matter adequately at EBM/83/178.

There was little room for maneuver in Madagascar, Mr. Tshishimbi observed. Taxation was already high, and it would hardly be possible to increase the rate of taxation. The authorities had done what they could to improve the collection of taxes, so that little more could be expected from that source. It was because the authorities had found themselves unable to cover the financing gap completely--and there was little scope for adjustment if they could not do so--that he had proposed that the amount to be provided under the stand-by arrangement should be increased.

When the Chairman read his proposed summing up, Mr. Prowse remarked that he had no difficulty at all with the reference in the Chairman's summing up to the debt service ratio. However, he had already asked why the staff considered that a 50 percent debt service ratio was not viable. If 50 percent was not viable, what figure would the staff consider satisfactory?

The Deputy Director of the African Department recalled that in the not-so-distant past, debt service ratios of between 15 percent and 20 percent had caused observers to start being worried. Perhaps such figures would no longer cause the same concern as they had done previously. However, the Paris Club rescheduling had taken place and had, on average, left the debt service ratio at about 15 percent. Consequently, it might be surmised that those concerned with debt rescheduling often found cause for concern when the figure rose much above that level. A debt service ratio of 40-50 percent would be quite unmanageable for any long period. In 1987, the most debt payments that Madagascar could be expected to bear would be rather less than 25 percent of export earnings. That figure might well be taken as the threshold for Madagascar's debt service ratio on a sustained basis.

Mr. Shaw considered that the summing up ought to contain a sentence stating that the next consultation with Madagascar would take place on a 12-month cycle.

Mr. Shaw's proposal was adopted.

The Chairman made the following summing up:

> Directors were in broad agreement with the views expressed in the staff paper for the 1983 Article IV consultation with Madagascar.

In recent years, there had been a substantial adjustment in fiscal and monetary policy, but this had not resulted in a corresponding improvement in the overall balance of payments, primarily owing to extremely high and growing levels of external debt service payments. Despite several debt reschedulings obtained under the Paris Club and from other official creditors, as well as an agreement in principle from the London Club, debt service payments had reached 38 percent of exports of goods and services in 1983 and would rise to over 60 percent on average in 1984 through 1987. This debt service burden was seen as unsustainable and, as long as it remained at those high levels, the attainment of balance of payments viability over the medium term would be unlikely. One Director suggested the appointment of a debt coordinator as a useful procedure.

Directors commended the authorities for the substantial policy actions undertaken since 1982, most notably their fiscal adjustment. The budget deficit, which in earlier years had been a major element of excess demand, had been reduced as a proportion of GDP by nearly 40 percent. Primarily as a result of the fiscal adjustment, credit and monetary expansion decelerated in 1983.

Directors also commended the authorities for the reorientation of pricing policies. A substantial liberalization of pricing and marketing in the rice sector had been implemented in the spring of 1983. Exchange rate policy and interest rate policy had become more flexible, and controlled industrial prices had been raised, thus virtually eliminating operating subsidies to industrial parastatals. However, Directors stressed that these reforms need to be reinforced and extended. In the agricultural sector, the planned extension of the liberalization of pricing and marketing of rice to the two producing areas currently reserved for state marketing agencies was considered crucial. More generally, price and marketing liberalization should be extended to other agricultural commodities and industrial goods. The approach to exchange rate and interest rate policy should be not only more flexible but also more aggressive. The maintenance of an appropriate effective exchange rate and the achievement of positive real interest rates were considered crucial objectives.

Several Directors commented on the seriousness of Madagascar's structural problems and on the inappropriate sectoral allocation of investment hitherto. They emphasized the importance of close collaboration between the Fund and the World Bank to bring about improved structural adjustment policies.

Directors recognized that the balance of payments would remain under severe pressure over a number of years, even if all the suggested policy measures were implemented. Given the prospective growth of debt service payments, it would be difficult for Madagascar to attain sustainable growth with external equilibrium over the medium term. Debt rescheduling alone would not be sufficient to lead to medium-term viability in the balance of payments, especially as there was a need for an increase in imports of nonconsumer goods to support medium-term growth. Hence, it was crucial for Madagascar to keep strictly to its stabilization program, to continue its pricing reforms, particularly with a view to increasing the production of efficient import substitutes and exports, and to seek concessional financial assistance. Considerable emphasis was placed on the necessity of obtaining large amounts of external financing for many years to come.

