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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 83/178

10:00 a.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	
	S. R. Abiad, Temporary
T. Hirao	T. Yamashita
J. E. Ismael	Jaafar A.
	D. I. S. Shaw, Temporary
	C. Robalino
	G. Grosche
	C. P. Caranicas
R. N. Malhotra	A. S. Jayawardena
	J. E. Suraisry
J. J. Polak	
A. R. G. Prowse	
G. Salehkhou	O. Kabbaj
	E. I. M. Mtei
M. A. Senior	
J. Tvedt	
	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, A. B. Diao, 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. External Relations Department: G. P. Newman. Legal Department: G. P. Nicoletopoulos, Director; J. G. Evans, Jr., Deputy General Counsel; M. Ogoola. Middle Eastern Department: A. S. Shaalan, Director; S. H. Hitti. Secretary's Department: A. P. Bhagwat. Treasurer's Department: Q. Md. Hafiz. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: E. A. Ajayi, H. A. Arias, L. K. Doe, K. A. Hansen, W. Moerke, J.-C. Obame, Y. Okubo. Assistants to Executive Directors: H. Alaoui-Abdallaoui, J. R. N. Almeida, M. Camara, M. B. Chatah, M. Eran, C. Flamant, I. Fridriksson, G. Gomel, V. Govindarajan, D. Hammann, N. U. Haque, C. M. Hull, H. Kobayashi, M. J. Kooymans, G. W. K. Pickering, T. Ramtoolah, M. Rasyid, Shao Z., S. Sornyanyontr, J. C. Williams, A. Yasseri.

1. RATE OF REMUNERATION AND FUND INCOME POSITION

The Chairman commented that he wished to take up during the afternoon the most recent staff paper on the rate of remuneration and the Fund's income position, which had been circulated the previous day (EBS/83/237, Sup. 1, 12/20/83). The meeting could be held in informal session. Executive Directors needed to reach agreement on the rate of remuneration in order to allow the Executive Board to take up a package concerning not only the rate of remuneration but also access to the Fund's resources and access to the special facilities.

The Executive Directors agreed to proceed as suggested by the Chairman, it being understood that if no agreement was reached during the afternoon, they would meet again on the same topic on Friday, December 23, 1983.

2. MADAGASCAR - 1983 ARTICLE IV CONSULTATION, AND REQUEST FOR STAND-BY ARRANGEMENT

The Executive Directors considered 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).

The Deputy Director of the African Department made the following statement.

> Since the issuance of EBS/83/255, the Malagasy authorities have provided the staff with partial information on revised balance of payments estimates for 1983. These estimates show an SDR 11 million shortfall in 1983 clove exports, instead of the SDR 32 million shortfall projected in EBS/83/255. EBS/83/255 contains balance of payments tables based on the assumption of a delay in clove sales. 1/ Imports f.o.b. are projected by the authorities to be SDR 11 million, or 8 percent lower than the figure contained in EBS/83/255, resulting in a trade deficit of SDR 70 million, or 35 percent lower than originally projected. With the associated decline in service payments, the current account deficit is projected at SDR 280 million or 10 percent of GDP, compared with SDR 335 million or 13 percent of GDP in 1982. Taking into account a projected SDR 25 million decline in capital inflows and some other revisions, the revised estimate of the 1983 overall deficit is SDR 83 million, compared with the previous

1/ The balance of payments tables in the Article IV consultation staff report (Tables 4 and 7 and Appendix II, Table I in EBS/83/235) assumed that the clove sales would occur before the end of 1983.

estimate of SDR 111 million contained in EBS/83/255. Accordingly, debt service payments will reach 38 percent of exports of goods and services.

The residual gap in the 1983 balance of payments, now estimated at SDR 93 million, is being financed in part by a net accumulation of external arrears, largely with respect to debt service; these arrears on a net cash basis are now estimated to have increased by SDR 40 million in 1983 through the end of October. The outlook for 1984 remains unchanged.

The Malagasy authorities confirm that the overall government deficit for 1983 is still projected at FMG 81.9 billion, or 6.7 percent of estimated GDP. The 1984 budget was approved by the National Assembly on December 2, 1983. Budgetary revenues are estimated by the authorities to rise by 20 percent in 1984 (after 14 percent in 1983), current budgetary expenditure to rise by 9 percent (18 percent in 1983), and capital expenditure to rise by 28 percent (4 percent in 1983). Taking into account extrabudgetary operations, 1/ the overall government deficit in 1984 will not exceed 5.5 percent of GDP, as stipulated in the letter of intent attached to EBS/83/255. The authorities have indicated that no new measures or tax rate changes would be necessary for this purpose.

As foreseen under the program, credit to the nongovernment economy has expanded to allow for an upturn in activity and to accommodate agricultural market liberalization. Data through end-October indicate that credit to the nongovernment economy has been expanding at an annual rate of 50.6 percent since June 1983. That rate of expansion of credit, combined with a slower rate of growth in the first half of the year, should mean that the program target of 27.1 percent for the year as a whole will be attained. End-October data show that net credit to Government has declined by 1.1 percent since June 1983, and has risen by only 1.5 percent since the beginning of the year. This is in line with the program, and Madagascar should be able to respect the end-December performance criteria.

The staff has been informed that on November 9, 1983, the Malagasy authorities, based on a survey of paddy prices in free markets adjacent to the principal area reserved to state marketing organizations, instructed the Managing Director of SOMALAC to increase the minimum paddy price paid in Lac Alaotra by 8 percent, to FMG 70 a kilogram. Minimum producer prices in the rest of the country have not been raised, although the authorities stated that actual producer prices were already higher than the minimum throughout the country with the exception of Lac Alaotra.

1/ Consisting of FNUP (stabilization fund) operations and rice import operations of the Central Bank.

Continuing his remarks, the Deputy Director referred to paragraph 5 of the letter of intent from the Minister of Finance and Economy (on pages 26-27 of EBS/83/255) relating to certain actions that were to be taken by the authorities in connection with producer prices. The Minister had now informed him that the minimum producer price of paddy had been increased by about 8 percent, the figure that the authorities claimed would make the price correspond to the prices received by producers in the adjacent free markets. The Minister had also confirmed that producer prices for other crops would be increased in accordance with the letter of intent, but commencing at the beginning of the respective crop season for each product. The staff had not yet been informed of the specific timetable for those actions, or of the intended increases in prices of commodities other than rice. The staff did not have adequate information to confirm that the increases were in conformity with the undertakings in the letter of intent.

However, the Deputy Director of the African Department continued, the staff had been in touch with the Minister of Finance and Economy, and had agreed with him that a small team should visit Madagascar in early January not only to update information that might be required for the forthcoming Paris Club and Donors Club meetings but also to look into the appropriateness of the proposed price increases as well as into the increase in paddy prices just announced. In those circumstances, the staff would suggest a change in the proposed decision (set out on page 20 of EBS/83/255) so as to make the decision on the effectiveness of the stand-by arrangement subject to the Fund's assessment about the appropriateness of the Malagasy authorities' actions on prices. The staff would also be proposing some change in the decision regarding the application of the enlarged access policy.

Mr. Tshishimbi made the following statement:

My authorities are in broad agreement with the conclusions of the staff report for this Article IV consultation discussion.

The request for the stand-by arrangement that we have before us should be seen as a continuation of the adjustment effort undertaken by Madagascar since 1980. The adjustment effort was aimed at reducing large financial imbalances brought about by the implementation of an investment program, which, in retrospect, was too onerous. The bulk of the investment was concentrated in education and transportation equipment, and financed almost exclusively by foreign borrowing. This eventually led to a substantial increase in Madagascar's external debt. The investment boom of the late 1970s stimulated Madagascar's economy, and an expansion in real GDP of about 10 percent was recorded in 1979. Since then, activity has decelerated considerably, and real output growth, which decreased by a little less than 1 percent in 1980, fell again by 9 percent in 1981, and a little more moderately in 1982. The sharp reduction in investment outlays, together with the shortage of imported spare parts and raw materials, as well as inadequate producer pricing policies and adverse weather conditions, contributed to the unfavorable fluctuations in overall economic activity.

On the other hand, the overall fiscal performance improved, as the deficit on government operations declined from about 18 percent in 1980 to less than 15 percent in 1981, mostly on account of cutbacks in spending.

A further amelioration of the Government's financial position occurred in 1982, when the overall fiscal deficit declined by 7 percentage points to about 8 percent. This was due to a higher domestic sales tax and better collection of overdue taxes. The growth of total domestic credit decelerated from 45 percent in 1980 to about 21 percent in 1981, with a further deceleration to 17 percent in 1982, largely on account of the restrictive monetary policy pursued by the authorities.

The recourse to bank financing and the overall fiscal deficits, which were quite substantial in 1980, were thus reduced in succeeding years.

In the external sector, the position deteriorated markedly. The current account deficit rose to 19 percent of GDP in 1980, mainly owing to a decline in exports, and fell moderately to about 15 percent in 1981 and 13 percent in 1982, but the capital account weakened considerably both in 1980 and in succeeding years.

The program undertaken in 1982 was aimed at reviving economic activity through achieving positive real growth while limiting the current account deficit to about 15 percent of GDP. To this end, price controls were relaxed; in particular, the producer and consumer prices of rice--the main staple in Madagascar--were increased by 28 percent in 1981 and 87 percent in 1982. Government expenditure was tightened, and a 15 percent devaluation of the Malagasy franc was effected.

At the end of the 1982 program, Madagascar met almost all the performance criteria set out under the program. But in view of the persistent imbalances in the economy, the Malagasy authorities decided to strengthen the adjustment effort. That is why they have adopted a new program for 1983/84. The principal objective of this program is to liberalize domestic prices and marketing further in order to stimulate production and exports while building on the achievements in the fiscal sector. Under the new program, GDP is expected to grow by about 1 percent, and exports will increase by about 30 percent.

