INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 86/124

10:00 a.m., July 30, 1986

J. de Larosière, Chairman
R. D. Erb, Deputy Managing Director

Executive Directors	Alternate Executive Directors
	K. Yao, Temporary
C. H. Dallara	M. Lundsager, Temporary
J. de Groote	
M. Finaish	T. Alhaimus
H. Fujino	M. Sugita
G. Grosche	B. Goos
	W.-R. Bengs, Temporary
Huang F.	
J. E. Ismael	Jaafar A.
	H. A. Arias
	J. Hospedales, Temporary
	M. Foot
	R. Fox, Temporary
H. Lundstrom	I. Puro, Temporary
	L. Leonard
E. I. M. Mtei	A. Abdallah
F. L. Nebbia	M. A. Weitz, Temporary
Y. A. Nimatallah	J. E. Suraisry
P. Pérez	R. Valladares, Temporary
	S. de Forges
J. J. Polak	
	A. V. Romuáldez
	O. Kabbaj
A. K. Sengupta	A. S. Jayawardena
S. Zecchini	N. Kyriazidis

L. Van Houtven, Secretary
B. J. Owen, Assistant

1. Conference on Growth-Oriented Adjustment Programs . . . . . Page 3
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Also Present

IBRD: D. Dunn, Eastern and Southern Africa Regional Office. African Department: A. D. Ouattara, Director; L. M. Goreux, Deputy Director; N. Calika, M. E. Edo, J. M. Jiménez, A. Oloyede. Exchange and Trade Relations Department: W. A. Beveridge, Deputy Director. External Relations Department: P. E. Gleason, H. O. Hartmann, M. Goldstein. Legal Department: F. Gianviti, Director; P. L. Francotte, R. H. Munzberg, J. M. Ogoola. Secretary's Department: J. W. Lang, Jr., Deputy Secretary; A. P. Bhagwat. Treasurer's Department: T. Leddy, Deputy Treasurer; D. Williams, Deputy Treasurer; D. Berthet, D. H. Brown, A. G. Chandavarkar, R. B. Hicks, Y. Kawakami, A. F. Moustapha, P. M. Tillotson. Bureau of Statistics: I. Szalki. Personal Assistant to the Managing Director: R. M. G. Brown. Advisors to Executive Directors: L. K. Doe, L. P. Ebrill, S. Ganjarerndee, G. D. Hodgson, K. Murakami, A. Ouanes, A. Vasudevan. Assistants to Executive Directors: H. Alaoui-Abdallaoui, O. S.-M. Bethel, A. Bertuch-Samuels, B. Bogdanovic, K. Celebican, F. Di Mauro, W. N. Engert, G. Ercel, V. Govindarajan, Z. b. Ismail, S. King, W. K. Parmena, M. Rasyid, J. Reddy, V. Rousset, D. Saha, G. Schurr, B. Tamami, L. Tornetta, H. van der Burg, E. L. Walker, B. D. White.

1. CONFERENCE ON GROWTH-ORIENTED ADJUSTMENT PROGRAMS

The Chairman informed Executive Directors of an initiative that had been suggested to the World Bank, which had agreed to the suggestion that a joint Fund/Bank conference should be held on growth-oriented adjustment programs. Detailed proposals would be circulated to Executive Directors that day (EBAP/86/187, 7/30/86). He hoped that Directors would be able to support the proposals, and he asked when they would be prepared to consider them, since an early date was presently suggested for the conference.

The Executive Directors agreed to take up the proposals before the Executive Board went into recess (see EBM/86/131, 8/6/86).

2. INCOME POSITION - PRINCIPLES OF "BURDEN SHARING," INCOME TARGET FOR FY 1987 AND FY 1988, RATE OF CHARGE, AND RATE OF REMUNERATION; AND RATE OF CHARGE AS OF MAY 1, 1986

The Executive Directors resumed from a previous meeting (EBM/86/122, 7/25/86) their consideration of the principles of burden sharing. They had before them the text of the decisions adopted at that meeting (EBS/86/162, Rev. 1, 7/28/86), together with a revision in light of the discussion at EBM/86/122, of the Chairman's summing up at the informal meeting held on July 17, 1986. 1/

Mr. Dallara asked whether it would be equally satisfactory to others if the additional, last paragraph of the summing up were amended to state that "techniques will be studied, and implemented as practical, of adjusting...." In that way, the question of how practical it might be to fully implement the idea would be left open, without detracting from the clear presumption that the U.S. share in the burden of creditor countries would be mitigated, if possible.

The Chairman noted that he had no difficulty with Mr. Dallara's suggestion.

Mr. Fujino, Mr. Grosche, Mr. Nimatallah, Mr. Pérez, Mr. Zecchini, Mr. Foot, and Mr. Leonard said that they could go along with the proposed amendment.

Mr. Polak said that he could also support the amendment although he wished to note that the particular techniques to be devised would have to be compatible with other principles underlying the operational budget.

1/ Reproduced in Annex.

Mr. Dallara said that he could assure Mr. Polak that his authorities would not pursue an approach that radically altered or distorted the way in which the operational budget was drawn up. For the purpose of making certain adjustments, techniques would have to be found for incorporation in the next operational budget to be submitted to the Executive Board.

The Deputy Treasurer explained that because the measurement of U.S. reserves posed special problems, the decision on the use of currencies in the operational budget provided sufficient flexibility for ad hoc treatment for the United States. Therefore, the staff had the authority to propose to the Board the application of whatever technique or techniques were considered feasible. The Board would need to approve the application of such a technique in the context of agreeing with each operational budget. However, the amounts to be adjusted could not be known in time to permit whatever technique was devised to be applied in the forthcoming operational budget, which would be submitted within the next two weeks. The adjustment might also have to be retroactive with respect to the first half of FY 1987, once the amount of additional deferred income was known, and a decrease in remuneration and an increase in charges had been implemented.

Mr. Dallara said that he recognized the limitations of timing. As the Deputy Treasurer had indicated, there should be some symmetry between the application of the concept underlying the adjustment mechanism and the application of the principles of burden sharing. Retroactivity was therefore appropriate to the extent that the principles of burden sharing were applied before the adjustment mechanism could be incorporated in the operational budget.

Mr. Leonard said that he recognized the value of the statement that had been added in the form of subparagraph (5) as a means of moving toward an overall consensus on the principle of burden sharing and the Fund's income position. However, he wished to suggest a drafting amendment that would retain all the elements of the compromise that had been reached while leaving it open to the Executive Board to reach whatever agreement it considered appropriate in future on the issue of provisioning. To that end, he proposed that the parenthetical clause "or in the absence of a decision by the Executive Board" be replaced by the following wording: "unless a decision by the Executive Board on provisioning has fundamentally altered the treatment of the problem in the meantime."

Mr. Nebbia remarked that the amendment suggested to him that not only would there definitely be provisioning but that the door would be kept open to retain the reserve target at 7.5 percent after FY 1988 as well.

The Chairman suggested that Mr. Nebbia's point could be met by deleting the reference to "fundamentally" altering the treatment of the problem.