It is expected that the next Article IV consultation with Madagascar will take place on a 12-month cycle.

The Executive Board then took the following decision:

Decision Concluding 1983 Article XIV Consultation

1. The Fund takes this decision in concluding the 1983 Article XIV consultation with Madagascar in the light of the 1983 Article IV consultation with Madagascar conducted under Decision No. 5392-(77/63), adopted April 29, 1977 ("Surveillance over Exchange Rate Policies").

2. Madagascar maintains restrictions on payments and transfers for current international transactions as described in EBS/83/235 and in SM/83/245. The Fund notes the intention of the authorities to remove these restrictions as soon as possible. In the meantime, the Fund grants approval for their retention until October 31, 1984 or the completion of the 1984 Article IV consultation with Madagascar, whichever is earlier.

Decision No. 7586-(83/179), adopted
December 21, 1983

The Directors then considered the stand-by arrangement set out in EBS/83/255, Supplement 1.

The Deputy Director of the African Department proposed that, since it could not be known when the stand-by arrangement would come into force, it would be better to change the beginning of paragraph 1 to read "1." For the period from the effective date of the approval of this arrangement and ending on March 31, 1985, Madagascar will have the right...."

The staff circulated a new proposed decision on the stand-by arrangement, incorporating a reference to the enlarged access policy.

Mr. de Maulde suggested that the closing date of March 31, 1985 should be changed to December 31, 1984.

The Chairman said that he did not believe that Mr. de Maulde's proposal for shortening the period to one year from 15 months would be acceptable to a majority of the Executive Board.

Mr. Tshishimbi inquired what was meant by the proviso at the end of the proposed decision.

The Director of the Legal Department explained that the effect of the proviso was that the decision would become effective in an operative sense when the Executive Board decided that the Fund would continue to grant stand-by arrangements and extended arrangements under the enlarged access policy. The staff hoped that that decision would be taken in the next few days.

Mr. Erb stated that he could accept the approach incorporated by the staff in the final sentence of the proposed decision, provided that Madagascar was one of the countries that had been mentioned as needing relief under the enlarged access policy at the time when the extension of that policy had been discussed at EBM/83/166 and EBM/84/167 (12/2/83).

The Chairman confirmed Mr. Erb's understanding. If there were no general decision on the enlarged access policy by the time that Madagascar met the conditions set out in paragraph 3 of the proposed decision, management would bring to the Executive Board an ad hoc decision along the lines of that proposed for other countries earlier in the month. He hoped that there would be no need for any further transitional arrangements.

Mr. de Maulde said that he hoped that those Executive Directors who had been unwilling to allow the Fund to make available larger resources for Madagascar would ensure that their countries would fill the gap when they attended the meeting of donor countries and creditors for Madagascar in early 1984.

The Executive Board then approved the proposed amended decision on the stand-by arrangement for Madagascar.

The decision was:

1. The Government of the Democratic Republic of Madagascar has requested a stand-by arrangement for the period ending on March 31, 1985 in an amount equivalent to SDR 33 million.

2. The Fund approves the stand-by arrangement attached to EBS/83/255, Supplement 1, subject to paragraph 3 below, and waives the limitation in Article V, Section 3(b)(iii).

3. The approval of the stand-by arrangement under this decision shall become effective on the date on which the Fund finds that:

(a) satisfactory arrangements have been made with respect to the financing of the estimated balance of payments deficit for 1984; and

(b) adequate increases in the producer prices of agricultural commodities have been adopted

provided that, by that date, the Fund has decided that a stand-by arrangement may be approved that provides for enlarged access to the Fund's resources on the terms of Decision No. 6783-(81/40), adopted March 11, 1981.

Decision No. 7587-(83/179), adopted
December 21, 1983

APPROVED: April 24, 1984

LEO VAN HOUTVEN
Secretary