On the budget front, the overall financial deficit is expected to decline from 6.7 percent in 1983 to about 5.5 percent in 1984. Thus, gross domestic investment is expected to increase by 13 percent, and a significant proportion of this investment is going to be found through increased domestic savings.

The current account deficit before debt rescheduling is expected to decline to 9.2 percent of GDP from its present level of 12.2 percent of GDP.

In the area of pricing, the key element of the program--the price of imported whole grain rice--has been increased by some 43 percent to about FMG 200 a kilogram. This action has been taken with a view to eliminating further subsidies, and further reducing imports of rice. Marketing of rice, previously restricted to public enterprises, has now been opened to the private sector.

These liberalization policies, coupled with the cutbacks in rice imports, should help to ensure the attainment of the medium-term objective of self-sufficiency in rice.

The Malagasy authorities are carrying on discussions of their pricing policies for industrial products with the World Bank, with a view to stimulating production in that sector.

Regarding fiscal policy, the Government--capitalizing on the new centralized expenditure system--has placed a tight control on current expenditure; in particular, total spending on personnel will be limited to about FMG 900 million. In this regard, public service recruitment will be limited to 1,000 workers.

On the investment side, the Government intends to discuss with the World Bank its investment program for 1984, but emphasis will be placed on the rehabilitation and the maintenance of existing capital, and there will be no new financing of investment projects.

To support the fiscal and income policies, total credit expansion will be contained. The demand for credit by the non-government sector, however, will be appropriately accommodated in the ceilings.

To ensure that the financial structure efficiently supports the liberalization policies being implemented, the authorities are conducting a full examination of the functioning of the banking system. It is their expectation that a favorable impact of the projected deceleration in the growth of monetary expansion on domestic price development would contribute to a noticeable decrease in inflationary pressures in the economy.

In the external sector, the program is intended to reduce the current account deficit, excluding interest payments, from about 7.4 percent of GDP in 1983 to about 5 percent in 1984. This would be achieved through a reduction in imports, and particularly rice imports. In this respect, the volume of rice imports is forecast to decrease by 46 percent in 1984. On the other hand, in the productive sector, in line with the aim of reducing bottlenecks, imports of raw materials and spare parts will be increased.

With regard to exports, the authorities regard the need to reinforce the competitive position of Madagascar in international markets as an important element of their overall financing policies.

As to the adjustment program, the authorities intend to maintain a flexible approach in exchange rate policy. My Malagasy authorities are fully aware that, despite the progress achieved in several areas during the last few years, large imbalances remain entrenched in the economy. Therefore, the adjustment effort must be vigorously pursued. It is my authorities' view that their policies would have a reasonable chance of success only if supported by sufficient external resources. In this respect, the Government of Madagascar has instructed me to inform the Board of its extreme disappointment at the low level of financial assistance being proposed by the staff. Moreover, the successful implementation of the proposed arrangement implies additional balance of payments assistance, including favorable debt relief. My Malagasy authorities hope that the policy measures that they have implemented so far, and are resolved to continue to implement in 1984, will convince Madagascar's creditors and donors, as well as investors, of the crucial importance of foreign financing to support the country's adjustment efforts and development.

As the staff has rightly pointed out in its report, the rescheduling of Madagascar's external debt should not be limited to the part that has not yet been the object of agreement. It is the Government's hope that the Fund will play a very active role in the upcoming debt rescheduling negotiations. I would therefore ask my colleagues to consider favorably the request presented by Madagascar.

Commenting on the observation by the Deputy Director of the African Department that the information received from the Malagasy authorities was inadequate, Mr. Tshishimbi remarked that he had been in touch with the authorities in Madagascar immediately before entering the Board Room. They believed that they had acted in the spirit of the letter of intent. They stated that the producer price of rice, especially in the area of Lac Alaotra, would be raised to the level prevailing in adjacent regions. In September 1983, the estimated average price in those regions had been some FMG 80 a kilogram, as indicated by the Minister of Finance and Economy in his communication to the staff. The authorities had, however, engaged outside consultants to make a survey, and those consultants had concluded that the price in the regions adjacent to Lac Alaotra was FMG 70 a kilogram as opposed to the FMG 80 a kilogram that prevailed elsewhere. Consequently, his authorities felt that the increase in the producer price for rice that they had recently brought into effect was fully in line with the spirit of the letter of intent.

Mr. de Maulde stated that in his view the proposed program in connection with the stand-by arrangement was adequate to address the problems facing the economy of Madagascar. The problems had arisen from three major causes. First, it was true that during the second half of the 1970s the authorities had pursued ill-conceived economic policies, especially in agriculture, where producer prices had been kept too low, resulting in a decline in output. Moreover, the transportation network had been allowed to decline, although it played an essential role in a country like Madagascar, which was often described not as an island but as an archipelago. Together with severe government regulation, the lack of transportation had led to a reduction in trade and in the creation of great difficulties for those wishing to market foodcrops or export their products.

The second cause of the present difficulties was the vast investment effort on which the authorities had embarked in 1979 and 1980, the practical outcome of which had largely been a series of white elephants, Mr. de Maulde remarked. In the past three years, Madagascar had become a graveyard for dead or dying projects that would never produce anything except debts to be repaid. The responsibility for such a situation lay not only with the Malagasy authorities but also with a number of equipment suppliers supported by various agencies and commercial bankers.

The third cause of Madagascar's problems was the world recession and the country's deterioration in its terms of trade, Mr. de Maulde noted. The most important factor had been the increase in petroleum prices in 1979-80, at the very moment that the authorities were undertaking their investment effort, and the decline in the international price of Madagascar's main export products. As was well illustrated in Table XXI on page 106 of SM/83/245, the terms of trade had fallen by almost 25 percent between 1979 and 1982. Moreover, Madagascar had been unable to take advantage of the slight recovery in 1983, because it had proved impossible to sell the country's clove crop. The country had also been hit by the overvaluation of the U.S. dollar, in which part of its external debt was denominated, and by the level of real interest rates. All such factors were clearly beyond the authorities' control

In 1981, Mr. de Maulde observed, the Malagasy authorities had started to tackle their problems with the assistance of the Fund, which had approved three successive stand-by arrangements. Although the program had not remained on track, substantial adjustment had taken place, and the magnitude of the effort should not be underestimated. In the space of three years, the budget deficit had been reduced by 12 percentage points of GDP, a sizable amount. The authorities had in fact brought about a complete turnaround of their economic and financial policies. For instance, after an initial devaluation of the Malagasy franc in May 1982, they had pursued a flexible exchange rate policy with periodic realignments, of which the most recent had taken place no more than three months previously.

The authorities had carried out sweeping changes in pricing and marketing policies, Mr. de Maulde considered. They had raised producer prices and liberalized the whole marketing and transportation system, and the result had been a halving of rice imports in 1983. He had been interested in the staff's opening comments, announcing that further measures in connection with prices would be closely monitored. He had no objection to such an arrangement.

The limited success of the last three programs had perhaps been due to some extent to the authorities' slowness to act in a number of fields, Mr. de Maulde conceded. However, the main causes had been the overoptimistic nature of the assumptions underlying the programs, in particular those relating to the external environment.

The program for 1984, Mr. de Maulde maintained, followed on the thrust of the previous programs while introducing a number of measures that would further liberalize productive and marketing activities. As the bulk of the adjustment effort had already been carried out, at least in public finance, it seemed normal that the decline in the budget deficit should be smaller in 1984 than in previous years. Moreover, a number of the measures were structural, and it would take some time before their beneficial effects could be felt, especially as there were many bottlenecks that would have to be removed with the help of the World Bank, which was currently appraising two sectors, one in agriculture and the other in light industry.

In passing, Mr. de Maulde stated, he considered Madagascar to be a test case for increased cooperation between the Fund and the World Bank. He intended to put forward shortly to his colleagues in the Board a number of suggestions on that topic, as well as bringing the matter up in the Executive Board of the World Bank.

A real problem with the proposed stand-by arrangement, Mr. de Maulde considered, was the amount of SDR 33 million proposed. For 1984, the financing gap was estimated at SDR 163 million. If the Fund were to provide SDR 27 million in 1984, as in Table 1 of EBS/83/255 seemed to show, there would remain an unfinanced gap of SDR 136 million, to be covered in part by rescheduling by the Paris Club, and in part by the contributions of aid donors. The most that could be expected from the Paris Club rescheduling would be the equivalent of SDR 70 million, leaving a residual gap of SDR 66 million to be found by aid donors, compared with a gap in 1983 of SDR 50 million, which had been filled only with the greatest difficulty. It seemed more than likely that the residual gap for 1984 would not be filled, and that in consequence the stand-by arrangement would remain dormant.

On the other hand, Mr. de Maulde agreed, if the Fund were to grant Madagascar a drawing of SDR 51 million, the figure initially envisaged by the authorities, there was a reasonable chance that the Fund would be able to mobilize the support of the financial community. In short, the Fund would have to bear a heavy responsibility if it refused to agree on a realistic figure for its share of the financing of Madagascar's recovery, unless donors were prepared to provide much larger balance of payments assistance than they had in 1983. He therefore urged Executive Directors to authorize a purchase of SDR 51 million, representing 76 percent of the new quota for 15 months, or 61 percent on an annual basis.

