DOCUMENT OF INTERNATIONAL MONETARY FUND AND NOT FOR PUBLIC USE

September 10, 1985

To: Members of the Executive Board

From: The Secretary

Subject: Final Minutes of Executive Board Meeting 84/172

The following correction has been made in the final minutes of EBM/84/172 (12/3/84):

Page 2, 3rd line from the bottom: For "J. W. Orleans-Lindsay" read "J. K. Orleans-Lindsay"

A corrected page is attached.

Att: (1)

Other Distribution:
Department Heads

NOT FOR PUBLIC USE

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 84/172 - Corrected

10:00 a.m., December 3, 1984

J. de Larosière, Chairman

Executive Directors	Alternate Executive Directors
A. Alfidja	
C. H. Dallara	M. K. Bush
J. de Groote	H. G. Schneider
	X. Blandin
	T. Alhaimus
	M. B. Chatah, Temporary
	T. Yamashita
G. Grosche	B. Goos
J. E. Ismael	
R. K. Joyce	L. Leonard
	C. Robalino
R. N. Malhotra	A. S. Jayawardena
	A. Abdallah
F. L. Nebbia	
Y. A. Nimatallah	E. M. Ainley, Temporary
	E. M. Taha, Temporary
P. Pérez	G. Ortiz
J. J. Polak	T. de Vries
	A. V. Romuâldez
G. Salehkhou	O. Kabbaj
J. Tvedt	
	T. A. Clark
	J. Bulloch, Temporary
S. Zecchini	N. Coumbis
Zhang Z.	Wang E.

L. Van Houtven, Secretary
S. J. Fennell, Assistant

Also Present

E. C. Cain, Ambassador of Belize to the United States. C. Grant, Ambassador of Guyana to the United States; J. Tyndall, Executive Director, Inter-American Development Bank; L. Robinson, Embassy of Guyana. African Department: A. D. Ouattara, Director; D. T. S. Ballali, Y. Fassassi, J. Kakoza, H. R. Lorie, I. C. Tandeciarz. Exchange and Trade Relations Department: W. A. Beveridge, Deputy Director; M. Guitián, Deputy Director; E. H. Brau, K. M. Huh, S. Kanesa-Thasan, C. Puckahtikom. Fiscal Affairs Department: G. Blöndal, S. K. Chand. Legal Department: G. P. Nicoletopoulos, Director; Ph. Lachman, A. O. Liuksila, J. K. Oh, S. A. Silard. Middle Eastern Department: M. Schulze-Ghattas. Research Department: K.-Y. Chu, T. Gudac, N. M. Kaibni, E. A. Milne, T. K. Morrison. Secretary's Department: A. P. Bhagwat. Treasurer's Department: W. O. Habermeier, Counsellor and Treasurer; D. Williams, Deputy Treasurer; D. Berthet, W. L. Coats, D. Gupta, W. E. Hermann, T. B. C. Leddy, P. van den Boogaerde. Western Hemisphere Department: E. Wiesner, Director; S. T. Beza, Associate Director; M. E. Bonangelino, M. Caiola, J. Ferrán, C.-J. Lindgren, A. López-Claros, C. M. Loser, L. L. Pérez, B. C. Stuart, E. C. Suss, F. van Beek. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: E. A. Ajayi, H. A. Arias, G. Castellanos, H.-S. Lee, G. E. L. Nguyen, P. Péterfalvy, G. W. K. Pickering, T. Sirivedhin, D. C. Templeman, A. Vasudevan, W. A. Weitz. Assistants to Executive Directors: H. Alaoui-Abdallaoui, J. R. N. Almeida, I. Angeloni, W.-R. Bengs, L. E. J. M. Coene, J. de la Herrán, C. Flamant, G. D. Hodgson, Z. b. Ismail, A. K. Juusela, H. Kobayashi, S. Kolb, A. Koné, M. Lundsager, K. Murakami, J. K. Orleans-Lindsay, D. J. Robinson, J. E. Rodríguez, A. A. Scholten, S. Sornyanyontr, A. J. Tregilgas, A. H. van Ee, E. L. Walker, B. D. White.

1. ARGENTINA - REPORT BY MANAGING DIRECTOR

The Chairman informed Directors that after intense negotiations the Argentine authorities had reached a tentative agreement with the commercial banks on debt restructuring and the provision of new loans. He had explained to the bankers that Argentina's adjustment program could be financed only if the commercial banks would grant at least $4.2 billion in new loans to Argentina.

Argentina's overall financing need was of the order of $7.1 billion, the Chairman indicated. The balance of payments financing need in 1984 and 1985--autonomous flows minus current account deficits in those years--was projected to amount to about $3.1 billion. The Argentine Government would also need to repay arrears totaling about $3.2 billion, of which $600 million was owed to the Paris Club, $52 million to multilateral institutions, $1.525 billion to the banks, and $1.045 billion to other creditors, essentially suppliers. Furthermore, the gross reserves of the Central Bank of Argentina would need to be reconstituted to a minimum of $530 million in 1985. In addition to those financing requirements, Argentina must repay the bridge loan to the commercial banks and settle some swap operations, which together amounted to $1 billion.

Of Argentina's total financing need, the World Bank and Inter-American Development Bank would contribute a little more than $600 million, the Fund would finance $1.175 billion under the proposed stand-by arrangement, should the request be approved by the Executive Board, and the Paris Club contribution would be of the order of $730 million, assuming that 85 percent of principal and interest was rescheduled, the Chairman noted. Additionally, member countries had indicated their willingness to provide an estimated $1 billion of official export financing. The staff, after some study, had come to the conclusion that Argentina had met the requirements for a drawing under the compensatory financing facility, and a request amounting to about $275 million would be presented to the Board in the near future.

After an intensive week of negotiations, the 11 banks on the Advisory Committee had agreed to provide $4.2 billion in new loans to meet Argentina's remaining need for financing, the Chairman said. The Advisory Committee would notify the 300 or so smaller banks that would be included in the financing arrangement. He had informed the bankers that the Fund would need written assurances from the banks before Argentina's request for a stand-by arrangement could be considered by the Executive Board on December 28. The terms of the financing arrangements had already been agreed: the spread for the new loans would be 1 5/8 percentage points and, for the rescheduling, 1 3/8 percentage points. The restructuring arrangements allowed for the payment of the principal falling due in 1985 over a period of ten years. The U.S. Treasury had agreed to provide a bridging facility of $500 million, to be repaid by the authorities when Fund resources were made available. That financing would be used by the Argentine authorities to pay the arrears on interest to the banking community, thus facilitating the completion of the financing arrangement.

The discussions between the authorities and the commercial banks over the weekend had involved the Fund to a greater extent than usual, the Chairman remarked. The banks had insisted on having direct contact with the final private sector utilizers of a certain amount of the new financing. Given that Argentina had recently embarked on a tight credit policy, the Fund had been concerned about that element of the financing arrangement, which could complicate the attainment of the performance criteria under the proposed stand-by arrangement. The Fund was thus concerned about the modalities and amounts of such special allocations of external credit to some private borrowers in Argentina.

It had eventually been agreed that $200 million of the $4.2 billion financing package would be reserved for private borrowers in 1985, the Chairman stated. The banks would make four payments of $50 million to those borrowers on a quarterly basis. After the initial distribution of $50 million, the Fund would consult with the authorities to determine how the system was working. If they were experiencing difficulties in meeting the performance criterion for net domestic assets and implementing domestic policies, the Fund could ask the banks to interrupt or modify that element of the financing arrangement. While the banks' wish to direct some of the new financing to their clients was understandable, it was in their interest to avoid disturbing the smooth implementation of the authorities' adjustment policies. The Argentine authorities were in complete agreement with the views that he had expressed at the meeting.

The Executive Directors took note of the Chairman's remarks.

2. GHANA - PURCHASE TRANSACTION - COMPENSATORY FINANCING FACILITY - FLUCTUATIONS IN COST OF CEREAL IMPORTS; AND STAND-BY ARRANGEMENT - MODIFICATION OF PERFORMANCE CRITERION

The Executive Directors considered a staff paper on a request by Ghana for a purchase equivalent to SDR 58.2 million under the compensatory financing facility (EBS/84/219, 10/22/84; Sup. 1, 11/16/84; and Sup. 1, Cor. 1, 11/20/84). They also considered a staff paper on Ghana's request for a modification of the performance criterion relating to net domestic assets of the banking system under the stand-by arrangement (EBS/84/243, 11/28/84; and Sup. 1, 11/30/84).