Mr. Kabbaj inquired whether the Executive Board would be respecting the Articles of Agreement if it dealt with the issue of provisioning as suggested in subparagraph (5), especially with Mr. Leonard's amendment, which seemed to encourage consideration of provisioning.

The Chairman commented that the intention of subparagraph (5), in the original version or as amended by Mr. Leonard, was to state simply that there was a possibility--not a certainty--that the reserve target would be set at 7.5 percent after FY 1988, unless the Board took a decision on provisioning that altered the shape of the problem at that time.

The Director of the Legal Department said that the principle of provisioning was not prohibited by the Articles of Agreement and thus it remained a possibility. However, there were certain limits and the modalities of provisioning would have to be studied carefully.

Mr. Sengupta said that for the sake of consensus, he was ready to accept some reference in the summing up to the presumption with respect to what would be done after FY 1988. As he understood the discussion, the presumption was that the entire financing mechanism agreed for FY 1987 and FY 1988 would be extended, and not only that the reserve target would be set at 7.5 percent after FY 1988. Therefore, he would have preferred a very neutral reference to the fact that the issue of provisioning would be discussed by the Board. If Mr. Leonard's formulation was accepted, it should be on the understanding that the strong presumption was that the financing mechanism for FY 1988, which included an increase in the reserve target from 5 percent to 7.5 percent, would be continued after FY 1988.

Mr. Dallara said that he had no difficulty with Mr. Leonard's amendment, which did not however reflect the notion in the concluding remarks by the Chairman at EBM/86/122 that the Board would take an early look at the issue of provisioning. Therefore, he suggested that subparagraph (5) be prefaced with a statement to that effect.

Mr. de Forges recalled that his authorities were not convinced of the necessity of establishing a system for provisioning in the context of the Fund at the present stage. Nevertheless, he could go along with the thrust of subparagraph (5) as amended by Mr. Leonard if that would restore the consensus reached at the informal meeting on July 17, 1986.

Mr. Foot said that he strongly endorsed the view that achieving a consensus on the issue would provide by far the best basis for dealing with the difficult period that lay ahead. He could accept Mr. Leonard's amendment, together with Mr. Dallara's suggestion that the Board take an early look at provisioning. At the same time, it seemed to him to be more logical to place the content of subparagraph (5) in the text of the summing up, rather than among the points dealing with the compromise on the financing mechanism for FY 1987 and FY 1988, following the sentence stating that the mechanism would be in place for two years.

Mr. Nebbia said that he was prepared to include a reference to provisioning in the summing up, along the lines suggested by Mr. Leonard, but only for the sake of consensus, as Mr. Sengupta had said. While mention had been made at EBM/86/122 of the Board's early consideration of the issue, the Chairman had also drawn attention to the possibility of reducing the reserve target to at least 5 percent, depending on whether or not an agreement on provisioning was reached. That latter point was not reflected in subparagraph (5).

The Chairman considered that subparagraph (5) as amended by Mr. Leonard was consistent with what he had mentioned at the conclusion of EBM/86/122. Depending on the outcome of any decision on provisioning, the reserve target would either be retained at 7.5 percent or reduced to 5 percent or less.

Mr. Polak said that he agreed with Mr. Foot that subparagraph (5) was misplaced. Indeed, he believed that the content of that subparagraph did not belong in the summing up at all. It would be much better to reflect the understanding relating to the issue of provisioning in a short, separate summing up of the present discussion. The additional summing up need refer only to the understanding that the Executive Board would turn its attention to provisioning at an early stage, with an additional paragraph along the lines suggested by Mr. Leonard. Mr. Sengupta's point with respect to the continuation of the financing mechanism, in accordance with the general principles of burden sharing on an equal basis--should the problem of overdue financial obligations remain serious--was implicit in the text as drafted; however, the point could be restated in another paragraph.

Mr. Fujino said that he could go along with the modification proposed by Mr. Leonard but that he would have difficulty accepting Mr. Sengupta's suggestion for a more explicit statement of the duration of the financing mechanism. It was already clear from the agreed principles set out as the preface to the Chairman's summing up that burden sharing would continue as long as the problem of overdue financial obligations existed. At the same time, it was stated that those principles would remain in effect as a temporary understanding. The delicate compromise reflected in those principles should not be jeopardized. Mr. Sengupta's point was implicit in subparagraph (5) as amended.

The Chairman noted that in addition to the statement of the agreed principles governing burden sharing in the summing up, Section I of the decision that had been adopted at EBM/86/122, which extended beyond FY 1987 and FY 1988, stated that the financial consequences for the Fund that stemmed from the existence of overdue financial obligations would be shared between debtor and creditor member countries, the sharing to be applied in a simultaneous and symmetrical fashion.

Mr. Grosche said that he agreed with the Chairman. He could support subparagraph (5) as amended by Mr. Leonard and Mr. Dallara. In addition, he considered that Mr. Polak had made a sensible proposal in suggesting that the content of that subparagraph be included in the summing up of the present meeting.

Mr. Sengupta said that if his point was implicit in the decision and the summings up, he would not insist on his proposal.

Mr. Dallara said that his authorities had reviewed carefully the question of burden sharing in light of the discussion at EBM/86/122 as well as the earlier informal meeting of Directors. He continued to support the position that he believed had provided the basis for the consensus reached at that informal meeting. Likewise, other Directors were maintaining their own positions. He regretted the misunderstandings that had arisen out of the different interpretations of that meeting and he remained willing to discuss the various elements of a package that could form the basis of a renewed consensus.

With that in mind, his authorities had studied the decisions adopted at EBM/86/122 and the summing up, Mr. Dallara continued. Moreover, the discussion at the present meeting suggested that views did not differ greatly. Therefore, he was prepared to accept the decisions, if the summing up could be further amended. Instead of the amendment to Rule I-6(4)(a) that he had proposed in order to incorporate an increase in the reserve target, he suggested the deletion in subparagraph (5) of the reference to the strong presumption that the reserve target would be set at 7.5 percent after FY 1988, and its replacement with a direct reference to the reserve target remaining at 7.5 percent after FY 1988 if the problem of overdue financial obligations remained serious. In addition to deleting the words "the strong presumption," the amendments suggested by Mr. Leonard, Mr. Polak, and himself, would be incorporated. He ventured to put forward his proposal in light of the discussion that had taken place at the present meeting, even though he recognized that some Directors might be reluctant o consider it. However, the approach he was suggesting would involve a move on the part of his authorities away from their interpretation of the agreement reached at EBM/86/122, as well as some movement on the part of others. The difference between a presumption and a clear statement was important to his authorities. He recognized that from the viewpoint of the debtors, there was a sufficient majority to reach a decision on the basis of the earlier understanding. Perhaps the only reason for others to consider the approach he had outlined might be that reaching a decision on any basis other than a consensus, given the efforts that creditor governments had made, would tend to render somewhat hollow the spirit of international cooperation that had been evoked frequently during the discussion and that would continue to be required as the Board considered other policy issues during the months ahead.