Even that figure would be quite moderate for a number of reasons, Mr. de Maulde considered. First, SDR 33 million was the equivalent of only 49.7 percent of Madagascar's new quota. As the drawing was to be for 15 months, Madagascar would be receiving only 39.8 percent of quota on a 12-month basis. In addition, the proposed drawings were back-loaded. In view of the evident strength of the adjustment effort and the magnitude of the country's balance of payments needs, the proposed amount did not seem to be out of line with similar cases that had come before the Executive Board in the past. Second, Madagascar was not so far heavily indebted to the Fund, as it had not completed drawings under previous arrangements. Even if the country drew the full amount made available under the proposed stand-by arrangement, the Fund's holdings of Malagasy francs subject to repurchase would represent 204 percent of the new quota or, excluding the compensatory financing facility, 154.7 percent of quota. The country would therefore still be far from the new cumulative access limit of 500 percent of quota.

Third, Mr. de Maulde went on, if the drawing were restricted to SDR 33 million, there would occur a net transfer of resources from Madagascar to the Fund during the program period. Table 1 on page 2 of EBS/83/255 showed that for the nine months from July 1984 to February 1985 the net transfer of resources would be SDR 4.59 million from Madagascar to the Fund, including a repayment of SDR 10.95 million under the compensatory financing facility. Excluding interest charges, from March 1984 to February 1985 there would still be a negative transfer of resources from Madagascar to the Fund amounting to SDR 2.24 million. Finally, with a view to arousing the interest of his colleagues elected by Vanuatu and the Caribbean countries, he noted that Madagascar undoubtedly fell into the category referred to in paragrah 5(f) of the Interim Committee communiqué, in which the Committee had stated: "In implementing its policies on access to its resources, the Fund should be particularly mindful of the very difficult circumstances of the small-quota low-income countries."

While the four arguments that he had put forward were certainly strong in themselves, Mr. de Maulde remarked, the real reason why he had suggested raising the drawing from SDR 33 million to SDR 51 million was to ensure that the Fund was effective in its catalytic role. If, as was proposed, the Fund were seen as reducing its own contribution by permitting Madagascar to draw no more than 50 percent of quota on an annual basis while the previous stand-by had represented 100 percent of quota for one year, it seemed quite probable that the financing package would never be put together. The Executive Directors would do well to take the proper decision at the present meeting, instead of having to take it two or three months hence, when the first steps had proved inadequate.

Mr. Ismael stated that he was in broad agreement with the thrust of the report put forward by the staff. He could support the two proposed decisions.

Nevertheless, Mr. Ismael went on, after three successive stand-by arrangements with the Fund, the economy of Madagascar was still facing serious financial and structural imbalances. While some progress had been achieved in the past three years in reducing fiscal and current account deficits, some of the other macroeconomic indicators had deteriorated. Both the external debt burden and payments arrears had mounted, while domestic savings had dwindled, inflation had accelerated, and economic growth had become negative. To correct the situation a more comprehensive program, with greater attention to structural changes, would have to be pursued for a number of years.

In the present circumstances, Mr. Ismael considered, it could reasonably be asked how effective the previous stand-by arrangements had been and what factors had conjoined to make them less effective than they ought to have been. The past programs might have dwelt too heavily on financial aspects without paying sufficient attention to other related aspects, which were of great importance in achieving a viable balance of payments equilibrium. In a number of fields, inappropriate policies had apparently been pursued throughout the stand-by arrangement. The authorities had for instance maintained a comprehensive system of price controls, negative interest rates, monopoly marketing of major exports and other commodities, and an inappropriate sectoral allocation of investment, while allowing the share of consumption in total GDP to rise. He would be interested to know how much the Fund had done to try to influence the authorities away from those policies. Naturally, he understood that many of the aspects that he had mentioned would more appropriately be dealt with by the World Bank, as a development institution. He would therefore like to hear the staff comment on the extent of the cooperation between the World Bank and the Fund in the previous adjustment programs, together with an explanation of the way in which World Bank programs and Fund programs had been coordinated.

He was glad that in the proposed new program more emphasis was being placed on supply-side measures, Mr. Ismael observed. For instance, there there was to be a substantial liberalization of the pricing, marketing, and distribution of agricultural and industrial products, together with a better selection of investment products, the adoption of a flexible exchange rate, some allocation of imports, and the introduction of measures to strengthen the operation of public enterprises. Such action should reinforce those already taken or being contemplated in the fiscal, monetary, and external fields. He noted that some adjustment measures were to be implemented in cooperation with the World Bank and donor countries. Better coordination among all the parties involved in designing and implementing programs, especially between the Fund and the World Bank, was most desirable.

Mr. Erb stated that he had been willing to accept a waiver of the four-week rule for the discussion of the papers on Madagascar. Nonetheless, he was rather surprised to find some important policy issues being raised in connection with the request for a stand-by arrangement with Madagascar, and he would have preferred to have been made aware of the prospect at the time that a waiver had been requested.

He could support the proposed program, Mr. Erb continued, although he had serious questions regarding its content. As to the broader issue raised by Mr. Tshishimbi and Mr. de Maulde regarding the amount to be made available to Madagascar under the program, his chair had in the past raised questions about the adjustment path followed by Madagascar under previous stand-by arrangements, and it had had doubts about the magnitude of the resources committed to Madagascar in the past under the enlarged access policy in light of the probable length of the adjustment period. Even now, the adjustment period remained uncertain, although the Malagasy authorities had been taking steps for the past two years to restructure the economy both in the fiscal field and in connection with the exchange rate, while attempting to deal with some of the structural rigidities in their way. It was evident that there was a long way to go in both those fields.

In the present case, Mr. Erb considered, the Executive Board could be liberal in applying the enlarged access policy, despite the open-ended nature of the adjustment, provided that it was careful to limit the size of the Fund's resources that were committed to the country. It seemed evident from the present proposal that the Fund would continue to play an important role in Madagascar, while ensuring that its financing role was consistent with its policies, including the policy on enlarged access.

Commenting on the domestic policy adjustments undertaken by the authorities, Mr. Erb remarked that they had made some major steps not only in the fiscal and monetary fields but also on the structural side. Nevertheles, major adjustments remained to be made in the exchange rate system. He had in the past questioned whether the real depreciation of the exchange rate in 1982 had been adequate, and he had been disturbed to find that the effect of the depreciation had disappeared in the following year. He was glad to see that action had been taken to return the exchange rate to what it had been in 1982; but he still wondered whether even that level was appropriate in view of Madagascar's external circumstances. He would prefer to see a more aggressive exchange rate policy implemented by the authorities, particularly in view of the inflationary movements at home, a point made by Mr. Ismael.

On the fiscal side, Mr. Erb went on, while it was clear that the authorities had made a large adjustment by bringing down the fiscal deficit from 12-13 percent of GDP to some 6 percent of GDP, it seemed evident that more adjustment still would be needed in fiscal policy. During the early 1970s, Madagascar's fiscal deficit expressed as a percentage of GDP had been in the range of 2-3 percent.

Major adjustments and changes in policy would also have to be made on the structural side, Mr. Erb considered, not only to bring in new pricing policies but also to improve and, indeed, perhaps to reduce some of the activities of the state enterprises. On the pricing front, the rice pricing policy remained complex and cumbersome, as did certain other aspects of pricing. Clearly, that was an area in which the World Bank would have a critical role to play, and he agreed with Mr. Ismael that there should be close cooperation between the Fund and the World Bank in dealing with the structural problems that were restraining the growth potential of Madagascar.

On the external financing side, it seemed evident from Table 7 on page 17 of EBS/83/255 that the creditors and donors would need to accept both the rescheduling and the assistance that was required if Madagascar were to be placed on the path of medium-term viability. From experience, it was evident that donors and creditors were at times willing to make unusual efforts to deal with a country's external debt service problems, but they would have to be satisfied that the authorities were making equally unusual efforts on the domestic side. The donors and creditors would also have to consider the implications for the balance of payments of the large debt service burden that Madagascar would have to face for the next few years. It certainly seemed likely that there would continue to be a need for major debt rescheduling efforts for some time to come. In brief, the adjustment period would be quite lengthy, and it was unclear when a sustainable position would be achieved. For those reasons, he could support the extent of Fund involvement in Madagascar proposed by the staff.

Mr. Clark stated that he could support conditional approval of the proposed stand-by arrangement. He did so, however, with major reservations, relating as much to the general philosophy of the program as to the detailed structure, on which he agreed with Mr. Ismael and Mr. Erb.

He was troubled by the fact, Mr. Clark asserted, that the Executive Board was being presented with a proposed stand-by arrangement that seemed to offer little progress toward external viability in the medium term, while leaving substantial financing gaps. While he recognized the catalytic role that a Fund program could play in encouraging potential lenders, the weight given to that role in the present instance seemed excessive. Furthermore, although he recognized the difficulties facing Madagascar, the solution did not seem to him to lie in the country's taking on more relatively expensive debt. He would therefore be extremely cautious in committing Fund resources, and he would oppose an increase in the size of the program beyond what the staff had proposed.

On points of detail, Mr. Clark observed that it seemed to him that there was some risk that by the time agreement had been reached on the program, the statistical basis on which it had been founded would be out of date. Naturally, that was a general risk whenever the Executive Board approved programs conditionally. Second, in view of the importance attaching to gathering financial resources and arranging for the rescheduling of existing debts, it would surely be helpful for the Malagasy authorities to seek the services of an external finance coordinator.