The staff representative from the African Department informed Directors that the authorities had decided to pay one half of the December civil service wage increase in November and the remaining half in December, probably because of the understandings reached with the labor unions. In addition, the authorities had reduced the number of items under price control from 23 to 17, effective December 3, 1984.

Mr. Salehkhou made the following statement:

The Ghanaian authorities are grateful to the Fund staff for its cooperation. They largely share the staff's analysis of the economy's conditions under the 1984/85 Fund-supported adjustment program and its appraisal of Ghana's two requests for compensatory financing and modification of a performance criterion under the stand-by arrangement.

Since the last Article IV consultation with Ghana, which the Executive Board concluded on August 27, 1984, the signs of a significant improvement in Ghana's economic and financial conditions have been mostly encouraging, particularly with respect to economic recovery and containment of the rate of inflation. The improvement is, in no uncertain terms, due to the authorities' scrupulous observance of both the letter and the spirit of the adjustment program, as Ghana has met all the performance criteria for end-September 1984 and as broad aggregates remain largely within the program's targets.

Under the first program, successfully implemented during 1983/84, considerable progress was achieved with a significant reduction in the budget deficit as a proportion of GDP, curtailment of external arrears, adjustment of relative prices, restoration of the competitive position of Ghana's exports, and strengthening of the financial position of the productive sectors. The authorities had also succeeded in substantially reducing the inflation rate and had initiated, in cooperation with the World Bank, an ambitious plan for the rehabilitation of Ghana's productive base.

The prospects for a good performance under the 1984/85 program are strong as a result of the authorities' continued commitment to a successful implementation of the program and the favorable weather conditions in 1984, which ended a three-year period of low rainfall and drought, and permitted an excellent 1984 harvest. Other encouraging signs include the expansion of Ghana's exports; higher level of imports, particularly of spare parts; rising capacity utilization; and restoration of electrical power following the rise of the water level of the Volta Lake. The recent World Bank report on Ghana, entitled "Managing the Transition" makes clear that "the success of Ghana's economic recovery program is heavily dependent on a substantial increase in concessional aid flows...." Against this conclusion, the same report makes clear that per capita ODA to Ghana has steadily fallen in recent years. The expected rise in the inflow of financial resources in 1983 and 1984 in the form of loans or direct investment is yet to materialize; when the country entered into stand-by arrangements with the Fund all expectations had pointed to a reversal of the prevailing lack of financial inflows.

The authorities are curious that it is unclear if the international financial markets only reward good performers, as measured by the IMF adjustment programs, then what is holding some of them back in the case of Ghana. They request the Fund staff and management to seriously pursue this issue with the Consultative Group next week, not only for the sake of Ghana, but also to prevent the detrimental impact and doubt it could cast on other Fund-supported adjustment programs and on the widely-held notion that concluding a program of adjustment with the Fund opens the door to other commercial financial avenues. More seriously, the lack of such financial resources could jeopardize the adjustment process in Ghana, despite the harsh medicine patiently swallowed by the country.

Concerning the financial elements of the Fund's program, available information indicates that fiscal targets with respect to the overall deficit and its financing are attainable despite large shortfalls in customs duty revenues and net foreign financing. Nevertheless, the authorities have been able to offset the shortfall in import-related revenues through better than expected collections of the cocoa export levy, more effective tax collection, new discretionary measures, and the postponement of some important development expenditures owing to the low disbursement of foreign resources.

The lower than expected levels of imports and net capital flows also affected money and credit developments, as credit to the economy and monetary expansion remained below the new program's targets. However, largely owing to the 1984 bumper harvest, a strong demand for credit has been recorded in the second half of the year, bringing the corresponding data for end-September 1984 close to the program's ceilings and necessitating the request for a modification of the end-December 1984 ceiling on net domestic assets of the banking system.

With regard to balance of payments developments, although stronger exports and lower imports should result in a smaller current account deficit than projected under the program, the overall deficit is expected to be larger, reflecting the sizable shortfall in net capital flows. It should be noted, however, that both deficits would show a substantial improvement over 1983.

In the implementation of the 1983/84 stand-by arrangement with the Fund, the Ghanaian authorities repeatedly resorted to additional and discretionary measures to adapt their policies to adverse developments and ensure the success of the program. Faced with strong pressures to allow a significant increase in wages and salaries--which remain at an excessively low level and seriously jeopardize the smooth implementation of the program by maintaining a low morale and a dangerous lack of incentives among government workers--the authorities have again shown tremendous flexibility by advancing to November 1984 many important measures previously envisaged for 1985. Thus the necessary salary adjustment--which should result only in a modest real improvement for civil service employees--is accompanied by a further devaluation of the cedi of about 23 percent in terms of the U.S. dollar, upward adjustments in interest rates, and additional price decontrol measures with some more adjustment to take place at the time of the 1985 budget announcement.

With regard to the prospects for 1985, the authorities are preparing next year's budget within the targets and objectives of the 1984/85 stand-by arrangement. They have also issued a comprehensive report to the participants to the Consultative Group meeting to be held in Paris on December 11 and 12. The report outlines in particular Ghana's strategy for economic recovery as well as the country's growth prospects and medium-term resource requirements.

Two decisions are before the Board: a request for a second drawing under the compensatory financing facility and a modification of a performance criterion under the stand-by arrangement with Ghana.

The staff report on the request for compensatory financing clearly establishes its consistency with corresponding Board decisions, including the requirements of a balance of payments need, cooperation with the Fund, and the causes of the shortfall in export receipts and of the excess in the cost of cereal imports. Both the export shortfall and the cereal import excess are largely due to unfavorable weather conditions in the year ended May 1984. Furthermore, the compensable amount is fully based on actual data and, owing to quota contraints, represents only a little more than one half the calculated shortfall.

The requested modification in the end-December 1984 ceiling on the net domestic assets of the banking system mainly reflects the 1984 larger than anticipated agricultural output and the adoption of additional measures to strengthen the program, including the large devaluation of the cedi. The proposed modification would in particular allow for a maximum credit of ₵ 500 million for maize financing, which will be subject, as a performance criterion, to a complete repayment to the banking system by end-September 1985. The requested increase is temporary in nature and should be instrumental in supporting the producer price of an important food crop and preserving adequate incentives to farmers for the next year.

Mr. Ismael stated that Ghana's request for a purchase under the compensatory financing facility met all the requirements set forth in Executive Board Decision No. 6860-(81/81), adopted May 13, 1981. Ghana clearly had a balance of payments need; the balance of payments deficit had been large in 1983 and was projected to be substantial in 1984, and international reserves were low. The factors leading to the export shortfall and the excess cereal import costs were temporary and beyond the authorities' control. Furthermore, Ghana had met the test of cooperation with the Fund by successfully implementing the previous adjustment program and adopting the present stand-by arrangement. While the projection for exports in the postshortfall years might prove to be optimistic, the amount requested was lower than the estimated shortfall and the risk of overcompensation was insignificant.

He also supported Ghana's request for a modification of the performance criterion under the present stand-by arrangement, Mr. Ismael commented. The requested increase in the end-December 1984 ceiling on the banking system's net domestic assets was justified given the strong performance of the economy--particularly in food crop and cocoa production--and the advancement of some major adjustment measures. The extension of sufficient bank credit to finance stocks of cocoa and maize was seasonal in nature and was appropriate to stabilize prices for those products and maintain necessary producer incentives. Additional credit to finance imports would also be necessary in view of the recent 23 percent devaluation of the cedi.

In spite of the authorities' decision to increase wages and pensions by 50 percent in November and 50 percent in December, the banking system's net claim on the Government at end-December 1984 would remain within the program limits, Mr. Ismael noted. Furthermore, the authorities intended to take additional adjustment measures to compensate for the expansionary impact of the wage increases. He was, however, concerned about the size of the increase, given the decline in the rate of inflation and the 40 percent increase in salaries in June 1984, and also about its impact on the rest of the public sector and the private sector. Moreover, he doubted whether the pressures for wage increases in 1985 had been eliminated or significantly reduced. He urged the authorities to monitor closely wage developments throughout the economy in order to ensure continued success in implementing the present program.