Whatever the outcome of the present discussion, Mr. Dallara said that he recognized that there was a sufficient majority in support of the currently formulated summing up. Therefore, his authorities were prepared to participate fully in the Board's decision, playing their role by absorbing the approximately SDR 45 million that might constitute the share of the United States in the burden sharing arrangements over the two subsequent financial years.

Mr. Grosche considered that it was important to reach a consensus on matters affecting the Fund's financial position. Therefore, if it would be helpful to Mr. Dallara, he could go along with the deletion of the reference to a strong presumption and with somewhat firmer language.

Mr. Zecchini stated that in the spirit of compromise and for the purpose of reaching unanimity, he was ready to support the amendment proposed by Mr. Dallara, although he had also been prepared to accept the amendment suggested by Mr. Leonard and particularly by Mr. Foot.

Mr. Polak said that he could accept Mr. Dallara's proposal although it might need to be formulated slightly differently in order to avoid the risk of suggesting that the reserve target would be set forever at 7.5 percent. He suggested that it would be better to state that "for any financial year after 1988, in which the problem of overdue obligations remains serious, the reserve target will be set at 7.5 percent...."

Mr. Fujino said that he could support Mr. Dallara's modification, if it was acceptable to the Board. It was important to ensure participation by creditors in the decision.

Mr. Foot said that he too could support Mr. Dallara's proposal, in the interest of unanimity. He asked for confirmation that, whatever the wording of the summing up, the Executive Board would have to take a decision, by the appropriate majority, for the reserve target to remain at 7.5 percent, if necessary.

The Director of the Legal Department confirmed that a decision would have to be taken, by a 70 percent majority of the voting power.

Mr. Nimatallah stated that, for the sake of unanimity, he could support Mr. Dallara's proposal in principle. Although he was in favor of a permanent increase in the net income target to 7.5 percent, he could accept a lower net income target of 5 percent if the problem of overdue obligations subsided markedly. The formulation suggested by Mr. Polak was acceptable, with the inclusion of some linkage between the duration of the problem of overdue obligations and the period for which the net income target would remain at 7.5 percent. Mr. Dallara's proposal to eliminate the reference to a strong presumption and to replace it by a firmer statement would probably send a better signal to the world.

The Chairman stated that that linkage was covered by Mr. Dallara's formulation, which contained two caveats with respect to the net income target of 7.5 percent. First, the problem of overdue financial obligations would have to remain severe for the reserve target to remain at 7.5 percent; and second, if that problem had been altered by a Board decision on provisioning, the net income target would also have to be changed.

Mr. Dallara said that he had no difficulty with Mr. Polak's rewording of his suggestion. While he recognized Mr. Foot's point that a subsequent formal decision would be required, the approach of his authorities was based on the clear understanding at EBM/86/122 that the summing up would be part of the formal record, whatever the outcome of the discussion.

The Chairman confirmed that the understanding in the summing up would be in the record, but that a new decision would be needed for the reserve target to remain at 7.5 percent.

Mr. Nebbia commented that if so many modifications to the summing up were to be accepted, he would like Mr. Sengupta's point concerning the continuation of the financing mechanism for 1988 in the future introduced in the text proposed by Mr. Polak. In that way, the consensus that had been reached during the past days would be preserved.

Mr. Pérez said that he had no difficulty with either Mr. Leonard's proposal or Mr. Dallara's modification as amended by Mr. Polak, on the understanding that any extension beyond FY 1988 of a reserve target of 7.5 percent would also be burden shared under the principles governing the overall consensus.

The Chairman said that if any Director had any doubt that the extension beyond FY 1988 of a net income target of 7.5 percent would be burden shared, as noted in subparagraph (4) of the summing up, they should so state.

Mr. Dallara remarked that the only caveat that he would make to the Chairman's understanding in that respect was related to the continuation of the arrears problem, which was certainly implicit in the Chairman's understanding.

Mr. Huang, Mr. Sengupta, and Mr. Alhaimus said that they supported the Chairman's understanding.

Mr. Polak asked whether the need for a decision would be affected by the difference in the wording of the references in subparagraph (5) to the reserve target being "set at 7.5 percent after FY 1988" or to the wording proposed by Mr. Dallara stating that the reserve target would "remain at 7.5 percent after FY 1988."

The Director of the Legal Department said that it would be clearer to state that "the rate will be set at 7.5 percent."

Mr. Dallara remarked that his authorities saw an important distinction between the two verbs. They were not asking for the wording he had suggested to be incorporated in any way in the formal text of the decisions. But the use of the verb "remain" would be helpful because it would lend some credibility to the concept underlying that decision that the net income target would stay at 7.5 percent or at least at 7.5 percent.

The Chairman remarked that that would preclude a higher rate; it seemed advisable not to close any options.

Mr. Leonard remarked that use of the verb "remain" would be inconsistent not only with subparagraph (4) as noted by the Chairman but with the wording of the summing up that was under discussion. After all, the reserve target might not be at 7.5 percent for every year after 1988.

Mr. Dallara remarked that there would be no inconsistency between subparagraph (4) and the summing up, and there need be no concern about the reserve target never going beyond 7.5 percent, if reference was made to the reserve target remaining at least at 7.5 percent.

Mr. Polak inquired whether such a formulation would be tantamount to a decision by the Executive Board.

The Director of the Legal Department responded that no decision determining the actual net income target would be taken. Directors would at the present point in time have reached an understanding.

Mr. Sengupta observed that the reserve target was being raised higher and higher. To refer to the reserve target remaining at least at 7.5 percent went considerably beyond a strong presumption that it would be 7.5 percent to a statement that 7.5 percent would be a floor.

The Chairman suggested that the understanding be based on Mr. Dallara's initial proposal to state that "the reserve target will remain at 7.5 percent." When the Executive Board took the relevant decisions, it would also take into account developments in the meanwhile.

Mr. Polak recalled that there had been some support for including the content of subparagraph (5) in the summing up of the informal meeting in a summing up of the present discussion, with the addition of a paragraph stating the general agreement that the increase in the reserve target above 5 percent would remain subject to burden sharing. The record would be clearer if that negotiated agreement, which might at some point be at variance with the decisions that had been adopted, took the form of a summing up by the Chairman.

The Chairman suggested that subparagraph (5) should be taken out of the summing up of the informal meeting and included in the summing up of the present discussion, as an understanding of the Executive Board to the effect that beyond 1988, the increase in the reserve target above 5 percent would remain subject to burden sharing, as long as the increase was required by the problem of overdue obligations. Of course, if the problem of arrears disappeared, the way would be left open for the Board to take whatever decision was needed in light of the prevailing circumstances. An increase in the net income target might no longer be required, or alternatively, the Board might have to decide to maintain the net income target at 7.5 percent for other financial reasons; in the latter event, there would of course be no burden sharing.

Mr. Fujino recalled that he had made the point that the content of those paragraphs that it was proposed to include in the summing up had been covered in the introductory principles to the summing up of the informal meeting.

The Chairman recalled that in deference to Mr. Fujino's views, the content of subparagraph (5) had been moved to the summing up, where it became an understanding of the legal position, for the record of the present meeting. That record would provide guidance to the Executive Board when it returned to the issue after 1988.