Mr. Mtei stated that he could agree with the general thrust of the staff appraisal. Madagascar had been facing a number of problems, including a stagnant or declining gross domestic product, a high rate of inflation, domestic financial imbalances, worsening terms of trade, growing external payments deficits, accumulations of arrears, and a relatively heavy debt burden. The authorities were certainly aware of those problems, as had been shown by the staff; they had adopted three adjustment programs in the past, as a result of which there had been some improvements. For instance, the overall budget deficit had been reduced from 18.4 percent of GDP in 1980 to 8.7 percent in 1982 and 6.2 percent in 1983. The situation was expected to improve even further in 1984, when the ratio of fiscal deficit to gross domestic product was expected to stand at no more than 5.5 percent. Nonetheless, there was still room for improvement, particularly if the authorities persevered in implementing all the measures contained in their program.

The elements of the program set out in Table 2 of EBS/83/225 were quite appropriate, Mr. Mtei considered. If they were all followed to the letter, they would make a large contribution to bringing the economy back on track. Both the exchange rate action undertaken and the price incentives already introduced were worthy of note. Between them, they would no doubt stimulate production in some areas and reduce or eliminate dependence on imports or increased exports in others. Nevertheless, exports were strictly restrained by marketing problems, including restrictions on Madagascar's exports. Unless Madagascar's trading partners took positive action in that connection, anything that the authorities would do was unlikely to bear the desired fruit.

As to the financial assistance that the Fund proposed to make available to Madagascar, Mr. Mtei stated that he found the amount too low to be effective. The staff took the line that the Fund's role in Madagascar should be purely catalytic. He wondered how that role could be translated into funding, particularly when the Fund's own new exposure was no more than 50 percent of Madagascar's new quota, and when the trend of official development assistance and commercial bank lending to small countries was taken into account. Even if the general rescheduling terms that the staff was suggesting for Madagascar were realized, it was doubtful whether all the needed financing would be made available. In those circumstances, the definition of the Fund's catalytic role devised by the staff was rather puzzling. Unless the Fund showed its confidence in a country by offering a sufficient volume of resources, it could not expect either bilateral or multilateral institutions, still less commercial lenders, to take part. The minimum that the Fund could make available to Madagascar to ensure that the program would be effective was the SDR 51 million originally proposed, which amounted to no more than 100 percent of Madagascar's quota under the Seventh General Review of Quotas. In that connection, he was glad to have heard Mr. Erb say that the Fund could be flexible in applying the enlarged access policy, and he was concerned that Madagascar would be permitted to draw no more than SDR 3 million in the first instance after the Executive Board's approval. Even the availability of that amount was to be subject to agreement being reached on closing the financing gap, something that might not happen soon, so that the country would be unable to meet its performance criteria for December 1983. In addition, the authorities would require time to collate their statistics and to inform the Fund whether or not they had met the December targets. The procedure represented a step in the wrong direction, and he hoped that it would not set the pattern for small quota countries in the years ahead.

Madagascar had not met two of the performance criteria contained in the program for 1982/83, Mr. Mtei conceded. For instance, Madagascar had been unable to reduce arrears because it was short of cash. Without the Fund's assistance, it would continue to be short of cash and continue to be unable to meet arrears. Similarly, the automatic licensing of priority imports needed to be seen in the light of the prevailing circumstances. He was inclined to believe that the content of priority imports varied with the seriousness of the situation, depending on developments in the external payments position. He was not convinced that it was desirable to include in the performance criteria an item that was subject to individual judgment.

In conclusion, Mr. Mtei said that, while he would support the decision as proposed, he would appeal to the creditors to be particularly generous to Madagascar in order to ensure that the financing gap could be closed. He hoped that the Executive Board could agree to an arrangement whereby the amount of the drawing could be raised from SDR 33 million to SDR 51 million.

Mr. Shaw stated that he too would support the staff appraisal. He could agree with other speakers that the authorities had made some progress over the past few years, particularly since 1979, although the programs had not always been on track. He commended the authorities particularly for their adjustments on the fiscal side and for their flexible approach to exchange rate policy. However, like Mr. Erb, he wondered whether the exchange rate policy had really become more flexible, and whether the adjustments had actually had the desired effect. He would welcome comments by the staff on whether or not the exchange rate was currently appropriate.

He supported the staff strongly in the view that supply-side measures were needed to improve production, and he had welcomed the comments by the Deputy Director of the African Department on producer prices, Mr. Shaw continued. But he also agreed that the staff would have to watch the situation closely, and that in its mission to take place in early January it should determine specifically whether in fact the changes were in line with the letter of intent.

The main concern of his authorities, as of Mr. Erb, was that the balance of payments gap would apparently still continue to exist, Mr. Shaw observed. He supported the proposal to approve the decision in principle; clearly, exceptional debt rescheduling efforts and an extraordinary response from a donor would be required to close the financing gap. It seemed to him that there would have to be 100 percent rescheduling at the least, if the gap were to be closed. He wondered how much short-term debt had been rescheduled or was included currently for rescheduling. Table 17 in SM/83/245 seemed to show that, even after rescheduling, Madagascar would have an outstanding short-term debt of SDR 6.4 million to be paid in each year from 1983 to 1987. He wondered what the nature of that debt might be; in particular, it would be interesting to know how much of the guaranteed debt was short term.

As to the amount of assistance that ought to be provided by the Fund, he supported the staff view that 65 percent of present quota was sufficient, Mr. Shaw said. The balance of payments gap was still large, and the country did not seem likely to attain any medium-term viability. Consequently, continued Fund assistance would be required for many years, and the staff proposal was appropriate in the circumstances.

Mr. Abiad stated that he had no difficulty with the thrust of the staff appraisals in either the consultation report or the paper on Madagascar's request for the use of Fund resources. Considering the economic background against which the authorities had had to pursue their adjustment over the past few years, performance under recent stand-by arrangements with the Fund had been quite reasonable. During that period, significant budgetary adjustment, reflected in successive reductions in the overall government deficit relative to GDP, had been achieved. The authorities had brought about those results, inter alia, by adopting various revenue-raising and expenditure-controlling measures in support of the restrained demand management policy that they had been pursuing. As a manifestation of their commitment to adjustment, the authorities were reported to have further tightened their financial policies in the second half of the most recent stand-by program. As a result, the budgetary outturn was shown to have been even more restrictive than the program had envisaged. Moreover, almost all the performance criteria set out in the most recent stand-by arrangement had been observed, with the notable exception of the reduction of external arrears.

However, despite the improvement in the budget performance, the external accounts of Madagascar remained weak, Mr. Abiad noted. The steady improvement in the trade balance had been largely overshadowed by a renewed deterioration in the overall balance due to the size and growth of the debt service burden. It seemed ironical that while the budget position had originally been considered a major cause of the balance of payments weakness, a substantial improvement in that position had not been accompanied by a commensurate reduction in the balance of payments deficit. Such an outcome seemed to confirm that the country's difficulties were largely structural and related chiefly to the real sector. Perhaps the weakness of the balance of payments could have been lessened if greater emphasis had been placed on the supply side at an earlier stage.

In any event, Mr. Abiad went on, it was encouraging to note that the new program was focused much more strongly on the production side. The program appropriately envisaged strengthening pricing and marketing policies as the best way of raising production and encouraging export diversification, particularly in the agricultural sector. The policy measures to be taken during the program period were broadly in line with those objectives.

Nevertheless, the staff papers showed that, even if the necessary measures were successfully implemented, Madagascar would still be facing serious difficulties, Mr. Abiad observed. The structural imbalances in the economy would remain large. Moreover, the external accounts would continue to be under severe strain for several years to come, as could be seen from the projections for the external financing gap. Clearly, the adjustment effort would have to continue over the medium term, mainly in the real sector, if effective progress toward balance of payments viability were to be achieved, and if the country's capacity to service its external debt were to be significantly enhanced. The staff had emphasized the importance of rescheduling and the need for exceptional balance of payments assistance for the success of Madagascar's adjustment endeavor. The Fund would have to play a particularly active role as a catalyst if it wished to support Madagascar in view of the modest amount of resources that it was proposing to make available. He had noted Mr. de Maulde's remarks on the level of access; his arguments in favor of a larger amount than the one mentioned by the staff seemed convincing. He had no difficulty with the program proposed by the Malagasy authorities, and he could support an amended decision reflecting Mr. de Maulde's suggestion if the Executive Board agreed.

Mr. Suraisry commended the authorities for the progress they made in recent years toward reducing the domestic financial imbalances in the economy. Since 1980, the budget deficit had been reduced significantly in terms of gross domestic product. Moreover, borrowing to finance the budget deficit had been sharply reduced. It was however clear that serious problems remained. The debt service burden in particular was expected to remain high for the remainder of the decade. It was therefore encouraging that the authorities had requested a stand-by arrangement with the Fund and were seeking further restructuring of their debt obligations.

He welcomed the emphasis in the new program on strengthening production, particularly in view of the recent negative growth rate of the economy, Mr. Suraisry continued. Growth was essential if Madagascar were to be able to service its debts.

Quantitative performance criteria had been specified only until the end of 1983, Mr. Suraisry noted. Such an arrangement seemed reasonable, since financial developments in 1984 would clearly be influenced by the outcome of the forthcoming debt rescheduling negotiations. He would not go so far as the staff in requiring quantitative performance criteria for the whole of 1984 to be set during the first program review. There might perhaps be a case for specifying the quantitative performance criteria for the first half of 1984 during that review, and those for the second half of 1984 during the second review.

While he could sympathize with those who argued for increasing the amount that the Fund should make available to Madagascar under the proposed stand-by arrangement, Mr. Suraisry stated, as it was likely that further assistance by the Fund would be needed. As the present stand-by arrangement was the fourth one with Madagascar since 1980, he could support the proposed decision as amended by the staff.

Mr. Coene remarked that the present program for Madagascar built on the substantial progress was achieved with previous Fund assistance. It would however clearly be necessary for the authorities to undertake further adjustment if they were to shorten the period within which they hoped to achieve a sustainable balance of payments position. The tables in the various staff papers seemed to show that an improvement in the balance of payments would have to come mainly from an expansion of supply, either in the export sector or in the import competing sectors.