The announcement of a 1.5 percentage point increase in interest rates, effective November 30, was a step in the right direction and reflected the authorities' intention to stick to their objective of achieving positive real interest rates by end-1985, Mr. Ismael remarked. Nevertheless, given the present substantially negative real rates, the inflationary impact of the recent devaluation, and the planned reduction of price controls, he wondered whether more rigorous steps might be required in that area.

Mr. Alfidja, commenting on Ghana's request for a modification of the performance criterion on net domestic assets of the banking system for end-December 1984, noted that the authorities remained committed to the adjustment policies and were determined to take any necessary additional measures to meet the objectives of the program. All performance criteria for end-September 1984 had been met, and he had no hesitation in endorsing the staff appraisal and supporting the proposed decision.

The economy had improved in 1984 as envisaged, Mr. Alfidja noted. Favorable weather had contributed significantly to increased agricultural output, particularly of maize and cocoa, which was estimated to be higher than expected; the restoration of the electricity supply to all users appeared to be having a positive impact on industrial production; the export sector was benefiting from producer incentives and the availability of spare parts; and the rise in imports was easing the bottlenecks in the manufacturing and transport sectors, as well as improving capacity utilization. Owing to those encouraging developments, real GDP was estimated to increase by about 5 percent in 1984 from less than 1 percent in 1983. The rate of inflation had also declined.

The authorities had taken the necessary discretionary measures to ensure that revenue growth remained on target, Mr. Alfidja pointed out. They had curtailed some current and development expenditure to keep the budget deficit, and its financing from the banking system, within the programmed levels. Credit ceilings for end-December 1984 would have been met had it not been for the larger than expected cocoa crop, maize harvest, and the adoption of early measures to strengthen the program. Ghana's request for a modification of the performance criterion on net domestic assets merited the Board's strong support.

The further depreciation of the cedi by 23 percent in terms of the U.S. dollar was a major policy action that supported other important fiscal and monetary measures, Mr. Alfidja said. The additional revenue from cocoa export duties arising from the exchange rate action would help to finance the exceptional wage and pension increases for the civil service that were necessary to restore workers' morale.

The authorities had increased interest rates in line with their objective of achieving positive rates by end-1985 or mid-1986 at the latest, Mr. Alfidja noted. Interest rates would be adjusted according to the agreed formula; a key variable in the formula was the consumer price index (CPI). In view of the uncertainties regarding domestic price stability in 1985 and the high sensitivity of the consumer price index to movements in food prices, which had a weight of 49.2 percent in the national index, could the staff throw some light on the treatment of the CPI in the agreed formula for adjusting interest rates?

Regarding external financing for 1985, Mr. Alfidja noted that the consultative group for Ghana was scheduled to meet soon in Paris. The staff had indicated that imports for 1984 would be about 10 percent below projections, reflecting a shortfall in net capital inflows, particularly official long-term loans and suppliers' credits. The staff might attempt to provide an explanation for that unfortunate development in the forthcoming review of the program. The adverse effects of a continued shortfall in net foreign financing on Ghana's development efforts could not be overemphasized, and he agreed with the staff that despite some encouraging signs, many impediments to an orderly economic recovery remained. Recovery would not be possible without external official financial support, and he therefore hoped that the outcome of the next consultative group meeting would be more successful than the previous one.

He had no reservations regarding Ghana's request for a purchase under the compensatory financing facility, Mr. Alfidja indicated. Ghana was clearly experiencing a balance of payments need, and the shortfall in export earnings and excess cereal import costs for the year ended May 1984 had been due largely to developments beyond the authorities' control. The request also satisfied the test of cooperation, as the authorities had recently completed a one-year stand-by arrangement and were successfully implementing a follow-on arrangement. Furthermore, the authorities had indicated their willingness to continue to cooperate with the Fund in an effort to find appropriate solutions to the country's external payments problems. Finally, the shortfall was temporary in nature.

Mr. Schneider remarked that while the Ghanaian authorities were determined to put their economy back on track, events beyond their control threatened the achievement of the program's objectives. The shortfall in export earnings and increased costs of cereal imports during the year ended May 1984 had been due mainly to drought, which had also necessitated the drawing under the compensatory financing facility in August 1983. At that time some Directors had considered that the shortfall had been partly attributable to the inadequacy of domestic policies, which were clearly not the cause of the present difficulties.

Ghana had made great strides since 1982 in changing its policies within the framework of an adjustment program supported by two consecutive stand-by arrangements with the Fund, Mr. Schneider observed. The adjustment effort had focused on exchange rate policy; the cedi had been devalued and a flexible formula for periodic adjustment of the exchange rate adopted to restore the competitiveness of the Ghanaian economy. Furthermore, the authorities had agreed to a comprehensive review of the exchange rate policy at the time of the first review of the current stand-by arrangement. Pricing policy, designed to restructure relative prices in favor of the productive and export sectors, was to complement exchange rate policy. The authorities were therefore deregulating price controls gradually.

The economic situation had improved considerably since the shortfall year, Mr. Schneider commented. The request for a modification of the end-December 1984 performance criterion with respect to net domestic assets had been prompted by those improvements and was understandable given the need to finance the larger than expected output of agricultural products, especially cocoa and maize. The authorities' plans to protect prices, maintain incentives for producers of maize, and provide for possible food shortages appeared appropriate. In view of the additional measures taken by the authorities, he could accept the second set of reasons for the request: the early introduction of the public wage increases and the need for additional import financing resulting from the accelerated exchange rate adjustments necessitated by those wage increases. Imports were vital for Ghana's successful recovery, and the additional financing requested to cover both import prices and the higher than expected cocoa and maize output was unlikely to endanger the adjustment program.

In sum, the prospects for Ghana's economic future depended largely on the financial assistance donor countries would be willing to provide, Mr. Schneider noted, and he hoped that the consultative group meeting would have an encouraging outcome. The authorities' determination to tackle the country's economic problems was exemplary, as the World Bank staff had indicated in its report "Ghana: Managing the Transition." Finally, he supported Ghana's request for a purchase under the compensatory financing facility and the modification of the performance criterion.

Mr. Leonard indicated that the export shortfall during the year ended May 1984 and the higher than average cost of cereal imports, for which Ghana was requesting compensatory financing, were due to factors beyond the authorities' control. The drought in West Africa during 1982 and 1983 had hampered production of export crops, such as cocoa and cereals for domestic consumption. He supported Ghana's request and agreed that the considerable progress being made by the authorities under the current stand-by arrangement with the Fund was ample evidence of the cooperation required for a purchase under the compensatory financing facility. The proposed purchase, if approved by the Board, would raise Ghana's total cumulative purchases under that facility to 87.4 percent of quota, which was close to the upper limit and did not leave the authorities much room for maneuver should further shortfalls occur in the near future. Strict adherence to the economic adjustment program was therefore essential.

On the request for modification of a performance criterion under the stand-by arrangement, Mr. Leonard stated that he was encouraged by the steps that the Ghanaian authorities had taken in their adjustment program. Not only had they used sound judgment in responding to unforeseen events, such as lower than expected capital inflows, but they had implemented a number of measures ahead of schedule, a fact that deserved the recognition of the Executive Board.

While an overnight doubling of civil service staff compensation would normally be a cause for serious misgivings--because of the implications for inflation, the balance of payments, and the fiscal balance--the situation in Ghana was singular in a number of ways, Mr. Leonard observed. The wage increase came at a time when the price level was falling; it also represented only partial compensation for the dramatic loss in real public sector wages over the past decade; and, despite the wage increase, the fiscal deficit and total expenditure would remain within the program limits owing to the offsetting measures to be taken by the authorities.

He could therefore go along with the wage increase, but any undesirable effects should be monitored closely and countermeasures taken as soon as possible.

A waiver or modification of a performance criterion was rarely sought because the economy of a member was doing well, as was largely the case in Ghana, Mr. Leonard noted. He appreciated the authorities' desire to provide adequate financing for the large cocoa crop and to stabilize the market for maize in order to encourage production in 1985. The rapid depreciation of the cedi had placed domestic importers in a difficult situation, especially as the expected capital inflows had not materialized. In view of those factors, he supported the requested modification of the performance criterion. He would appreciate an indication by the staff whether there would be any merit in programming the repayment of maize and cocoa credit into the ceilings on net domestic assets for 1985.

Mr. Goos expressed his support for both of the proposed decisions. All the requirements for a drawing under the compensatory financing facility had been met. He was, however, concerned about the reference in footnote 1 on page 4 of EBS/84/219 to the possible overcompensation under the previous compensatory financing drawing.