In response to a question from Mr. Nimatallah, the Chairman confirmed that the idea that the problem of overdue obligations would have to remain serious to require maintaining the net income target at 7.5 percent, with burden sharing, was implicit because the overdue financial obligations were the trigger factor.

The concluding remarks by the Chairman at the informal meeting on July 17, as revised, follow:

> Although we need to look at the language, the principles I outlined at the outset of this afternoon's meeting are acepted, but the mechanism for FY 1987 and FY 1988 is different.
>
> The agreed principles are:
>
> First, the consequences for the Fund which stem from the problem of overdue financial obligations should be shared between debtor and creditor member countries. Second, the burden sharing in principle should be applied in a simultaneous and symmetrical fashion inasmuch as the Articles of Agreement make possible the full application of this principle. Third, the remuneration coefficient would be raised to 100 percent of the interest rate on the SDR.

The principles governing burden sharing shall remain in effect as a temporary understanding, as long as the problem of overdue financial obligations which gave rise to the need for burden sharing at present continues.

The compromise on the financing mechanism for FY 1987 and FY 1988 is as follows:

(1) The remuneration coefficient will be increased to 100 percent, effective February 1, 1987; until that time the coefficient will move according to the existing formula.

(2) The income for FY 1986 in excess of target--SDR 26 million--remains part of reserves; it will not be deemed as income for FY 1987.

(3) As a reserve effort in FY 1987 and FY 1988 the target will be increased from 5 percent to 7.5 percent; there will be burden sharing, without refunding.

(4) The FY 1988 reserve target of 7.5 percent may be raised beyond that figure if needed; burden sharing will apply above 5 percent and amounts in excess of 7.5 percent will be refundable.

(5) Net income above 5 percent will be placed in a special line of "reserves."

The mechanism will be in place for two years; afterward, the Board will take a new decision.

As for the 85 percent floor to the rate of remuneration, if the remuneration coefficient is moving toward that limit the situation will be reviewed in advance to determine what action the Fund should take; the Board will reach a decision in light of the circumstances at that time. The existing safeguard clause continues, to avoid a vacuum.

Techniques will be studied, and implemented as practical, of adjusting, in the context of the operational budget, the share of the United States in total remunerated positions with a view to mitigating the share of the United States in the amount of burden sharing to be assumed by the creditor countries.

The Chairman made the following summing up of the discussion at the present meeting:

With reference to the texts of Decision No. 8348-(86/122) and Decision No. 8349-(86/122) taken at EBM/86/122 on July 25, 1986, and noting today's revision (7/30/86) of the concluding remarks on July 17, it was understood that:

The Executive Board will come back at an early date to the issue of provisioning.

For any financial year after 1988, in which the problem of overdue obligations to the Fund remains serious, the reserve target will remain at 7.5 percent unless a decision by the Executive Board on provisioning will have altered the treatment of the problem in the meantime.

The increase in the reserve target above 5 percent will remain subject to burden sharing as during FY 1987 and FY 1988 as long as the increase is required by the problem of overdue obligations.

The Chairman expressed his appreciation to Executive Directors for having participated in reaching a full consensus.

Mr. Dallara inquired whether any plans had been made for giving publicity to the decisions taken by the Executive Board, or whether the impact of those decisions would become visible in the Fund's financial statements for future quarters.

The Deputy Treasurer noted that the usual practice was to issue a press release when decisions were taken to set a new rate of charge or change the remuneration coefficient. If the Executive Board agreed, an attempt would be made by the Treasurer's Department and the External Relations Department to summarize the decisions that had been adopted.

After a brief discussion, the Executive Directors agreed that a short press release should be issued stating that effective May 1, 1986 the basic rate of charge would be 6 percent, to be adjusted in light of developments with respect to overdue charges, and that the remuneration coefficient would move to 100 percent on February 1, 1987, with the rate of remuneration to be adjusted in a similar fashion as the rate of charge. Fuller details of the decisions could be provided in the Annual Report for 1986.

3. ETHIOPIA - 1986 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1986 Article IV consultation with Ethiopia (SM/86/174, 7/15/86). They also had before them a report on recent economic developments in Ethiopia (SM/86/175, 7/18/86).

Mr. Mtei made the following statement:

In 1985/86 Ethiopia recorded considerable success as a result of the convergence of a favorable external and domestic environment. On the domestic front, it was due to a combination of good weather conditions, prudent fiscal and monetary policies, and the continuation of a policy of careful management which aimed at channeling a large proportion of resources to priority sectors and, in particular, agriculture. The broad-based improvement in 1985/86 was in sharp contrast with the performance of the previous two years--1983/84 and 1984/85--that was overshadowed by the effects of the severe drought that attracted the attention of the international community, which responded with generous emergency relief. Thus, GDP in 1985/86 is estimated to increase by 13.8 percent compared with a decline of 6.5 percent in 1984/85 and, largely as a result of the improved food supply situation, the consumer price index has fallen by 10 percent compared with a rate of inflation of 16 percent in 1984/85. Although imbalances persist, an impressive performance was recorded in the fiscal and external sectors. In 1985/86 the authorities' perseverance with a prudent restrictive fiscal policy is expected to reduce the budgetary deficit to 8.5 percent of GDP from 11.2 percent in 1984/85.

In the external sector, this policy stance, together with improved terms of trade, facilitated a significant reduction in the current account deficit, leading to a more than twofold expansion in the overall balance of payments surplus which has emerged since 1984/85. Ethiopia, which continues to remain current with all its external payments obligations, was thus able to build up its external reserves steadily to more than two and a half months of imports in 1985/86. In the meantime, the authorities' cautious external borrowing policies have curbed the growth of the external debt service ratio to 27 percent in 1986, about 10 percent below the ratio predicted earlier by the staff.

Despite the impressive gains recorded in 1985/86 the authorities recognize that production levels are still below the predrought levels and that the favorable external environment that contributed to the outcome cannot be expected to last. They are aware that once coffee prices fall back and oil prices rise there will be renewed pressures on the budget and in the balance of payments. The authorities are therefore taking appropriate measures to consolidate the gains attained in 1985/86 and to improve their medium-term prospects.

On the supply side, the authorities will continue to keep the planning system under review with a view to enhancing economic efficiency. In this connection, it is their intention to submit a request soon for the use of Fund resources under the structural adjustment facility (SAF). In the meantime, they are proceeding with measures to strengthen the agricultural sector, applying the lessons learned from the last two years of severe drought. Some of the measures include intensified research, enhanced extension services, increased inputs, and an improved transportation network. With respect to the marketing system, while the authorities have taken note of the staff views that the role of private market forces should be enhanced, they stress that this is already the case to a great extent. For example, they point out that a larger proportion of food crops is marketed by private traders. Nevertheless the authorities have been working in close collaboration with the World Bank on the further streamlining of agricultural marketing and appropriate producer price adjustments.