The liberalization that had been applied to pricing and marketing for domestically produced rice in two areas could be extended to all the producing areas in the country as a means of providing adequate incentives for domestic production, Mr. Coene considered. They should also be extended to other agricultural products, and to industrial products as well.

The authorities should undertake further work on interest rates as a means of bringing about the increased mobilization of domestic savings, Mr. Coene observed. They should not wait for inflation to subside before making interest rates positive in real terms.

In view of the great part to be played by exports, particularly nontraditional exports, in the medium-term adjustment effort, Mr. Coene remarked, he wondered whether the Fund should not press for a more active exchange rate policy. While the present flexible policy was an improvement on the previous one, the exchange rate in real effective terms remained at the May 1982 level. He wondered whether the staff considered that level appropriate, or whether it would welcome further adjustment.

The staff should keep a close eye on developments under the stand-by arrangement, Mr. Coene said. The proposed review should ensure that proper progress was being achieved. Overperformance should not be grounds for relaxation; it should be used to shorten the adjustment period. In view of the uncertainty about the length of that period, the Fund should be cautious in deciding on the amount of assistance that it would provide, if it wished to play a continuing role in promoting adjustment. Nevertheless, in the present instance perhaps the staff had been overcautious. It was difficult to see how the Fund could play a convincing catalytic role when it apparently intended to start reducing its exposure in Madagascar from mid-1984, and the adjustment period continued beyond 1987. Even if the Fund were to make available the amount proposed by Mr. de Maulde, it would have ample room for further assistance over the years ahead without coming anywhere near the ceiling under the policy on enlarged access. In view of the adjustment efforts made by the authorities, the balance of payments need and the length of the adjustment period, he could support Mr. de Maulde's proposal to increase the amount proposed by the staff.

Mr. Prowse observed that the staff estimates in EBS/83/235 seemed quite acceptable. The one outstanding cause of the present difficulties was that, in response to the economic stagnation of the late 1970s, the authorities had undertaken an overlarge investment effort, which had been largely financed from commercial sources rather than with development assistance. It could not be denied that the investment had led largely to the establishment of white elephants, but that unfortunate historical episode could not be allowed to stand in the way of further efforts. The proposed program was therefore correct in emphasizing the structural aspects of adjustment. The second main purpose of the program should however be to achieve a restructuring of Madagascar's debt, as an essential prerequisite to any possible successful outcome. Consequently, he had been impressed by the idea that the Fund should attempt to play the role of a catalyst. He was however rather dismayed by the proposal to adopt the decision in principle, subject to the financing gap being closed because, if the financing could not be completed, there might be a suggestion that the Fund was walking away from Madagascar. When the Executive Directors had discussed the staff paper on criteria for the amount of access in individual cases (EBS/83/233, 10/31/83), the staff had referred to a category of countries in which the Fund's role was likely to be primarily that of a catalyst. At least some Executive Directors had felt that the categorization was being carried too far, and it had certainly not been endorsed by all Executive Directors. He was therefore rather concerned that the narrow application of such a concept might lead to an unfortunate outcome in the present instance.

In any event, he was by no means certain that even a narrow interpretation of the catalytic role of the Fund would lead him to conclude that SDR 33 million over 15 months was a uniquely appropriate amount of assistance for Madagascar, Mr. Prowse stated. He had been impressed by the observations of Mr. de Maulde and Mr. Tshishimbi, and he could support the larger amount that Mr. de Maulde had proposed on the grounds that it would enhance the Fund's role as a catalyst. If those who felt differently were worried about the prospects of obtaining repayment, there was a question whether the Fund should offer any assistance at all. He himself was not so concerned, and he could not see any reason for limiting the amount proposed to such a small figure. He therefore invited the staff to say how it had decided on the figure of SDR 33 million. He did so because, during the discussion on criteria for access in individual cases, it had been agreed that it would be helpful to Executive Directors to know how the amount was determined in each case.

Nevertheless, while he agreed with Mr. de Maulde about the desirability of offering Madagascar a larger drawing than had been proposed, Mr. Prowse continued, he did not believe that the small-quota, small-island concept suited the present case. Madagascar was a country with a population of almost 9.5 million, with a work force of 4.5 million and a quota of SDR 6 million. If Mr. de Maulde wished to include Madagascar in that category, he might also have to include France, which had a somewhat smaller land area.

More to the point, Mr. Prowse observed, Madagascar did have the potential to overcome its difficulties, which was a good reason why the Fund should persist in its relationship with the country. What was required was the confidence of the creditors to reschedule Madagascar's debts and to provide extraordinary assistance. Such confidence would be boosted by the Fund if it participated in a comparatively wholehearted manner.

Another question that had been raised in connection with the request by Madagascar, Mr. Prowse noted, was that of defining a viable debt service ratio. Madagascar's debt service ratio was said by the staff to be 42 percent in 1983 and to rise to 68 percent in 1985 before dropping to 60 percent in later years, as shown in Table 7 of EBS/83/255. While such figures were clearly not viable, they seemed likely to be seen in connection with many other countries for some time to come. It would therefore be interesting if the staff would say what it considered to be a tolerable debt service ratio for Madagascar and, more generally, whether it saw any general principles that might be applied.

In conclusion, Mr. Prowse stated that if the Executive Board saw a case for making a larger amount available for Madagascar, he would certainly endorse that view. Second, if the Executive Board adopted the program on an "in principle" basis, it should be on the understanding that even if the rescheduling failed to achieve what was desired, the Fund should quickly review the situation with the intention of reaching agreement with Madagascar on a different program.

Mr. Malhotra stated that he agreed with the staff appraisal. He believed that in the past three adjustment programs Madagascar had made considerable progress, although much still remained to be done on the structural side. In particular, he noted the progress made in reducing the budget deficit, in improving the exchange rate system, and in moving toward more rational pricing policies. The Fund ought clearly to be involved in further adjustment in Madagascar for some period ahead.

Any further substantial reductions in the budget deficit might not be feasible, Mr. Malhotra commented. Therefore, the target of reducing the deficit from 6 percent to 5.5 percent of GDP in one year seemed reasonable.

He was worried by the high rate of inflation, Mr. Malhotra said. So long as inflation remained high, the authorities would need to pay greater attention to exchange rate flexibility, and he was glad that they appeared ready to do so.

Major efforts would be needed to improve the functioning of the real sector of the economy, Mr. Malhotra considered. Substantial action would be necessary to salvage whatever could be saved from the rather heavy investment, some of which might have been misguided, that had led to the large debt service burden. The Fund and the World Bank should cooperate in an appropriate program over the next few years. Regarding the proposed amount of Fund financing, he had been impressed by Mr. de Maulde's remarks; he agreed that the suggested financing was inadequate. He recalled the statement made by his chair on that point at the time of the discussion on access to the Fund's resources in individual cases (EBS/83/233, 10/31/83). If the present proposal represented the way in which the Fund envisaged its catalytic role, he feared that it would be providing too little finance, and often too late.

In the present instance, Mr. Malhotra observed, the Fund would be receiving substantial payments by way of repurchases--in the order of SDR 33.7 million--in 1984. SDR 40.7 million would be received by the Fund in 1985, and a similar amount in 1986. Consequently, the net exposure of the Fund would be negative in 1984. If Executive Directors were convinced that the Fund should continue to be involved in Madagascar, and if they believed that the design of the program was satisfactory, should the Fund be reducing its net exposure? There were admittedly uncertainties regarding how much rescheduling of outstanding debt would in fact materialize, how many further commitments would be made by aid donors, and what action could be taken if the financing gap were not fully met.

He was surprised, Mr. Malhotra said, about the small size of the proposed first drawing, no more than SDR 3 million. He suggested that Executive Directors should take note of the circumstances and raise the amount of Fund financing by appropriately amending the proposed decision. The Executive Directors might take a decision in principle to provide financial resources to Madagascar. Even if a financing gap did remain, it did not seem to him that the Fund would be running any great risk in view of the existing schedule of repayments.

Mr. Caranicas remarked that earlier speakers had described various aspects of the efforts by the Malagasy authorities to overcome the complex problems facing the country's economy, particularly the needed structural adjustment. Nevertheless, Madagascar had had a succession of stand-by arrangements from 1980 to 1983. He wondered whether an extended arrangement had ever been considered, and, if so, why it had not been proposed by the staff. At least some of the requirements for an extended arrangement seemed to have been met. While the first two Fund-supported programs had focused mainly on short-term stabilization policies, particularly in the fiscal area, greater emphasis was now being placed on structural and supply-side policies, which were designed to improve pricing and marketing in agriculture, to increase production for export and import substitution, and to decontrol industrial prices.

On the stance of the demand management policies in the present program, he had no quarrel with the staff, Mr. Caranicas stated. A further reduction in the budget deficit seemed feasible, as most of the measures described, especially on the revenue side, had been implemented earlier in the year. As to monetary management, he subscribed to the staff's call for a correction in interest rates, which were negative in real terms, and for some degree of deregulation in the financial system.

There was no doubt, Mr. Caranicas considered, that Madagascar's present problems revolved around the country's external position, its deep indebtedness, its incapacity to deal with its debt service, and its medium-term financing needs. There was considerable uncertainty regarding the financing of the balance of payments gap for 1984 and, despite some encouraging figures from the staff, the situation seemed still to be quite critical. The present debt service obligations seemed likely to exceed the country's debt servicing capacity by a large margin for many years to come. He found the presentation in Table 7 of EBS/83/255--which clearly showed the magnitude of the financing gap confronting the country--rather alarming. He shared the staff view that continued generous aid with no strings attached would be needed to enable Madagascar to close the gap. In EBS/83/235, the staff had stated that there would be large balance of payments gaps each year through 1987; in the letter of intent dated November 2, 1983, the Malagasy authorities had written that the program was dependent upon the availability of the necessary minimum imports to activate production, implying the need for an extremely generous solution to the debt problem over the medium term.