He supported the request for a modification of the performance criterion on net domestic assets but hoped that the crop financing would be repaid in the near future, Mr. Goos commented. In any event, the increased ceiling should not give rise to a relaxation of the overall stance of monetary policy. In view of the likelihood of renewed inflationary pressure arising from the recent devaluation of the cedi and the large increase in public sector wages, an increase that would also influence wage demands in the private sector, further tightening of financial policies appeared appropriate. He was confident that the staff, in its discussions with the authorities on the targets and performance criteria for 1985, would pay due regard to the potential inflationary effects of recent developments and to the widening of the balance of payments gap.

Mr. Clark remarked that Ghana's stand-by program remained clearly on track and that developments in a number of areas, particularly real GDP growth and inflation, had been better than expected. The authorities' request for a modification of the performance criterion had been largely necessitated by the better than projected cocoa and maize harvest and the accelerated exchange rate adjustments, implemented as a countermeasure to the civil service wage increase, for which there was a good case in Ghana. As the recently introduced adjustment measures were appropriate and the financing for maize and cocoa purchases would be repaid by end-September 1985, he had no difficulty in supporting the proposed decision.

Ghana's request for a purchase under the compensatory financing facility seemed equally straightforward, Mr. Clark indicated. There was a clear balance of payments need; the shortfall in exports and the excess in the cost of cereal imports were largely temporary in nature and outside the authorities' control; and Ghana's record of cooperation with the Fund over the past 18 months had been laudable. The authorities had remained strongly committed to the adjustment program and had taken additional measures to keep it on track. He could therefore support the proposed decision.

Like Mr. Goos, he was concerned about the footnote on page 4 of EBS/84/219, Mr. Clark stated. Could the staff explain why the shortfall had been overestimated? Perhaps the staff could prepare an annual paper on the accuracy of estimates of export shortfalls and excess cereal import costs for countries making use of compensatory financing.

Ms. Bush stated that the arguments put forward by the staff supporting Ghana's request for a modification of the performance criterion under the stand-by arrangement were persuasive. The need for additional credit was due to the better than expected harvest and resulting economic growth, and to the accelerated implementation of some adjustment measures, including the exchange rate action and interest rate increases of November 30, 1984.

In most cases a 100 percent wage increase--as announced by the Ghanaian authorities on November 30--would be questionable, Ms. Bush considered. However, even following the wage increase, real public sector wages in Ghana would still be less than one half of their 1975 level. Furthermore, the authorities had introduced other measures in tandem with the wage increase. She therefore supported Ghana's request for a modification of the end-December 1984 ceiling on net domestic assets.

While she did not agree completely with the staff appraisal on Ghana's request for a drawing under the compensatory financing facility, she could support the request for three reasons, Ms. Bush indicated. First, Ghana continued to face a tight balance of payments situation, even with the increase in cocoa exports. Second, Ghana was cooperating with the Fund, as demonstrated by its speedy implementation of the adjustment measures. Third, exports were already increasing, indicating the temporary nature of the shortfall.

She did not, however, consider that the entire shortfall was attributable to exogenous events, Ms. Bush stated. For several years Ghana had resisted implementing the policy measures necessary to sustain the cocoa industry, and production had fallen dramatically. The adjustment program embarked upon in 1983 included a sizable exchange rate change. But a substantial portion of the shortfall in June 1983 to May 1984 had been due to the lingering effects on production of the rapid real appreciation of the cedi that had occurred between 1981 and early 1983. Agricultural production could not be expected to respond instantaneously to the April 1983 devaluation. Furthermore, shortfalls in other exports had resulted from the lack of spare parts, whose acquisition was limited by the lack of foreign exchange owing to the overvaluation of the cedi. She could not judge how much of the cocoa shortfall might have been due to a slow supply response to policy changes. However, since the proposed purchase was barely more than one half of the calculated export shortfall and cereal import excess, she could support the request.

Mr. Abdallah remarked that Ghana's performance was praiseworthy. Fund and World Bank policies had been successful in Ghana, and the need for a modification of the performance criterion had arisen from the success rather than the failure of the adjustment program. However, the staff had not taken a sufficiently long-term view of the food situation in Ghana, and it had only recommended a modification to accommodate credit needs up to September 1985. African countries experienced drought on a regular basis, sometimes as often as once every four or five years. It therefore seemed advisable for the Ghanaian authorities to stockpile any domestically produced surplus maize. The Fund and the World Bank should encourage Ghana to build up food reserves and should make available sufficient financing for stockpiling food crops. Finally, he endorsed the staff appraisal and supported the proposed decisions.

Mr. Blandin indicated that he supported Ghana's request for a drawing under the compensatory financing facility. He was particularly glad to observe that SDR 9 million of the total purchase of SDR 58.2 million would be used to cover fluctuations in the cost of cereal imports, a feature of the compensatory financing facility that his chair supported but that did not seem to have been frequently utilized. At a time when many African countries were suffering from the disastrous consequences of drought, necessitating an increase in cereal imports, he wondered whether the cereal component of the compensatory financing decision might not be used more often.

Ghana's request for compensatory financing was straightforward, Mr. Blandin considered. There was clearly a balance of payments need; the member had cooperated with the Fund by successfully implementing a previous stand-by arrangement despite adverse external developments and was continuing to implement adjustment measures under the stand-by arrangement approved in August 1984; and the shortfall in merchandise exports and the excess in the cost of cereal imports had been beyond the authorities' control. Furthermore, the projections of earnings from exports of cocoa and other commodities in the two postshortfall years were conservative.

He could approve Ghana's request for a modification of the end-December ceiling on net domestic assets of the banking system, particularly as the upward adjustment in credit ceilings had been necessitated by a greater than envisaged production of cocoa and maize, Mr. Blandin noted. The improved output of those two crops had resulted mainly from a good rainy season in 1984, after three years of drought. However, some good rainy seasons in the 1970s had not prevented production from falling. The sweeping policy changes made by the authorities over the past 18 months had played a decisive role in improving output. The devaluation of the cedi and the flexible exchange rate policy, together with the liberalization of prices and improved marketing of agricultural products, had provided incentives for producers, most notably in the agricultural sector.

It would be counterproductive to let real wages in the civil service decline to such an extent that the departure of the most skilled professionals would accelerate, Mr. Blandin remarked. He therefore endorsed the various measures taken by the authorities on December 1, in advance of the 1985 program, including a 100 percent increase in civil service wages. Finally, he supported the proposed decisions and commended the Ghanaian authorities for their strong commitment to the adjustment effort.

Mr. Chatah said that he supported the proposed decisions. An upward adjustment in the ceiling on net domestic assets of the banking system seemed justified; indeed, the factors justifying it reflected to a large extent the improved conditions in the economy, particularly with respect to agricultural production, and the advance implementation of adjustment measures. An increase in the domestic credit ceiling should help to avoid undue constraints on what appeared to be the beginning of a recovery. The requested modification was particularly important in a program that appropriately emphasized the restoration of growth after years of economic decline. Could the staff elaborate further on the reasons for setting a separate ceiling for government financing of maize output rather than incorporating it in the existing overall credit ceiling?

The requirements for a purchase under the compensatory financing facility were clearly met, Mr. Chatah stated. Cereal imports in the year ending May 1986 were projected to be of the same order of magnitude as in 1986, the excess year, and about twice the level forecast for 1985. Could the staff indicate the reasons for the projected turnaround in cereal imports in the next two years, particularly compared with 1984?

Mr. Malhotra expressed his support for the two proposed decisions. The adjustment program had remained on track and the Ghanaian authorities had made commendable efforts to turn their economy around. The increase in GDP and the successful reduction in the rate of inflation were particularly welcome.

The authorities' decision to increase wages in the civil service was appropriate, Mr. Malhotra considered. An economy could not function efficiently if wages were allowed to decline in real terms over a decade; even after the wage adjustment, real wages in the civil service would be about one half of their 1975 level. The authorities had taken offsetting measures to assure the attainment of the fiscal targets, and any problems arising from the wage increase would be tackled appropriately by them.

Ghana had reached the access limit under the compensatory financing facility, as had five other countries, Mr. Malhotra noted. Evidently, the reduction in the access limits under the special facilities was proving to be a constraint. On a related point, concessional assistance on a global basis had been stagnating for some years. Donors should appreciate the authorities' efforts and increase their assistance to Ghana, and Directors should note that the level of concessional assistance should be increased on a global basis.