On exchange rate policies, the authorities are aware of the role that the exchange rate can play, not only in the medium-term viability of the balance of payments but in domestic resource allocation and income distribution in general. However, they are of the view that at their level of development that role can be more effectively performed by a system of central planning under which the mobilization and allocation of resources to priority sectors can be channeled more deliberately, at the same time attaining a distribution pattern that is more compatible with their sociopolitical values. Nevertheless, their policy is to seek an equilibrium rate of exchange that can reflect the correct value of imports and exports so that, inter alia, it can accelerate import substitution and stimulate and diversify exports so as to strengthen the underlying balance of payments position in the medium term. The authorities are fully aware, as noted earlier, that the improved balance of payments position in the last two years was helped by high levels of public and private transfers, especially those related to emergency relief, and by the terms of trade, which improved by 10 percent and 33 percent in 1984/85 and 1985/86, respectively, due to rising coffee prices and falling oil prices. Although the combined effect of these phenomena considerably outweighed the negative impact of currency appreciation, these factors are transitory in nature. In the final analysis, therefore, for lasting improvements in the balance of payments, the authorities see the need to establish an appropriate exchange rate and peg. Prior to that, however, the authorities wish to undertake an in-depth study of an appropriate peg and exchange rate taking into account the sociopolitical circumstances of Ethiopia. In the meantime, they note that the Birr continues to depreciate with the U.S. dollar.

In the sphere of fiscal policy, the authorities are continuing their cautious stance. In 1985/86, current expenditures will be held virtually constant at the nominal level of the previous year while capital expenditures rise moderately. As in the past, the Government will continue to ensure that public enterprises contribute significantly to the budget through the payment of capital charges, interest, income tax, and the overall surpluses which they traditionally realize each year. In 1985/86 the authorities succeeded in reducing the budgetary deficit to 6.7 percent of GDP from 8.1 percent of GDP in 1984/85. They recognize that the improvement is in part attributable to a higher coffee export tax yield resulting from high coffee prices but also to the authorities' own improved revenue collection effort. Nonetheless, the limited scope for further revenue expansion in the short run underscores the authorities' restrained expenditure stance.

Developments on the monetary front have been determined by the level of budgetary deficit financing and interest rates. The authorities' persistence with restrictive credit policies has led to a noninflationary situation in 1985/86 and high real interest rates which, in turn, have given rise to a situation of considerable excess liquidity. Accordingly, on July 1, 1986 the Government decided to take advantage of the revival of economic activity to stimulate credit expansion for productive purposes by lowering interest rates while increasing interest rate differentials between sectors so as to give preference to priority areas. It is now expected that credit to the private sector will continue to accelerate until overall domestic credit expansion and the projected balance of payments surplus result in a rate of broad money expansion that matches the GDP nominal rate of growth estimated for 1985/86.

On the question of trade and exchange restrictions, with regard to the remaining temporary restrictions on the making of payments and transfers for current international transactions, the authorities wish to emphasize that since the last Article IV consultation they have made further progress in the direction of liberalization, notably in accommodating requests for the remittance of dividends. Executive Directors will recall that last year the Fund granted the approval of the retention of these restrictions in light of the emergency balance of payments situation associated with the drought. My Ethiopian authorities, noting that the staff is recommending their further extension for a period of only six months, consider that a more meaningful period of extension would be until the next Article IV consultation. As the staff has clearly explained, Ethiopia has yet to recover from the effects of the drought and the country's balance of payments remains precarious. The staff report has stressed that even the recovery that took place in 1985/86 has not restored output to predrought levels. As it has been pointed out, the authorities are undertaking exchange rate policy studies in order to put in place measures that can strengthen the medium-term balance of payments outlook and facilitate the removal of the remaining temporary exchange restrictions. I would, therefore, urge that the proposed decision be amended so as to extend the period until the next Article IV consultation.

Mr. Finaish said that he had noted the reference on page 10 of the staff report to the resettlement program launched by the authorities under which farmers were moved from areas susceptible to drought to areas with greater rainfall, about 170,000 families having been resettled by the end of 1985. The mission had been informed that the emphasis in 1986 would be on assisting those resettled families and that there would be no further movement of farmers for the time being. Additional information on the two types of resettlement schemes was provided on page 4 of the report on recent economic developments. The operation was certainly a massive and costly one that had many implications; it would affect the productive structure and agricultural output, and there were also ethnic and political implications with the large movement of population from Ethiopia to neighboring countries. He had been surprised to find no information in the staff reports on the impact of that operation, and asked the staff if it could provide a more detailed explanation. He also noted that it would be useful if the staff provided more information and analysis on those issues and their implications in future reports on Ethiopia.

The staff representative from the African Department responded that after the authorities had moved about 170,000 families, the problems of resettlement had become more evident. The heavier rainfall and more tropical climate in the areas to which the farmers had been moved, and the different plant and animal life, had revealed that the draft animals on which they had relied for most of their field work were not as efficient owing to the presence of the tsetse fly and other local conditions. The authorities had been compelled to allocate additional resources in order to provide tractors, increasing the costs of resettlement beyond what had been expected. A decision had therefore been reached not to move any more families until more experience had been gained by those families that had already been moved, especially in light of the overall restraint on resources.

Mr. Jayawardena said that he was in broad general agreement with the staff analysis. Therefore, he supported the proposed decision, subject to the amendment proposed by Mr. Mtei.

In evaluating economic management in Ethiopia, it was necessary to be constantly mindful of the very low per capita income of its 42 million people and the great adversities they had suffered in recent times owing to a severe drought, Mr. Jayawardena noted. In addition, many resources had been pre-empted by civil war. Yet all the evidence pointed to Ethiopia as a country with considerable prospects for development. Slow growth and great inequities in income distribution had led to revolutionary changes in 1974. The economy had been centralized and collectivized in some critical areas. The authorities had demonstrated a considerable degree of pragmatism since that time, however. Economic management was based less on doctrinaire concepts and more on practical, relevant economic grounds. Quite impressive achievements had been recorded in respect of social welfare, including health, education, literacy, and sanitation.

Fiscal management had been prudent, Mr. Jayawardena continued, the successful reduction of the fiscal deficit in 1985/86 being commendable in the circumstances. The external sector had also shown improvement, although it seemed to have been brought about largely by the more favorable terms of trade that Ethiopia had enjoyed in the past two or three years. The medium-term balance of payments scenarios indicated the possibility of a worsening of the external position in the medium term, and the authorities should once again be urged to exercise great caution.

In that connection, Ethiopia's intention to discuss a structural adjustment arrangement with the Fund was welcome, Mr. Jayawardena concluded. The authorities had been collaborating satisfactorily with the World Bank, significant reforms in agricultural production and marketing having been incorporated into a World Bank structural reform program. The intention of the authorities to undertake other structural reforms was indicated by their interest in seeking the Fund's assistance under the structural adjustment facility. In the event that Ethiopia requested a structural adjustment arrangement, the Fund should be ready to respond.

Mr. Zecchini made the following statement:

In the past year, Ethiopia's economy has shown some encouraging results which indicate that the country is recovering from the effects of the severe drought. Among the positive elements we noted that in 1985/86 real GNP is estimated to grow at a rate of about 14 percent and consumer prices are expected to decrease as a result of lower prices for agricultural goods whose production has been favored by better weather conditions. Furthermore, the authorities should be commended for having followed prudent financial policies in the face of difficult circumstances and for having honored their external debt service obligations in a timely fashion. However, a solid basis for a durable economic growth seems not to have been laid yet and the authorities continue to be reluctant to make the necessary structural changes in important areas such as pricing and exchange rate policies.