As to the nature of the Fund's role, and the amount of assistance, in the light of the argument put forward by Mr. de Maulde and Mr. Tshishimbi, he would take the position, first, that the country had been adjusting to a significant degree and, second, that the quality and strength of the program were beyond doubt, Mr. Caranicas stated. The financing need was large, and many conditions seemed to have been met for greater access to the Fund's resources. Mr. Tshishimbi had said that his authorities in Madagascar were deeply disappointed by the amount proposed, and Mr. de Maulde had observed that the authorities had carried out all the adjustment that was possible. While he agreed with those arguments, he did not remember the Executive Board's having ever changed a figure put forward by the staff in granting a request for a stand-by arrangement, unless there had been a single country in very particular circumstances. On the other hand, it was clear that the Malagasy authorities had originally requested a larger amount; one way of dealing with the problem might be to avoid using the back-loading principle set out in the proposed decision. In the circumstances, if the Board by a large majority agreed to reconsider the amount, he could support such a move.

In general terms, it would be interesting to know how the staff had reached the figure that it was proposing in the present instance, Mr. Caranicas remarked. While he understood that there was a considerable element of judgment, it would be helpful to the Executive Board to have some more detailed explanation regarding the criteria that had been used.

As to the future, Mr. Caranicas recalled that Mr. Tshishimbi had expressed the hope that the Fund would play a very active role in helping Madagascar to reschedule its debt. The Fund's role as a catalyst, even in cases like that of Madagascar, was likely to be inadequate, because under the circumstances, the amounts to be made available would be quite significant. In conclusion, he had no objection to approving the proposed stand-by arrangement in principle, pending the conclusion of negotiations for debt rescheduling, and agreement on further external financing.

Mr. Polak remarked that the various comments that had been made on the amount to be made available to Madagascar had not given him sufficient information to decide one way or the other. In the circumstances, he had three questions and one observation. First, Mr. de Maulde had mentioned that the amount originally considered had been SDR 51 million, and that the staff had reduced that figure to SDR 33 million. He would like to have confirmation of Mr. de Maulde's statement. Second, if Mr. de Maulde were correct, he would like to know whether the reduction was connected with the nature of the program put forward by Madagascar or with Fund policy. In any event, it would be interesting to know why the percentage was smaller than that made available under the previous stand-by arrangement. Third, he would like to know whether management or staff considered that providing an additional SDR 18 million for Madagascar would substantially improve the chances of success of the proposed program.

The staff had not given the clearest possible presentation of the relevant information to enable the Executive Directors to take a decision, Mr. Polak considered. It had started by saying that Madagascar's outstanding debt to the Fund was 261 percent of present quota on October 31, 1983, outstanding debt being defined as the Fund's holdings of Malagasy francs subject to repurchase. In Table 1 on page 2 of EBS/83/255 there was no statement of the Fund's holdings subject to repurchase, but only an indication of total Fund holdings, which amounted to some 370 percent for January-March 1984. He would encourage the staff to remain with Fund holdings subject to repurchase as the most suitable indication of the financial relationship between the Fund and the member.

Mr. Donoso said that he had no difficulty with the stand-by program, but that he would appreciate an explanation by the staff of the way in which it had calculated the amount being made available to Madagascar. The staff explanation would give a better idea of the way in which the guidelines for the use of the Fund's resources were applied in individual cases. Second, if there were insufficient resources to finance the program at the present stage, what made the staff think that there would be sufficient resources at some later time? He was particularly concerned about the ability of Madagascar to repay the Fund. If there were doubts whether the volume of resources proposed would ensure the success of the program, he would consider an increase in the amount to be made available by the Fund.

Mr. Salehkhou remarked that, like many of his colleagues, he believed that, despite mixed results, the previous programs with Madagascar had put the country on the right path. Table 3 of EBS/83/255 showed that the authorities had brought down the overall budget deficit from 18.4 percent of GDP in 1980 to 6.7 percent in 1983, indicating a major change in their policies. Second, while some ill-conceived policies carried out in the past had contributed to the deterioration of the situation, Madagascar had been hard hit by overwhelming exogenous factors. Like Mr. de Maulde, he strongly believed that the proposed amount for the stand-by arrangement, which represented less than 50 percent of Madagascar's new quota on an annual basis, was inadequate to assist the country in carrying out its programs. Furthermore, the amount seemed unlikely to be large enough to act as a catalyst in bringing in other donors.

Finally, Mr. Salehkhou asked Mr. Tshishimbi to explain what the authorities had in mind with respect to the pricing of rice. In giving such an explanation, he would be responding to the recommendation by the Interim Committee that the Executive Directors should pay due attention to the case of small-quota countries. He did not wish to seem to be interfering with the staff and management, but in the particular case of Madagascar he felt that the precautions taken by the staff--an agreement in principle only, the demand for prior action, the application of back-loading, and net transfers from Madagascar to the Fund--were the most that could be expected from a member country. As to the decision itself, he would accept it as it stood.

Mr. Grosche stated that he could go along with the staff appraisal. The proposed program provided for drawings that would enable the country mainly to honor its existing obligations to the Fund. Such an arrangement clearly represented a case of permanent use of the Fund's resources, a point that had been taken into account in choosing the amount of resources to be made available. Despite Mr. de Maulde's interesting observations, he would still accept the staff arguments. In view of the previous stand-by arrangements and of other arrangements that were likely to be needed in the future, larger drawings at the present stage would only further increase Madagascar's repayment burden, while limiting the amount of drawings that would be possible under future arrangements.

The balance of payments gap that was likely to remain was a further argument for limited involvement by the Fund, Mr. Grosche maintained. He shared the staff view that the Fund should confine itself to acting as a catalyst, and he recalled the discussion on the criteria for the amount of access in individual cases, which seemed to apply precisely to the circumstances of Madagascar. The great bulk of external financing ought in cases like the present to be provided on appropriate terms from sources other than the Fund. The general rule ought to be that when a member's balance of payments was so weak that it was unlikely that a sustainable external balance could be attained over the medium term, the Fund ought not to take a leading role. He would have liked to have more time to reflect on Mr. de Maulde's proposal; as it was, he would accept the decision as proposed by the staff.

Mr. Robalino stated that he would support the decision as proposed, but preferably with an increased amount.

The Deputy Director of the African Department, commenting first on the nature of the program with Madagascar, noted that speakers had inquired whether the staff would recommend an extended arrangement for Madagascar rather than a one-year stand-by arrangement. An extended arrangement was feasible only when the underlying short-term financial disequilibria had been corrected, so that a relatively stable financial climate was likely to endure for the coming three or four years. In Madagascar, notwithstanding the progress that had been made, the financial disequilibria were still so large and uncertain that it was difficult to find a firm basis on which a convincing and reasonable extended arrangement could be predicated.

Another consideration that had certainly influenced the staff in proposing a one-year stand-by arrangement was whether the authorities themselves were convinced that they were adopting the right policy and whether the new approach was firmly entrenched as a policy. The steps toward liberalization and reforming the private sector pricing system were being taken with the utmost caution, and there was still a considerable amount of political and social opposition to the new direction of policy. Indeed, opposition was so strong that the authorities had sometimes had to introduce new measures without giving them a great deal of publicity. Unless the authorities themselves were convinced that their new policy course was correct, it would hardly be appropriate to propose an extended arrangement.

Dealing with possible exchange rate action, the Deputy Director recalled that Mr. Erb had maintained that the level at which the present program aimed to restore the real exchange rate was inappropriate, and that a more aggressive exchange rate policy would be useful. There were two possible responses, one philosophical and one practical. The result of a real exchange rate adjustment in a country like Madagascar, where consumer prices had formerly been subsidized to the extent of 50 percent or 60 percent, was to bring about an increase in consumer prices of between 30 percent and 40 percent. Would such an increase mean that at the end of the program period, another larger depreciation would be needed? He was by no means certain that in the circumstances it was necessary to maintain the real effective exchange rate that had been reached before the massive pass-through of prices, following an exchange rate adjustment, had been put into effect.

Of course, the Deputy Director went on, he was prepared to agree with Mr. Erb that there was some doubt whether the original adjustment was adequate, and even whether additional adjustments would be required. It was that doubt that had led the staff at the time of the review in January 1983 to ask the authorities to undertake an adjustment, because in the meantime the exchange rate had appreciated. One point that the Executive Directors ought to bear in mind was that when the staff had asked the authorities to adjust the exchange rate in relation to the price changes, the authorities had inquired whether the procedure was reversible. The matter could become important. Indeed, during the past five months, the cost of living had remained almost unchanged. Was it therefore necessary to draw the conclusion that the real effective exchange rate of the Malagasy franc had been depreciated too far and that it ought to be appreciated? It was important to look at prices in a more pragmatic way over a longer period, and to adjust the exchange rate accordingly in the light of considerations not so intimately related to price developments.

On the question of the fiscal adjustment, the Deputy Director recalled that on page 19 of EBS/83/255 the staff had written: "However, it is not feasible for the size of fiscal adjustment in the coming year could match that of the previous three years, when the overall deficit was considerably larger and scope for expenditure economies greater." The implication was that the scope for further adjustment would necessarily be less than it had had been in the past.