Mr. Zhang and Mr. Polak stated that they supported both of the proposed decisions.

Mr. Taha added that he too supported Ghana's request for compensatory financing, which clearly met the requirements of the facility. Ghana had successfully completed a stabilization program in 1984 and was continuing its adjustment effort under a recently approved stand-by arrangement. The authorities were addressing their economic problems in a consistent manner and were aware that the adjustment effort would have to be sustained in the long term. In addition, Ghana was cooperating fully with the Fund and the Bank. The shortfall in Ghana's export earnings and the excess in the cost of its cereal imports were attributable to circumstances beyond the authorities' control. Finally, he could support Ghana's request for a modification of the performance criterion, which did not undermine or compromise the program objectives.

The staff representative from the African Department commented that the original compensation package in the 1984 program would have totaled ₵ 7.2 billion--28 percent of total expenditure--as opposed to about ₵ 7.9 billion--29.8 percent of total expenditure--after the recently announced wage increases. The total compensation package represented 2.9 percent of GDP as compared with an average in Africa of 8-10 percent of GDP. Any inflationary impact from the wage increase would be ameliorated by the authorities' efforts to keep the deficit down, particularly by restricting access to the banking system.

Food prices had a weight of about 50 percent in the consumer price index, the staff representative indicated. The staple food crops in Ghana were yam and cassava, output of which had recovered in 1984, and the increase in food prices in 1985 might, therefore, be reduced to the extent that root crops could be stored in the ground from one year to the next.

The authorities had not been involved in purchasing and storing food crops in the past, the staff representative said. They had been slow to respond to the increase in agricultural output in 1984 and, hence, had purchased only a small stock of maize. Given the poor output in the three previous years, the authorities intended to revise their policy on purchasing agricultural output and would address in detail the issue of maize financing in subsequent years.

The authorities aimed to increase interest rates to positive levels, based on the current rate of inflation, the staff representative from the African Department commented. Unfortunately, the consumer price index was available only with a lag of three months and, consequently, interest rates were adjusted to reflect inflation three months previously. As inflation was falling, the authorities hoped that interest rates would reach positive levels sometime in 1986.

The staff representative from the Exchange and Trade Relations Department explained that because financing for the purchase of maize was being provided by local commercial banks, a tight monitoring of that operation was important. If the credit ceiling for maize were integrated into the ceiling on net domestic assets, any of the ₵ 500 million not used for purchasing maize would be available for any other purpose. The staff had proposed establishing a separate ceiling to ensure that Ghana's monetary policy would remain tight.

The staff representative from the Research Department, in response to the question concerning the high projection of cereal import costs for 1985/86, maintained that cereal imports in the two postshortfall years should be averaged. Few orders for commercial imports of cereal had been placed for delivery in 1984/85, but cereal imports were expected to increase in the second postshortfall year, 1985/86.

With regard to Ghana's 1983 purchase under the compensatory financing facility, the staff representative indicated that the actual shortfall in Ghana's merchandise exports in 1982 had been smaller than the shortfall estimated at the time of that purchase owing primarily to the unexpected continuation of the drought. In footnote 1 on page 4 of EBS/84/219 the staff had simply made a statement of fact that had Ghana made a smaller purchase in 1983, it would qualify for a larger purchase at present. In the past, the staff had provided information on the accuracy of estimates of shortfalls on an ad hoc basis in its papers reviewing operations under the compensatory financing facility, but it could prepare such information for presentation to the Board on a regular basis. The first such review could be conducted in May 1985 at the time of the Executive Board's review of the cereal decision.

Since mid-1980, only five countries had drawn under the cereal decision of the compensatory financing facility, the staff representative observed. The limited use of that provision of the facility was due largely to an adequate worldwide supply of cereals and sufficient availability of cereals on concessional terms--purchases of which were not covered by the cereal facility. On the basis of information provided by the Food and Agriculture Organization, however, it appeared that the situation in many countries, particularly in Africa, had changed. The staff expected that more countries would qualify for the use of Fund resources under the cereal decision.

With reference to the question on the degree to which the shortfall was beyond the country's control, the staff considered that the residual effects of the policies pursued by Ghana in earlier years on export earnings in the shortfall year had been much less than the effects of those policies on earnings in the preceding two years, the staff representative from the Research Department stated. The adverse weather had been a major cause of the shortfall in cocoa, Ghana's most important export, and had had an adverse impact on other exports as well.

Mr. Salehkhou remarked that the authorities had demonstrated their commitment to adjustment, and their efforts should be recognized by the international community at the consultative group meeting. The lack of capital inflows had restricted imports, adversely affecting the recovery program. Furthermore, the recent drought had slowed the increase in exports.

The authorities had been facing particular problems as a result of the low level of real wages in Ghana, Mr. Salehkhou commented. Many of the educated and skilled labor force were migrating to other countries owing to the lack of incentives and low standard of living. Low wages affected morale, and might also encourage illicit practices which could be counterproductive to development. The proposed modification in the performance criterion would allow the authorities more flexibility in implementing the policies under the stand-by arrangement.

The World Bank had only recently stepped up its activities in Ghana, as the problems related to project implementation had started to ease, Mr. Salehkhou noted. Private creditors and investors should respond favorably to the increased credibility of the Ghanaian authorities.

The Chairman remarked that the authorities should be commended for taking additional measures to keep the adjustment program on track. The countries participating in the consultative group meeting should give favorable consideration to the courageous action taken by the authorities. Ghana had an obvious need for development and balance of payments assistance. Finally, he would ask the staff to prepare, on an annual basis, a paper on the accuracy of estimates of export shortfalls and excess cereal import costs for countries making use of Fund resources under the compensatory financing facility.

The Executive Board then took the following decisions:

Purchase Transaction - Compensatory Financing Facility

1. The Fund has received a request from the Government of Ghana for a purchase of SDR 58.2 million under the Decision on Compensatory Financing of Fluctuations in the Cost of Cereal Imports (Executive Board Decision No. 6860-(81/81), adopted May 18, 1981, as amended).

2. The Fund notes the representation of Ghana and approves the purchase in accordance with the request.

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

Decision No. 7851-(84/172), adopted
December 3, 1984

Modification of Performance Criterion

1. Ghana has consulted with the Fund in accordance with paragraphs 10 and 11 of the stand-by arrangement for Ghana (EBS/84/172, Supplement 4) and paragraph 31 of the letter dated July 30, 1984 from the Secretary for Finance and Economic Planning and the Governor of the Bank of Ghana.

2. The communication from the Secretary of Finance and Economic Planning and the Governor of the Bank of Ghana dated November 28, 1984 shall be annexed to the stand-by arrangement for Ghana, and the letter from the Secretary for Finance and Economic Planning and the Governor of the Bank of Ghana dated July 30, 1984 shall read as supplemented and modified by the communication dated November 28, 1984.

3. Accordingly, the limits on total net domestic assets of the banking system for end-December 1984 shall be those referred to in the communication dated November 28, 1984 in place of those referred to in paragraph 23 of the letter of July 30, 1984 and specified in the table appended to it, and there will be a separate limit for maize financing, as specified in the communication dated November 28, 1984.

Decision No. 7852-(84/172), adopted
December 3, 1984

3. BELIZE - STAND-BY ARRANGEMENT

The Executive Directors considered a staff paper on a request by Belize for a stand-by arrangement in an amount equivalent to SDR 7.125 million for 16 months (EBS/84/225, 11/5/84; and Cor. 1, 11/29/84).

Mr. E. C. Cain, Ambassador of Belize to the United States was present for the discussion.

Mr. Joyce made the following statement:

The Belizean economy has experienced poor growth since 1981. This slowdown can be largely attributed to the deterioration in Belize's terms of trade associated with the fall in the world price of sugar and, to a lesser extent, the virtual disappearance of export demand from Mexico. Accompanying these external developments has been a weakening in both central government finances and in the performance of the public enterprises.

As a result, Belize's external payments situation has worsened over the last four years. Increases in the current account deficit through the period 1980-82 were largely offset by increased official and private capital inflows. However, since 1983 a significant decline in net official capital inflows and a net outflow of private capital has resulted in a large loss of official international reserves and an accumulation of external payment arrears. Measures aimed at stemming the fiscal and external imbalances were taken in each of the last three fiscal years. However, these actions proved to be insufficient to correct the situation and by early 1984 the authorities decided that a more comprehensive adjustment effort was required.