As to pricing policy, we fully share the staff's view that prices and market mechanisms should play an increasing role in order to favor a more efficient allocation of resources and to provide incentives to increase production. In this respect, due to the weight of the agricultural sector in Ethiopia's economy and exports, we would like to have more information on the state of the discussions between the World Bank representatives and the authorities on delivery quotas and on producer prices. With the return to normal weather conditions, a review of the producer pricing structure for agricultural produce should not be delayed further. The new price structure should aim to promote domestic production and investment so as to raise the degree of self-sufficiency in consumption within a few years.

Exchange rate policy has to be viewed as an integral part of pricing policy for the purpose of establishing an appropriate set of relative prices and stimulating the production of export goods. In this respect, we note that the level of the peg between the birr and the U.S. dollar has not been changed since 1973 and that the authorities remain doubtful on the usefulness of a flexible exchange rate policy. Since the authorities have expressed the intention of discussing a program under the structural adjustment facility, pricing and exchange rate policy should be closely reviewed in that context. Understandings in these two areas should form an essential part of the program.

On fiscal policy, the overall fiscal deficit is expected to decrease to 6.1 percent of GDP in 1985/86. The staff cautions that this positive result has been partly due to transitory factors such as the special drought levy and high coffee surtax receipts due to increases in international coffee prices. As the fiscal year ended on July 7, it would be helpful to know whether information on the fiscal budget for 1986/87 is available. More specifically, we would like to know whether the authorities expect to maintain the special drought levy in the current fiscal year and, if not, whether compensatory measures have been envisaged.

As to monetary policy, the authorities have recently decided to change the interest rate structure by lowering lending rates and reducing to zero interest rates on time deposits of maturities of up to one year. We share the view that a lowering of nominal interest rates appears warranted by the decrease in inflation and also in order to favor a pickup in economic activity. However, in view also of the abundant liquidity existing in the economy we wonder whether a zero interest rate on deposits of shorter maturity might not cause some undesirable shifts from financial savings to forms of real saving or to consumption, with unfavorable repercussions on inflation and the balance of payments. Some elaboration by the staff on the possible repercussions of the recent modifications in interest rate policy would therefore be appreciated.

Finally, according to page 16 of the staff report, the balance of payments projections are based on the assumption of an average oil price of $15 a barrel for the first six months of 1986 and of $20 a barrel for the second half of the year. The latter assumption appears somewhat extreme at the moment and not consistent with the projections contained in other recent Board papers. For prices determined on world markets, such as the price of oil, greater efforts should be made to incorporate consistent assumptions in various Fund documents.

Ms. Lundsager made the following statement:

Economic developments in Ethiopia in the past fiscal year were much more encouraging than previously. With the return of favorable weather conditions, agricultural production increased significantly, resulting in a high rate of real economic growth. Most important, exports also increased in volume and the terms of trade improved with the increase in world coffee prices, leading to an improvement in the current account. The challenge now facing the authorities is to secure a sustainable growth trend in conjunction with a financeable external position. Attainment of that goal would, in our view, be facilitated by some basic enconomic reforms aimed at enhancing producer incentives.

In that respect, we noted some encouraging developments in the agricultural sector, including the distribution of improved seed varieties and the expansion of the rural transportation network, although we had the same concerns raised by Mr. Finaish and appreciate the comments made by the staff representative. The agricultural reforms that are being formulated with World Bank assistance are indeed welcome. I would be interested in additional details beyond the outline sketched in the staff report, which mentions discussions on delivery quotas and producer pricing policies for grains marketed through the Agricultural Marketing Board. While recognizing that a substantial portion of farm activity remains in private hands, as Mr. Mtei has reminded us, we strongly urge the authorities to consider expanding the scope for private initiative in this sector, in the expectation that higher rates of remuneration to farmers could have a strong impact on production. Of course, favorable weather and adequate inputs are extremely important as well, but without strong incentives, farmers most likely will hesitate to aggressively expand output beyond subsistence levels.

On a more general plane, the extensive network of price and trade controls presently characterizing the Ethiopian economy will not, in our view, promote profitable production and employment, either from a domestic or an international perspective. On the whole, the parastatal sector is performing fairly well, although the staff point out that profitability is not necessarily indicative of efficiency. We wonder if the profitability of this sector, which in large part represents manufacturing, is due to the extensive set of import controls and would appreciate staff comments on this aspect.

More generally, we realize that in the authorities' view, the public sector has certain advantages in making allocative decisions, but we would argue to the contrary. To be specific, a stronger, more diversified productive base could help to prevent a recurrence of the severity of the recent drought and could constitute the foundation for a growing economy. But it is very difficult for centralized authorities to be able to determine just what areas of production might be profitable in the long run. Furthermore, once authorities do make such decisions, and if those decisions turn out not to reflect underlying competitiveness, it is very difficult for the authorities to reverse their decisions and close down those enterprises. In addition, the authorities have expressed interest in attracting private foreign investment, which we believe could be a very useful source of foreign capital. Maintaining an extensive set of controls would, however, tend to discourage such foreign investment. For these reasons we urge enhanced reliance on the private sector to make fundamental producer decisions.

To be fully effective, of course, those decisions should be made in the context of appropriate monetary, fiscal, and exchange rate policies. In that regard, the depreciation of the U.S. dollar has led to a sharp real effective depreciation of the birr. This should improve export prospects, although we might suggest that a more flexible exchange rate policy be considered, to help restore and maintain competitiveness. We noted that the authorities have requested a study of this matter, a useful first step. Fiscal deficits have been contained, although it might be prudent to limit them further, in an effort to free resources for the productive sectors. We would emphasize expenditure controls, while recognizing that public sector wages have been kept low recently.

To refer briefly to monetary policy, we welcome the efforts to expand the banking sector to the rural areas, noting that the lack of institutions and instruments for saving in those areas has been a problem in a number of other countries. Regarding interest rates, we noted the authorities' rationale for the recent decrease in rates, but view a zero rate on short-term deposits as having adverse effects on the savings/consumption decisions of individuals, as Mr. Zecchini mentioned. While the recent substantial decline in domestic prices, following the harvest led to this action, we would nonetheless recommend that interest rates be kept under constant review in light of future domestic inflation developments.

In many respects, the structural adjustment facility appears aimed at countries like Ethiopia, where per capita income is very low and balance of payments problems may be temporarily hidden, the medium-term outlook indicating that a problem may emerge later in the decade. The structural adjustment facility is designed to assist countries in implementing basic structural reforms, within a sound macroeconomic policy framework. Directors have pointed to the need for various basic structural reforms to make the productive sector more responsive. We would expect that the same basic reforms as for other low-income developing countries would be appropriate for Ethiopia, despite the fact that it has a centrally planned economy. I strongly endorse Mr. Zecchini's comments on exchange rate and pricing policies.