Taking up the question of structural change in Madagascar, the Deputy Director noted that he had been asked whether the Fund had been collaborating with the World Bank. On the structural side, the staff had been in close cooperation with that of the World Bank. Not only had the Fund staff taken a full part in the World Bank Consultative Group; on the most recent Fund mission, when the Fund had been looking at structural policies--particularly as they related to agricultural prices--a World Bank staff member had been incorporated in the Fund team, and every effort had been made with World Bank headquarters to coordinate policies. However, it ought to be recognized that on occasion, even though the recommendations would not differ, the pace at which the Fund and the Bank might require the authorities to introduce recommendations could differ from institution to institution. Even in connection with the liberalization of agricultural prices and the extension of private sector operations into areas reserved for government action, although there had been complete agreement on the principles with the Bank staff in the field, at headquarters the Fund staff was more determined to accelerate the pace of change than was the staff of the World Bank. There might therefore be occasions when the Fund would be asking for more or less than the World Bank did, without there being any fundamental difference of opinion between the two staffs.

Regarding performance criteria, the Deputy Director observed that speakers had asked whether the requirement that the Fund should be satisfied with the changes in the pricing of rice before the stand-by arrangement could go into effect was reasonable. In general terms, he would not propose that a decision by the Executive Board should be conditional on a solution being found to a single microeconomic issue. However, the question of the price of rice was a major one in Madagascar. The intention was that the authorities should clearly show that they were making a fundamental change in pricing policies. Even more important, the medium-term solution of the balance of payments difficulties would depend largely on the success of import substitution in rice. In the circumstances, the proposal had some merit for consideration by the Board.

In discussing the role of the Fund in connection with the financial position of Madagascar, Executive Directors might wish to bear in mind that at no time had the staff taken any particular position regarding the terms that should be granted to Madagascar by the Paris Club in connection with rescheduling, either for interest or for principal, the Deputy Director remarked. All that the staff had said was that the debt problem was serious, and that the country would need generous debt rescheduling. The staff had based any calculations about what possible debt relief might be forthcoming on the terms granted in the past.

As to the Fund's catalytic role, the Deputy Director noted that the term could be interpreted to mean either that the Fund could generate certain required changes in domestic policies or that it could be instrumental in raising additional finance for a country, in the form of aid or of rescheduling. The two aspects were mixed, in the sense that the first could not come without the second; but he was not convinced that the extent to which the Fund could generate required changes depended upon the amount of money that it would grant to the country concerned. In Madagascar, for instance, although it had taken between six and nine months to negotiate a program, and although the authorities had not drawn upon the Fund, the policies agreed upon had been implemented by the authorities. That development would suggest that the adoption of policies was not necessarily directly related to the size of the Fund's commitment. The role of the Fund in the present case was to bring about the acceptance of the types of policy that were necessary if Madagascar were to succeed. The staff had indeed explained to the authorities that they ought not to be looking toward the Fund in connection with any particular amount of money, but rather for the kind of technical support that they could receive while trying to implement a program that would lead them toward a viable medium-term future.

He had heard considerable discussion of whether the amount of resources to be made available by the Fund would seem like an indication of confidence in the strength of the program, the Deputy Director observed. In practice, management and staff had decided to recommend to Executive Directors that they make available to Madagascar SDR 33 million over 15 months. In reply to Mr. Polak, he wished to note that the figure of SDR 51 million, referred to in the discussions, had never been a formal proposal. The staff, in discussing the program with the authorities, had used SDR 51 million--100 per cent of the old quota--as illustrative talking points for purposes of deciding what would have to be done with the remainder of the gap. Consequently, while SDR 51 million had been mentioned in discussions with the authorities, it had been made clear that management had not committed itself to that particular amount, nor had management authorized the staff to discuss a program based on that amount. It was true that SDR 51 million had been the amount in the previous stand-by arrangement, and the figure had been used for purposes of discussion on the present occasion. Mr. Polak had also asked why, if the figure of SDR 51 million had originally been advanced, the staff had made a recommendation for SDR 33 million. Mr. Polak's last question had been whether the staff considered that an additional SDR 18 million would have made a difference in the success of the program. Assuming that the total gap was SDR 163 million, any additional amount that the Fund could provide would, in a formal sense, help to close the gap. If SDR 18 million were to become available, the gap would be partly covered further.

As to why the staff had selected the amount of SDR 33 million, the Deputy Director stated that he thought that it would be unfortunate if the staff had to prepare for the Executive Directors a statistical explanation tying the provision of given amounts of resources to specific circumstances. In the case of Madagascar, for instance, the qualitative considerations had been more important than quantitative ones. Among those qualitative considerations, one was that the period for which Fund assistance would be required would be rather long, probably somewhere between five and eight years. The aim had been to scale down the amount of Fund assistance from year to year until zero assistance could be required in, say, 1988 or 1989. Starting from that point, an effort had been made to calculate the maximum amount that could be provided in 1984.

Moreover, the Fund and Madagascar had been linked by stand-by arrangements for some three years, and on each occasion the amount provided had been less than the previous year. The question therefore had been to relate the size of the resources to be provided in the present year with those provided in the past, and the staff had concluded that a slightly smaller amount would be appropriate.

Finally, the Deputy Director of the African Department mentioned, the purpose of the staff appraisal had been to show that Madagascar's problems at the present time arose essentially from the high level of indebtedness. It would therefore be wrong, in considering the role of the Fund in Madagascar, merely to substitute one form of indebtedness for another. Consequently, the proper forum for discussing the financing of Madagascar's needs was aid donors' meetings and debt rescheduling clubs rather than the Fund. Moreover, he had understood the Executive Directors to have said on several occasions that the aim should not necessarily be to cast the Fund in the role of a net provider of liquidity for any given country. Hence, while the staff had been aware that during 1984 Madagascar would be repaying to the Fund about SDR 30 million, that was not one of the considerations that had influenced the amount of the stand-by arrangement.

The staff representative from the Exchange and Trade Relations Department remarked that it had been evident from the outset that the balance of payments and debt situation of Madagascar was extremely serious. It was so serious that Madagascar was unlikely to reach a sustainable balance of payments position in the medium term. Consequently, there was a major question as to Madagascar's ability to service its indebtedness to the Fund in a manner that would preserve the revolving character of the Fund's resources. At the same time, as Madagascar would clearly need Fund support over an extended period both to bring about fundamental changes in its economy and to mobilize the necessary external financing on concessional terms from non-Fund sources, the staff had felt that the size of Fund support during the current program period should be relatively small. Furthermore, Madagascar's net use of Fund resources was already fairly substantial. While relatively large amounts of repurchases would fall due during the program period, most of them would relate to the compensatory financing facility. In terms of purchases under the tranche policy, there would be a net increase in the Fund's holdings of Malagasy francs during the forthcoming program period amounting to some 30 percent of the new quota.

There was of course no precise basis for arriving at the figure of SDR 33 million for the proposed stand-by arrangement, the staff representative said. The considerations taken into account by the staff had been as much qualitative as quantitative. However, a working guideline for cases in which the Fund's role should in principle be catalytic was that its support should be in the range of 25-50 percent of the new quota. Within that range, the specific number of 50 percent of Madagascar's proposed quota of SDR 66.4 million was considered appropriate in the circumstances. It was true that the amount of Fund support expressed as a percentage of the total financing needs of Madagascar would be quite small.

But in determining on how much financial support the Fund should provide, it was necessary to decide whether the amount would be based on the Fund's own criteria regarding the level of access to its resources, not whether it met the residual financing gap after calculating possible assistance from other sources. It would be impracticable for the Fund to determine its support by calculating how much could be derived from other sources and assuming that the Fund should make up the difference.

Finally, the staff representative from the Exchange and Trade Relations Department explained that the reason why the Fund had decided to provide only a token amount as the first purchase was that no performance criterion had been provided for the reduction of arrears at the time of the first drawing. It had been felt preferable to await the first review and arrive at some criterion for the reduction of arrears in 1984.

Mr. Erb inquired whether the Deputy Director of the African Department had meant that the exchange rate was appropriate, or whether it would not be eroded because of changes in inflation within Madagascar that differed from those in major exporters of like products. The staff seemed to have said that the devaluation of October 1, 1983 had brought the effective exchange rate back to the May 1982 level, a statement that seemed to imply that the May 1982 level was the appropriate one. The authorities had apparently spent 16 months contemplating what action to take, and during that time there had been a sharp depreciation of the real effective exchange rate. The staff maintained that the Malagasy authorities had followed a flexible policy in the past and would continue to do so in the future. He however did not believe that the past policy had been at all flexible, or that adjustments in the exchange rate ought not to be made more rapidly than they had been in the past year.

The Deputy Director of the African Department stated that the staff did not consider the rate appropriate, as it had not considered it appropriate when it had been adjusted in May 1983. When the staff had reviewed the program in January 1983, it had felt that the undertakings in respect of the exchange rate were inadequate. At that time, the staff had convinced the Malagasy authorities that they would have to make periodic adjustments in relation to the related change in the price index. As a minimum, the staff had explained, it would expect the authorities to return to the May 1982 exchange rate level by June or July 1983. In addition, the staff had explained to the authorities that the May 1982 level would not remain appropriate, and that therefore a further adjustment ought to be made.

As a result, the staff had a commitment from the authorities that future adjustments in the rate would be related to an absolute rather than a relative change in prices, the Deputy Director went on. Assuming that some inflation existed elsewhere in the world, the change would mean that the real rate of exchange appreciation or adjustment would be even faster. Consequently, it would be fair to say that the approach of the Malagasy authorities had been flexible. In those circumstances, it would be reasonable to ask the staff why, if convinced that the rate was incorrect, it would not demand more at the present time instead of waiting and making an adjustment in the coming year. The staff response would be that there were other ways of breathing life into the program than by additional exchange rate adjustment. If the authorities were making an effort in other fields and if the exchange rate were not producing unduly wrong signals, it would be better to put greater emphasis on those other efforts while continuing to work on making the exchange rate move.