In June 1984, the Government of Belize took a number of important steps aimed at restoring a basis for greater price stability, growth in employment, and a sustainable economic recovery. This adjustment program, for which Belize now seeks support from the Fund in the form of a stand-by arrangement, aims at strengthening public finances, restoring the balance of payments position to a sustainable level by the end of fiscal year 1985/86, and eliminating external arrears by September 30, 1985.

The adjustment effort centers in particular on the correction of fiscal imbalances. The objective is to bring the overall deficit of the nonfinancial public sector down to levels that can be financed entirely through external development credits. On current operations of the nonfinancial public sector, my authorities intend to move from a deficit of 2.1 percent of GDP in 1983/84 to surpluses of 2.5 percent of GDP and 3.5 percent of GDP in 1984/85 and 1985/86, respectively. It is also their intention to maintain a level of public investment that is adequate for generation of economic growth. The World Bank considers the proposed public investment program appropriate. Adjustment at the level of the Central Government will involve both an ambitious strengthening of revenues and further constraint on government expenditures. The revenue measures include a tax increase and a strengthening of collection procedures. The FY 1984/85 budget calls for a reduction in real terms in current expenditure through cautious public sector employment policies and improved expenditure control procedures. There is to be no general salary increase for public servants in the current year and no increase in the size of the public service.

The Government also intends to continue efforts started last year to improve the management of the public enterprises. To this end, electricity rates were increased by 16 percent and water rates by 33 percent in June 1984. A similarly austere stance will be adopted for 1985/86 and the budget will provide for further reductions in central government current expenditures as a percentage of GDP and a strengthening of expenditure control measures. Also, a major step toward improving financial management will be taken next fiscal year when, for the first time, the authorities intend to prepare a consolidated budget of the nonfinancial public sector.

Monetary policy will complement the adjustment efforts in the public finances. There will be a net amortization of the nonfinancial public sector's debt with the banking system and limits have been set accordingly on the outstanding net credit of the banking system to the nonfinancial public sector. These efforts have been assisted by an increase in the legal cash reserve ratio applicable to the commercial banks and a commitment to maintain a flexible interest rate policy.

In the external area, the program requires the elimination of all external payment arrears by end-September, 1985. Furthermore, an increase in net international reserves of $5 million is targeted for 1985. The servicing of Belize's public external debt does not currently pose problems over the medium term. Nonetheless, my authorities intend to improve the profile of external debt through greater reliance on long-term development credits and a reduction in outstanding external debt to commercial creditors. This will be achieved through limits on outstanding public external debt with a maturity of up to 12 years. On exchange rate policy, my authorities are committed to the maintenance of cost competitiveness. Given the productivity gains realized in recent years in Belize's main export sectors, the present exchange rate is considered appropriate.

The adjustment program initiated by my authorities last June represents a determined effort to reduce significantly the external imbalances in the economy and to revitalize the economy. In support of this program, the Government of Belize has requested a stand-by arrangement in the amount of SDR 7.125 million for the period through March, 1986. By that date, my authorities would expect that actions already taken or planned will have brought about a significant improvement in the Government's finances, the balance of payments, and the general level of economic activity.

I believe the program merits Fund support and I hope that it will meet with your approval.

Mr. Coumbis noted that the Belize authorities had requested a Fund-supported stand-by arrangement with the intention of significantly improving the Government's finances, balance of payments position, and economic activity in general. He agreed with the staff appraisal and supported the proposed decision.

The deficit of the nonfinancial public sector, which had increased from 4 percent of GDP in 1980/81 to 9 percent of GDP in 1983/84, had been the primary problem facing the authorities in recent years, Mr. Coumbis observed. The adjustment program was designed to address that problem effectively; the Belize Parliament had already approved a major tax package and the authorities were making concerted efforts to increase the operating efficiency of public enterprises. Furthermore, they intended to increase tax yields by improving collection and pursuing a cautious public expenditure policy.

Belize was moving toward a sustainable balance of payments position by the end of the decade, provided the authorities continued to apply prudent demand management policies and could secure official capital at concessional terms, Mr. Coumbis stated. The balance of payments projections were consistent with a rate of public investment of 12 percent of GDP, a rate of real GDP growth of 4 percent after 1985, a GDP deflator of 4 percent, and the complete elimination of arrears by 1985. The authorities were to be commended for undertaking the adjustment effort without recourse to exchange or trade restrictions.

Interest rates and exchange rate policies were cause for concern, Mr. Coumbis went on. The authorities should monitor external developments closely and should be ready to adjust their policies should changes in the external environment jeopardize the balance of payments position. Bank/Fund collaboration in Belize should have been discussed in a separate section on cooperation between the Bank and the Fund, particularly with respect to the amount and quality of public investment and the efficiency of the public enterprises.

Ms. Bush recalled that at the Executive Board discussion of the 1984 Article IV consultation with Belize (EBM/84/97, 6/20/84) her chair had noted the policy initiatives taken by the authorities to reverse the deterioration in the economy. She supported the authorities' request for Fund support of that adjustment effort. A temporary balance of payments need was demonstrated by the low level of official reserves and high current account deficit. A substantial improvement in the balance of payments was projected for the program period, although most of it would come in the form of higher capital inflows. The authorities had already implemented a number of appropriate policies, indicating their commitment to the adjustment program.

The emphasis in the adjustment effort on fiscal policy was appropriate, Ms. Bush considered. Revenues were projected to increase substantially, allowing for some nominal increase in current and capital expenditures while reducing the overall deficit. The authorities, however, should stand ready to take additional steps if revenues were lower than projected. Although no general wage increase was planned, the Government might consider eliminating the practice of reclassifying jobs, which had effectively raised wages in the past. The preparation of a consolidated government budget for 1985/86 would help the authorities to plan and implement fiscal policy.

As for the public enterprises, she welcomed the steps taken to reduce employment in the Electricity Board and to increase private sector participation in other state enterprises, Ms. Bush said. The rational pricing policy being implemented by the public utilities should encourage more efficient use of their products and help to achieve the goal of a zero operating deficit for the public enterprises by 1986. Efforts to generate surpluses for those enterprises would enhance their attractiveness for possible private sector partners and would permit them to contribute to national savings.

Monetary policy was appropriately geared toward maintaining a low rate of inflation and reducing the pressures of excess liquidity on the balance of payments, while providing adequate credit to the private sector, Ms. Bush observed. Higher interest rates on deposits were necessary to prevent continuing capital outflows, which might also be related to the exchange rate. Traditional exports remained competitive despite the real appreciation of the Belize dollar. But she wondered if import-competing and nontraditional export industries were being stifled. Exchange rate adjustment could be used as a tool to restrain demand for imports.

The current account deficit, although projected to improve, was still expected to be about 7.1 percent of GDP in 1985, Ms. Bush noted. Even though traditional exports remained competitive, the real effective exchange rate was overvalued as evidenced by the large trade and current account deficits. Furthermore, in 1985 the current account deficit would be offset by a substantial increase in capital inflows. Although capital inflows would be lower in the medium term, they would remain substantial, and beyond 1985 they would apparently include only project-related assistance. As balance of payments support might not continue to be as forthcoming as at present, she urged the authorities to adhere to a strong adjustment effort so that payments equilibrium could be maintained. It would be undesirable for the authorities to turn to commercial borrowing, which would increase the debt service burden beyond the single digit ratios projected for the remainder of the decade. The projected elimination of external arrears by September 1985 would help to regularize trade and encourage foreign investor interest. In conclusion, she welcomed the authorities' avoidance of exchange and trade restrictions and supported the proposed decision.

Mr. Goos indicated that he supported Belize's request for a stand-by arrangement. The measures envisaged under the adjustment program would improve the country's overall economic situation, and the authorities were to be commended for their adjustment effort. However, the extent and pace of adjustment were not ambitious enough, including the elimination of external payments arrears. Although a considerable overall balance of payments surplus was projected for 1985, the projected improvement in the external position rested largely on exceptional official balance of payments assistance. The medium-term outlook also appeared to depend crucially on an unparalleled level of official capital inflows, which would lead to a rapid buildup of public external debt.