Finally, let me add that the authorities deserve recognition for remaining current on their external debt-servicing obligations while strengthening their external reserve position. With respect to Mr. Mtei's suggested amendment to the proposed decision, I recall the discussion at the time of the 1985 Article IV consultation and our reservations about approving Ethiopia's exchange restrictions, in light of the expectation that the policy stance of the authorities at that time did not lend much hope of an early elimination of such controls. This year, the staff report presents a somewhat more optimistic picture in that the authorities are moving ahead on some important reforms with World Bank assistance and apparently would consider the additional reforms that would be part of a structural adjustment arrangement. In that light, we are prepared to support the decision as proposed in the staff report.

Mr. Fox observed that improved terms of trade and the return of normal weather conditions had come as a welcome respite in Ethiopia after the exceptional hardships of the past few years. As a result, economic performance had improved considerably in 1985/86. However, it was plain from the staff report that the underlying situation remained weak and that significant policy reforms were essential if economic performance in the medium term was to be strengthened. He fully endorsed the staff appraisal, and in particular the call for a more flexible attitude to agricultural pricing policies and the exchange rate.

If the Fund and the World Bank were to be able to play their respective roles in furthering Ethiopia's development, Mr. Fox added, it was vital for the authorities to use the coming months to demonstrate their willingness to cooperate more fully with both institutions, particularly if the forthcoming discussions on the possibility of a program to be supported by the structural adjustment facility were to reach a successful conclusion. In that connection, it was encouraging to see evidence of the authorities' readiness, as a first step, to liberalize their agricultural marketing procedures. However, it would be useful to have further information from the staff as to how that step meshed in with the statement on page 10 of the staff report that the long-term objective of the Government was the complete socialization of the agricultural sector.

Finally, Mr. Fox considered that the arguments put forward in the staff report for the renewal of the Board's supposedly temporary approval of Ethiopia's restrictions on the making of payments and transfers for current international transactions were not very convincing. As stated in the report itself, "the Ethiopian authorities have not yet implemented policies that would give the assurance that these restrictions are temporary." However, if it was generally agreed that the approval should be extended until the end of December 1986, he would be prepared to go along, but only on the understanding that there should be substantial progress in the meantime in the form of adjustment measures that would facilitate the elimination of remaining restrictions according to a specified timetable.

Mr. Nimatallah said that he was among those wishing to encourage countries like Ethiopia to enter into structural adjustment arrangements, which had many advantages, above all, that of involving both the Fund and the World Bank. The staff report on Ethiopia revealed two facts. First, the underlying weaknesses in the economy were expected to continue for several years to come, even if the weather and agricultural output improved. Second, the economy was essentially planned and subject to quantitative controls. Structural adjustment under a program supported by a structural adjustment arrangement would normally call for a flexible pricing policy. He had noted some indications that the Ethiopian authorities were prepared to move in that direction, and he asked the staff for its assessment in that respect. More generally, he inquired what prospects there were of Ethiopia entering into such an arrangement.

The staff representative from the African Department said that the Ethiopian authorities had confirmed to the World Bank mission that had visited Ethiopia shortly after the return of the Fund mission that it was their intention to liberalize the movement of agricultural products between regions. At present, there were restrictions on the movement of grain by private traders from one region to the other, all grains being moved through the Agricultural Marketing Corporation. As part of the program being discussed with the World Bank, that system would be reexamined. At the end of its mission, the World Bank had left some proposals with the committee formed by the Ethiopian authorities of deputy ministers of the ministries most closely concerned, including the ministries of agriculture, finance, and domestic trade. Consequently, the proposals would be considered at Cabinet level before a response was made to the World Bank's proposals. A further Bank mission would take place in the autumn, by which time the various ministries would have been able to study the proposals, in particular the specific arrangements being made with respect to quotas and prices, before taking detailed decisions. The opinion of the World Bank staff was that a marked shift in attitude on the part of the authorities suggested that the prospects of agreement on the various issues under discussion were encouraging.

No information had been received from the authorities about the budget for 1986/87, the staff representative continued. However, the difficulties that would arise if the drought levy was not maintained or if no compensatory measures were taken had been pointed out at the time of the mission. The deficit would rise, according to the projections made by the staff, from 6.7 percent of GDP in 1985/86 to 9.7 percent of GDP in 1986/87, to 11 percent in 1987/88, and to 12.3 percent in 1988/89. Therefore, the staff had emphasized the importance of the issue and hoped to receive information in the near future about the policy to be followed for the forthcoming fiscal year.

In making an assumption with respect to oil prices for its medium-term projections, the staff had been faced with two particular difficulties, the staff representative observed. First, Ethiopia imported oil from the Soviet Union under a special arrangement which did not necessarily take into account the movement in market prices for oil. Therefore, some adjustments had had to be made for the possibility of a fairly long time lag between changes in world prices and their reflection in the contract between the Ethiopian and the Soviet authorities. Second, as noted in the staff report, if the assumption had been based on the lower oil prices used for the current world economic outlook forecast--despite the obvious usefulness for Executive Directors of a comparison based on the world economic outlook--the accumulated balance of payments surplus through 1987/88 would have been larger by Br 115 million or the equivalent of about three weeks of imports.

The authorities' objective in reducing the rate of interest on short-term deposits from 4 percent or 5 percent to zero was to shift deposits from maturities of less than one year to maturities of more than one year, the staff representative explained. The change was meant to be a response to the decline in the rate of inflation in 1985/86, interest rates having become positive in real terms. The authorities considered that their interest rate policy had been flexible and their intention was to adjust interest rates accordingly, should the rate of inflation rise. The staff had brought the issue to the attention of the authorities, most recently through a World Bank staff mission.

Most of the prices currently being used for planning purposes were shadow prices that were obtained through an inverted input/output calculation by the Office of the National Committee for Central Planning (ONCCP), the staff representative said. The staff considered that the mechanism for determining prices was not sufficiently advanced to be used for the detailed planning purposes for which the authorities intended to use it, owing to the relative lack of skilled manpower and the inadequacy of the data base. Greater use of free prices at the enterprise level would improve not only efficiency and output but would reduce the burden on the administrators of the central planning organization. The authorities had expressed their willingness to examine specific proposals in that respect, recognizing that the central planning system was not incompatible with a more flexible pricing system at the enterprise level.

The monopoly position of parastatal enterprises in the domestic market was certainly another relevant factor underlying the profitability of parastatals, the staff representative from the African Department concluded, in addition to the fact that import prices and output prices were both controlled. The competitiveness of the economy should improve over time, as the balance of payments position improved and the authorities carried out their intention to reduce restrictions on external transactions. Many industries would have to increase their productivity if they were to maintain output at current levels.

The Deputy Director of the Exchange and Trade Relations Department recalled that the two criteria for the approval of restrictions were that there should be a balance of payments justification for the restrictions and that policies should be in place that offered a reasonable assurance that the restrictions were temporary. The staff had not recommended approval by the Board of Ethiopia's restrictions at the time of the 1985 Article IV consultation because in its judgment the second of those criteria had not been met. However, in concluding the 1985 Article IV consultation the Executive Board had decided that the Fund should grant approval of the retention of the exchange restrictions, in light of the current emergency balance of payments situation associated with the drought, until the completion of the next Article IV consultation or until May 31, 1986, whichever was the earlier.