Therefore, while the staff did not regard the exchange rate as appropriate from the longer-term standpoint, the present rate did not prevent the kind of adjustment policies that were needed in the present context, the Deputy Director of the African Department concluded. There was no understanding between the Malagasy authorities and the staff that the present rate would be maintained; indeed, he would look forward to a further adjustment.

Mr. de Maulde commented that the staff had earlier told Executive Directors that there had been no price increase in Madagascar for the past four or five months. If that were so, the rate of inflation must be lower than in the United States, Germany, or the United Kingdom for the time being.

Mr. Erb remarked that the lack of flexibility in the exchange rate might be symptomatic of the rigidities on the pricing side, as well as the other rigidities that might be constraining the growth potential of the country. During the past two years, the authorities had been slow to remove the rigidities in a way that would lay the foundations for economic growth. It would surely be in their own interests to move more rapidly toward removing some of the rigidities to give a better growth potential, in view of the resource base of the country.

Mr. Mtei stated that he agreed with the Deputy Director of the Exchange and Trade Relations Department that to some extent if the Fund put its stamp of approval on domestic policies, it would make it easier for the country to obtain support from bilateral or multilateral institutions and commercial banks. Similarly, technical support by the Fund would encourage other donors and institutions to provide assistance. But surely a wide financing gap would also discourage donors; and he could not agree that the Fund should not finance a residual part of the financing gap, especially if the amount involved would not exceed 100 percent of a country's quota. His own feeling was that, provided that the amount came within the quota rules of the Fund and it was possible to make the resources available while operating in an evenhanded fashion, there should be no objection to the Fund's financing part of a gap in resources, even when it was denominated "residual."

The Chairman recalled that, at EBM/83/166 and EBM/83/167 (12/2/83), he had explained to the Executive Board that in allocating the use of Fund resources, he had had in mind that there would be a category of countries that would have access to the Fund's resources in what might be called "more limited amounts." The criteria for placing a country in that category had been well described by the staff. The first criterion was that the country should be a large user of Fund resources, have large outstanding amounts of its currency held by the Fund, and be likely to need continued access to Fund resources. Second, the debt service liabilities of such a country would be large. In other words, a further use of Fund resources could add significantly to the debt service. Third, adjustment in such a country could be achieved only over a very long period. Fourth, the viability of the balance of payments would not really be assured over the medium term. All four criteria were clearly evident in Madagascar.

The exact amount of Fund resources to be made available to such a country was of course a matter for judgment, the Chairman conceded. It could however be generally accepted that the amount to be made available should not exceed 50 percent of new quotas.

As to why management and staff had chosen the exact figure of SDR 33 million, the Chairman went on, the first reason was that one of the main causes of Madagascar's external financial difficulties was its external debt. The Fund should not be considered the major agency for repairing a situation that had been largely created with the active collaboration of other sources of finance. It was important for the Fund not to be taking the place of other creditors. Second, the only fruitful line of approach for Madagascar would be to expand out of its present payments problems by appropriate development. For that it would need development assistance that was geared to effective agricultural or industrial projects. In the circumstances that he had outlined, the Fund ought certainly not to be the most prominent actor; and he would certainly agree that the World Bank should participate more fully in many such cases. It would therefore come as no surprise to learn that he had been very cautious in calculating the amount that the Fund ought to offer Madagascar. He would not be at all disturbed if Executive Directors were to increase the amount by a few percentage points; but the staff had been essentially correct in the reasons that it had given for selecting SDR 33 million as the appropriate amount.

Taking up the question of the net contribution by the Fund to the finances of Madagascar, the Chairman explained that during the 15 months or so of the program, the net contribution by the Fund would be in the neighborhood of SDR 20 million. Taking out the repayment of interest or amortization, SDR 20 million would constitute something like 20 percent of the gap, by no means a negligible amount. Nor could he go along with the observation that the Fund had entered the picture too late and was offering too little. The Fund had entered quite early and was perhaps offering too much given the debt servicing capacity of the country. Another argument that he was bound to reject was that the repurchases under the compensatory financing facility would cancel out something like SDR 17 million of the SDR 20 million made available by the Fund. He could not accept that line of argument, because the compensatory financing facility had been instituted to deal with shortfalls that were self-reversing by nature. If a country drew under the compensatory financing facility, the amount would have to be repaid within the period laid down under the rules for the facility itself. Consequently, the Fund's net contribution had to be looked at in terms of the use of Fund resources in the credit tranches.

In any event, most of the resources to close the financial gap would have to come from institutions other than the Fund, the Chairman stated. After all, the Articles of Agreement provided that the Fund could lend only when it was certain that the drawing would be repaid over the medium term. In Madagascar, balance of payments problems would persist for many years, and the Fund was bound to be particularly cautious. By that he did not mean that the Fund should be inactive or that it should turn its back on Madagascar. On the contrary, it should continue to be active in helping the country in undertaking badly needed adjustment efforts and in encouraging other sources of funds to produce the resources needed to carry out the adjustments that the Fund had in mind. But the Fund itself should not be overactive in providing the actual resources in the circumstances presented by Madagascar.

Mr. Prowse remarked that it was certainly important to approve a program for Madagascar during the present meeting. He would therefore not pursue the philosophical aspects very far. As to the proposed decision, he would support the larger amount originally put forward by Mr. de Maulde. Mr. de Maulde had adhered quite closely to the statements in the paper on guidelines for access in individual cases (SM/83/233), discussed by Executive Directors quite recently (EBM/83/166 and EBM/83/167). On page 4 of that paper, the staff had described a category of countries in which the Fund's role was likely to be that of a catalyst, and it had then described the characteristics mentioned by the Chairman. It was certainly possible that the present paper on Madagascar had been prepared without the benefit of the Executive Board's discussion on the issue of the Fund's role as a catalyst. But his recollection of the discussion of SM/83/233 was that quite a number of Executive Directors had had reservations about the particular category, and that the Chairman's summing up had not referred to the category at all. Although it had mentioned the concept of the Fund's role as a catalyst, it had noted quite correctly that a number of Directors expressed fears about the concept that had been set out in the paper, and that they were concerned that it might lead to the withholding of support for countries with large problems and little or no access to financial markets.

The Chairman observed that, while Mr. Prowse's quotation was absolutely correct, he himself had earlier stated in the same summing up that a number of Executive Directors had agreed with the guidelines.

Mr. Prowse said that he had absolutely no quarrel with the Chairman's summing up on December 2, 1983. His point had been that he had found the remarks interesting and justifiable in terms of the Madagascar case. However, the present discussion had gone beyond that paragraph with important nuances and reservations. In particular, he had been interested to hear the staff representative say that there was a specific guideline of between 25 percent and 40 percent of quota to govern the resources that the Fund would make available. He had not been aware of the existence of such a guideline hitherto. The proposition was a particularly interesting one, to which Executive Directors would no doubt have to return when they discussed the forthcoming paper on the revolving nature of the Fund's resources.

If it was in fact a guideline, it ought perhaps to be set out more explicitly or even adopted by the Executive Board. Indeed, he wondered whether it was possible to have such guidelines that were consistent with the application of the criteria that had been discussed.

As to the proposal that the Fund should be collaborating closely with the World Bank, Mr. Prowse remarked that the problems of Madagascar seemed to stem at least in large part from the misguided investment program of recent years, which had been intended to offset the stagnation in the country. The same situation had caused economic distress in other countries in which the World Bank had been involved more largely and for a longer period. He was concerned that the World Bank and the Fund could be involved in countries and yet the investment programs could so easily go off track. Was there no technique by which the World Bank--and perhaps to a lesser extent the Fund--could have a larger impact on the investment program in the countries in which they were involved? It was not enough for the Fund and the World Bank to direct their own resources into projects that were clearly justifiable according to the usual criteria, if at the same time the bulk of the country's own resources was being directed into programs of questionable value. Indeed, in such circumstances it was easy to say that the effect of World Bank assistance was to facilitate unwise investment. Naturally, neither the Fund nor the World Bank could influence sovereign governments in deciding on their budget priorities. But the desired outcome would not be reached unless the Fund and the World Bank together were able to influence the overall investment program. He had no solutions to offer, but it was an issue that needed to be addressed.

Mr. Erb stated that he shared Mr. Prowse's concern on his second point. During the discussion mentioned by Mr. Prowse, his chair had raised the question whether the category he had referred to fitted appropriately with the policy on enlarged access. Indeed, he would argue that in the present case the criteria spelled out in the policy on enlarged access were not being met. Therefore, if Executive Directors were to follow the letter of the decision, they would not be discussing the proposed program in connection with the policy on enlarged access.

Mr. Malhotra inquired whether, if a gap remained after the meetings of the Paris Club and donor countries, and if that gap were financeable under whatever criteria for Fund support had been devised by management, the Chairman would consider providing additional support. As he understood it, the staff had suggested that there might be a shortfall of SDR 17-18 million.

The Chairman responded that he would consider Mr. Malhotra's question and reply when the Executive Directors returned to the topic after lunch.

The Executive Directors agreed to resume their discussion in the afternoon.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/83/177 (12/19/83) and EBM/83/178 (12/21/83).

3. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 83/99 and 83/100 are approved. (EBD/83/316, 12/13/83)

Approved December 19, 1983

4. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/83/310 (12/16/83) is approved.

APPROVED: April 24, 1984

LEO VAN HOUTVEN
Secretary