The resulting debt service burden should cause no problems in the foreseeable future and the authorities should use foreign exchange proceeds from borrowing exclusively for project financing, Mr. Goos stated. Nevertheless, given the uncertainties surrounding capital flows, the sustainability of the balance of payments position would be more certain if further progress was envisaged in the current account. The authorities should regard the program targets and the developments underlying the medium-term scenario as the minimum that should be achieved. In view of the favorable real growth prospects for the years ahead, there should be scope for additional efforts by the authorities to reach a more viable balance of payments position.

While he supported the staff's assessment that the exchange rate policy should remain under close review, he was surprised by its view that, at present, there was no clear need for exchange rate action, Mr. Goos commented. The real effective exchange rate had appreciated considerably over the past few years, and the 25 percent public sector wage increase in mid-1981 had probably affected wages in the private sector. Although the projected increase in exports might indicate that the country's competitivenes had not been unduly affected, exports in 1985 would remain below, and imports would clearly exceed, their 1980 level. In fact, imports might have increased by an even greater amount than indicated in Table 2 of EBS/84/225 had unrecorded shipments been taken into account. To what extent were such imports still taking place and had they been included in the trade balance projections? Belize would undoubtedly have to maintain its external competitiveness in order to reach a sustainable external position.

Miss Bulloch said that she approved of the authorities' intention to carry forward the process of adjustment initiated in June 1984 in the context of a stand-by arrangement with the Fund. The mix of policies envisaged under the program seemed broadly appropriate.

Belize's external economic prospects to the end of the decade appeared reasonable, Miss Bulloch remarked. Public external debt, although equivalent to about 50 percent of GDP, was largely on concessional terms, and the debt service ratio would remain within single figures. There were uncertainties underlying the medium-term outlook, including developments in the world price of sugar. Section IV of the paper might have benefited from some analysis of the sensitivity of the projections to changes in key assumptions, particularly regarding the price of sugar. Could the staff provide any further information in that regard? In order to boost the economy's resilience to unforeseen external developments over the medium term, the authorities should sustain the broad thrust of their present policy mix beyond the expiration of the stand-by arrangement in March 1986.

The present adjustment program rightly focused on fiscal adjustment, with the aim of reducing the overall deficit of the nonfinancial public sector to a level that the authorities believed could be financed by development credits, Miss Bulloch observed. The World Bank viewed Belize's public investment program as appropriate. The planned buildup of public sector savings to 3 1/2 percent of GDP in 1985/86 was commendable. The measures to improve the efficiency of revenue collection would help to reinforce the tax package introduced in June.

The authorities' pursuit of a cautious wage policy was appropriate, Miss Bulloch went on. The introduction of firmer, centralized expenditure controls and the planned preparation of a consolidated budget in 1985/86 to include the public sector enterprises should greatly enhance fiscal management. A substantial drain on the public finances would be halted if the operating deficit of the public enterprises as a whole could be eliminated as planned. Those enterprises should continue to implement realistic pricing policies in order to generate surpluses for investment.

A flexible interest rate policy was needed both to encourage domestic savings and to help support the balance of payments, Miss Bulloch stated. Recent declines in U.S. interest rates had almost eliminated the margin against Belize; nevertheless, the authorities would be well advised to keep the situation under review.

The emphasis given in the Fund program to the elimination of external payments arrears should help to create an environment that was conducive to foreign direct investment, Miss Bulloch commented. The authorities were committed to maintaining the cost competitiveness of the economy. The implementation of a cautious wages policy should help to strengthen Belize's competitive position and hence promote and diversify exports. In addition, the authorities should keep exchange rate policy actively under review, bearing in mind the extent to which Belize's exports--in particular, of citrus products and garments--might be competing in the U.S. market with countries whose currencies had depreciated against the U.S. dollar. In conclusion, she supported the proposed decision.

Mr. Ainley indicated that he supported the proposed decision. The Belize economy had gone through an unsettled period in the past few years. Although a modest recovery was underway and the rate of inflation had been reduced to 3 percent, firm action was clearly needed to correct the underlying imbalances in the fiscal and external accounts. The authorities seemed committed to taking such action, and the program appeared to be well designed to create the right conditions for sustained growth over the medium term.

It was essential that the main focus of the adjustment effort should be on strengthening the public finances, Mr. Ainley considered. Most important, domestic savings should be generated to finance the ambitious public investment program. A comprehensive tax package was introduced in June and there were moves to limit the growth in current spending. Also, steps were being taken to improve the management and pricing policies of the public enterprises. However, the staff had noted that existing controls over the public enterprises were still inadequate, and it would be useful to know whether the control procedures had, in fact, been strengthened since the program had been formulated.

The moderate wage settlements in both the public and the private sector in the past two years had helped to keep inflation down and to maintain Belize's international competitiveness, Mr. Ainley noted. The authorities should hold their stand on public sector wages in 1985 and in the medium term.

The authorities' efforts to diversify exports were already showing results, Mr. Ainley observed. Diversification was particularly important given the uncertain outlook for the sugar sector, and the proposed study of the sugar industry could be undertaken without delay so as to establish a clear medium-term strategy in that area. In the long run, the prospects for the balance of payments depended largely on the successful implementation of the public sector investment program, which had been endorsed by the World Bank.

The implementation of the public investment program would also depend to a great extent on Belize's ability to attract adequate capital inflows on concessional terms, Mr. Ainley continued. External arrears should therefore be eliminated promptly; clear and effective debt management procedures should be established; and capital inflows should be directed to the most efficient and productive sectors. In sum, the adjustment program combined adjustment with growth, laying the basis for sound development over the medium term, and it fully deserved Fund support. Similar principles could be incorporated in future programs with other Fund members.

Mr. Robalino recalled that at EBM/84/97 his chair had commended the authorities for adopting several measures aimed at reducing the balance of payments pressures and had encouraged them to continue their efforts to reduce the fiscal and external imbalances. They had clearly made a concerted effort and deserved the full support of the Board.

The authorities had followed an appropriate adjustment path aimed at improving the management of the public finances, Mr. Robalino noted. For example, recent measures were taken on the revenue side to increase central government revenues by three percentage points of GDP in 1984/85 compared with 1983/84. Also, the authorities intended to reduce central government current expenditures during the coming years. The establishment of an Office of Budget and Management and the introduction of modern accounting and budget procedures would be key to the fulfillment of the fiscal objectives.

The estimated public sector deficit would be reduced to 5.1 percent of GDP in 1985 and that public sector savings would increase from minus 2.1 percent of GDP in 1983 to 3.5 percent of GDP in 1985, Mr. Robalino commented. The authorities' intention to exercise wage restraint in the public sector was appropriate and their efforts to implement management controls in state enterprises were essential. He supported the price adjustments made by the public sector enterprises to reflect their operating costs.

Adjusting interest rates to international levels might lead to a substantial increase in domestic savings and encourage private sector investment, Mr. Robalino said.

The maintenance of cost competitiveness was essential to promote and diversify exports, Mr. Robalino commented. Although exchange rate adjustment was not necessary at present, cost competitiveness should be closely monitored. The authorities had maintained an open trade and exchange system and they should replace existing import restrictions with import tariffs. Finally, the balance of payments projections indicated a shift from a deficit of $6.5 million in 1984 to a surplus of $5 million in 1985. The adjustment program would help Belize to maintain its comfortable debt profile and achieve a sustainable economic position in the medium term.

The staff representative from the Western Hemisphere Department, commenting on the appropriateness of the exchange rate, stated that the staff had surveyed the various export sectors. Apart from the sugar sector, which was facing extraordinary circumstances, all sectors had been performing well. More recent information on the nontraditional export sectors indicated that export projections for 1984 should be increased by about 10 percent, as garment and citrus exports had risen. The fishing and tourism industries had also been performing well, owing mainly to demand in the U.S. market. The authorities were aware of the need to monitor the exchange rate closely, but, in view of the developments in the nontraditional exports sectors, exchange rate adjustment was not necessary at present.

As for the medium-term outlook, the staff representative indicated that the Bank and the Fund staff were confident that the expected project-related credits would materialize. While grants to Belize were declining, external assistance was increasing in the form of loans.

The staff had been conservative in its assumptions on the price of sugar for its medium-term projections, the staff representative remarked. The Government intended to carry out a fundamental survey of the sugar industry in an effort to establish the medium-term outlook for that sector. An analysis of sugar prices and price sensitivities would be important in that survey, which would also consider the possibilities of large-scale diversification away from sugar.

Estimates of unrecorded imports had been included in the balance of payments projections, the staff representative said. Contraband imports from Mexico had been substantial following the depreciation of the Mexican peso in late 1982 but had since been declining. By 1985, contraband imports would be a small component of total imports.

The World Bank had been involved with development in Belize through the Caribbean Development Bank, the staff representative from the Western Hemisphere Department stated. In recent years, the Bank had shown greater interest in becoming directly involved in Belize, initially in the electricity sector and possibly in a sugar diversification scheme. A technical assistance loan from the Bank aimed at improving management in the public sector was being discussed. The Fund staff had worked closely with the Bank staff in assessing both the budget, particularly the public investment program, and the medium-term outlook. Few additional measures had been taken thus far by the authorities to improve the management of the public enterprises, but new control procedures were likely to be introduced together with the consolidated budget in fiscal year 1985/86.

The Deputy Director of the Exchange and Trade Relations Department stated that in the future, the staff would include in staff reports more systematic coverage of World Bank relations with member countries.

Mr. Joyce remarked that both his authorities and the staff considered that the adjustment program was sufficiently strong, although progress under the adjustment program would be appraised at the first review. The authorities remained committed to the adjustment program, particularly with respect to increasing revenues, controlling central government expenditure, and restraining wages. They were conscious of the need to monitor interest rate developments closely and were pursuing a flexible policy, but they were not convinced about the need to adjust interest rates at present.

His authorities were of the view that the current exchange rate was appropriate, Mr. Joyce stated. They were, however, willing to re-examine their exchange rate policy should Belize become uncompetitive. The authorities were well aware of the urgency of diversifying away from sugar exports and would undertake a study on that issue in the near future.

The Executive Board then took the following decision:

1. The Government of Belize has requested a stand-by arrangement for the period December 3, 1984 to March 31, 1986 for an amount equivalent to SDR 7.125 million.

2. The Fund approves the stand-by arrangement as set forth in EBS/84/225, Supplement 1 (12/4/84).

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

Decision No. 7853-(84/172), adopted
December 3, 1984

4. GUYANA - OVERDUE FINANCIAL OBLIGATIONS - SECOND REVIEW OF DECISION ON COMPLAINT UNDER RULE K-1

The Executive Directors considered a staff paper on the second review of the decision and complaint under Rule K-1 with respect to Guyana's overdue obligations to the Fund (EBS/84/244, 11/28/84).

Mr. Cedric Grant, Ambassador of Guyana to the United States; Mr. Joseph Tyndall, Executive Director, Inter-American Development Bank; and Mr. Leslie Robinson, Minister, Embassy of Guyana, were also present.

Mr. Grant made the following statement on behalf of Mr. Carl Greenidge, Minister of Finance of Guyana:

> The preparation of the budget for 1984, which I hope to present to the National Assembly in mid-December, requires my presence in Georgetown and has therefore militated against my attendance at the present meeting. I am deeply concerned with the matters that have occasioned this meeting and hope to assure the Executive Board that Guyana is sparing no efforts to resolve this difficult issue.
>
> Since I last addressed this Board on June 6, 1984 (EBM/84/88), Guyana has made payments to the Fund amounting to some 20 percent of its total export earnings. At that meeting Guyana had promised to make payments amounting to US$10.07 million. In fact, subsequent to the meeting and in further recognition of the growing difficulty being experienced with respect to the Rules of the Fund, the Government pledged to increase its efforts to liquidate the arrears. As a result, it made a commitment on August 24 to increase to 25 percent the Fund's share of Guyana's total hard currency earnings. To date, Guyana has kept close to the schedule in spite of the heavy shortfall in export receipts since September as a result of the unfavorable weather. The country has paid more than 30 percent of its total hard currency receipts to the IMF and will have to remit an additional US$2.98 million by December 31 according to the revised schedule, at which point Guyana will be in arrears with respect only to repurchases.
>
> The Government of Guyana has also implemented the range of measures that I alluded to at EBM/84/88. The exchange rate has been adjusted further, from G$3.7 to the U.S. dollar to G$4.15 to the U.S. dollar. The 37.5 percent devaluation of the Guyana dollar since January 1984 represents the largest movement in the value of the currency ever effected in one year. Prices of various commodities--including sugar, fuel, imports and electricity charges--have been increased. These price measures, together with administrative changes, have so affected the composition of imports that the value of consumer imports now stands at a mere 48 percent of the 1982/83 level.
>
> Increased fiscal efforts, including stricter enforcement of income and consumption tax regulations, have increased revenues by 6.7 percent over the level anticipated in the 1984 budget. The current share of central government revenues in GDP reflects a fiscal effort that is probably unsurpassed. The size of the internal debt is the major problem regarding the central government current account. Arrangements have been made to roll over some of the maturing debts, albeit somewhat later in the year than planned.

On the supply side, the Cabinet has approved proposals for the restructuring of Guyana's stock corporations. These proposals are currently being implemented and partners are being sought for joint ventures in some areas. In addition, the Guyanese Rice Industry Development Bill 1984 is to be enacted today, following its second and third readings in the National Assembly. The new pricing formula agreed to by the IDB has been in place since the beginning of the season. Exporters to hard currency areas can retain up to 20 percent of their export proceeds in order to secure imported inputs.

The main problem encountered during the year has continued to be the inadequacy of inputs, particularly of spare parts. For example, there had been insufficient machinery to meet the demand for harvesting the record rice acreage and the good sugar crop. Capacity underutilization remains chronic, and assistance is needed particularly to maintain the current levels of operation in the sugar industry.

There has been a de facto wage freeze since 1981, and it is impossible to maintain wages at the current level without a serious negative effect on worker incentives and the inevitable consequences for any recovery efforts. Wage adjustments in the region of 15 percent of the total wage bill will be implemented with respect to 1984.

Firm steps are being taken to rehabilitate the bauxite industry, although bauxite is not expected to contribute to total foreign exchange earnings until early 1986. Guyana will therefore continue to depend on sugar receipts for servicing the hard currency needs of the entire economy. The projected 1985 foreign exchange budget contains a minuscule allocation for the sugar industry because of the Government's commitment to service what are deemed priority creditors, of which the Fund is the largest. However, it must be recognized that, as imported inputs are currently a constraint on production, a greater allocation of foreign exchange to debt repayment would be detrimental to the economy and would undermine our ability to realize the volume of production necessary to finance debt repayments. G$66 million in debt repayments from total earnings of G$96 million may already be too large; what Guyana requires is time and understanding on the part of its creditors.

The 1985 budget will continue to address the problems of fiscal balance, public sector efficiency, and improved export performance. The exchange rate regime may also continue to be adjusted as part of a package of measures designed to correct the fundamental economic disequilibrium. In the absence of concessionary inflows, the disequilibria and the problem of debt will be solved through medium-term economic measures rather than short-term instruments. We are resolved to honor our obligations.

> It is therefore incumbent upon us to formulate and implement adjustment measures at a pace and in magnitudes that can be honored. We submitted to the management of the Fund in September 1984 our ideas on the appropriate economic measures, and we requested technical assistance in the areas of the consumer price index and fiscal policies. We have been more successful in meeting our obligations to the Fund in 1984 than we had initially envisaged. The Government will make continued efforts to improve the economy so that Guyana will be able to resolve the issue of indebtedness and can proceed with its relationship with the Fund to our mutual satisfaction.

Mr. Robalino remarked that the date proposed by the staff for the next review was not realistic because Guyana's exports were always low in the first quarter. He suggested that the review should take place some time in April.

The Executive Directors agreed to continue 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/84/171 (11/28/84) and EBM/84/172 (12/3/84).

5. FOREIGN DIRECT AND PORTFOLIO EQUITY INVESTMENT IN DEVELOPING COUNTRIES - PUBLICATION

The Executive Board approves the proposal to publish the paper "Foreign Direct and Portfolio Equity Investment in Developing Countries," in the Occasional Papers series, as set forth in SM/84/145, Sup. 1 (11/16/84).

Adopted November 30, 1984

6. EXECUTIVE BOARD TRAVEL

Travel by an Assistant to Executive Director and Executive Directors as set forth in EBAP/84/254 (11/26/84), EBAP/84/255 (11/27/84), and EBAP/84/257 (11/29/84), is approved.

7. STAFF TRAVEL

Travel by the Managing Director as set forth in EBAP/84/256 (11/28/84), is approved.

APPROVED: August 27, 1985

JOSEPH W. LANG, JR.
Acting Secretary