It should be plain from the staff report for the 1986 Article IV consultation that policies giving a reasonable reassurance that the restrictions were temporary had not yet been implemented, particularly with respect to prices and the exchange rate, the Deputy Director continued. In addition, although imports had risen significantly in the past 12 months, a further exchange restriction--the abolition of the foreign exchange allowance for tourism abroad--had been introduced. For those reasons, and for the sake of consistent treatment with other members whose restrictions had not been approved by the Fund--some of which were close neighbors of Ethiopia--the staff normally would not have recommended approval of any extension of Ethiopia's restrictions. However, the authorities had argued for at least some extension of the approval. Bearing in mind that it would not be known whether the full effects of the drought had been overcome until the new harvest was in, that the authorities were apparently making efforts to liberalize the economic system, and that it was desirable to encourage such a change in economic policy, the staff had proposed a brief extension for six months. It should be possible by the end of 1986 to evaluate the extent of the return to normal conditions following the drought and the intentions of the authorities with respect to appropriate measures under a structural adjustment arrangement.

Mr. Mtei reiterated that his Ethiopian authorities had asked him specifically to relay to the Executive Board their strong desire for the Fund's approval of the restrictions to be extended until the 1987 Article IV consultation. The points that they wished to highlight included the considerable dependence of the economy on the vagaries of nature and the external environment, making the maintenance of defensive measures, such as exchange control, the price that had to be paid to fend off unforseeable adverse developments. In general, recent experience had demonstrated to the Ethiopian authorities that the least developed countries should rely more and more on the conservation of their own resources to prop up extremely low levels of capital investment. Had Ethiopia had access to concessional resources that more closely matched the needs for development finance, it would have been able to follow a strategy based on more liberal policies.

The second argument advanced by the Ethiopian authorities for an extension was the fact that they had continued to be current in all their financial obligations to the rest of the world, despite the immense difficulties faced by Ethiopia, Mr. Mtei added. Finally, the authorities did not consider it helpful to discuss measures of substance unless they were considered in the context of specific programs and their mode of financing. Clearly, the Ethiopian authorities perceived a relationship between the discussion of a structural adjustment arrangement with the Fund and the possibility of easing or removing the remaining restrictions.

In sum, Mr. Mtei urged that the Executive Board approve an extension of its earlier approval of the restrictions. Approval of exchange and trade restrictions had been granted to many other members, for a variety of reasons. It would be stretching the point too far to demand one of the poorest of the Fund's members to lift its restrictions prior to reaching agreement on measures of structural adjustment and their financing that would permit the removal of the restrictions. Ways in which to achieve that objective could be considered in the light of developments in Ethiopia over the coming 12 months.

Mr. Jayawardena said that while he agreed with the staff that countries in similar situations should be treated evenhandedly, he had perceived from the staff report a movement in a positive direction in Ethiopia. The Government had made an effort to improve its economic management when it would have been easier for it, given the difficult circumstances it had faced, to relax that effort. Ethiopia had remained current in its obligations to the Fund, and it also intended to enter into discussions with the Fund on a possible structural adjustment arrangement. For those reasons he was willing to support Mr. Mtei's request for an extension of the period of approval of the restrictions.

The Deputy Director of the Exchange and Trade Relations Department remarked that evenhanded treatment would require the Executive Board not to approve the restrictions. For the reasons mentioned by Mr. Jayawardena, the staff had proposed extending the period of approval for approximately six months, until the end of December 1986.

Mr. Nimatallah remarked that he would like to see some link established between the period for which the restrictions were approved and the fruition of negotiations on a structural adjustment arrangement.

The Deputy Director explained that the staff itself had hoped that the negotiations for a structural arrangement would coincide approximately with the period of the proposed extension, especially as a further staff mission would be visiting Ethiopia after the Annual Meetings.

After a brief discussion, the Acting Chairman suggested that the decision as proposed by the staff should be approved, but that he should add to the summing up a reference to the concern expressed by Executive

Directors about the continuation of the restrictions in question, in addition to an expression of encouragement to the authorities to put in place the necessary structural policies that would facilitate the elimination of the remaining restrictions.

Mr. Mtei said that he hoped that the elimination of restrictions would not be a condition for approval of structural adjustment arrangements.

The Deputy Director of the Exchange and Trade Relations Department commented that one important element of a structural adjustment arrangement--and, of course, no such arrangements had yet been brought before the Board--would presumably be the need to establish a schedule for the elimination of restrictions. Structural adjustment arrangements would cover three years, and the question would be whether appropriate policies could be put in place in that period, particularly with respect to the elimination of arrears.

The Acting Chairman made the following summing up:

Directors expressed broad agreement with the thrust of the views in the staff appraisal. Directors noted that Ethiopia had suffered a severe drought in 1983/84 and 1984/85 which had greatly reduced domestic food production. Directors also noted that financial prudence on the part of the authorities, high coffee prices, declining oil prices, and the return of normal rains had resulted in much improved economic performance in 1985/86; real GDP had risen by nearly 14 percent and prices had fallen, although in the agricultural sector, output remained below predrought levels.

While recognizing those recent favorable developments, Directors focused on their concerns about the medium-term prospects for the economy. In their view, and on the basis of current policies, it would be difficult to maintain a satisfactory rate of economic growth over the medium term and the external debt service ratio would remain high. Directors accordingly stressed the importance of the implementation of substantial structural adjustment measures to provide adequate production incentives and to increase and also diversify output and exports. In that context, they commented favorably on the ongoing discussions between Ethiopia and the World Bank on the agricultural development plans of the authorities.

Given the large weight of agriculture in national production and exports, Directors stressed that measures needed to be taken urgently to raise producer prices and increase the access of agricultural producers to the free market. Directors urged the authorities to implement more flexible exchange rate and interest rate policies and to adopt more appropriate domestic pricing policies in order to improve the efficiency of productive enterprises and also to encourage private sector activity. Those measures were also seen as necessary to strengthen the balance of payments position and enable the Ethiopian authorities to ease the trade and exchange restrictions.

Directors expressed concern about the continued maintenance by Ethiopia of these restrictions and encouraged the authorities to put in place the structural adjustment measures necessary to facilitate the elimination of the remaining restrictions.

Finally, Directors welcomed the interest of the authorities in discussing a medium-term program under the structural adjustment facility and commended the Ethiopian authorities on remaining current in their external financial obligations.

It was understood that the next Article IV consultation with Ethiopia would take place on the standard 12-month cycle.

The Executive Board then took the following decision:

1. The Fund takes this decision relating to Ethiopia's exchange measures subject to Article VIII, Section 2(a), and in concluding the 1986 Article XIV consultation with Ethiopia, in the light of the 1986 Article IV consultation with Ethiopia conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. Ethiopia continues to maintain restrictions on the making of payments and transfers for current international transactions, as described in SM/86/175. The Fund urges the authorities to implement such policies and measures as will facilitate the withdrawal of remaining restrictions subject to approval under Article VIII, Section 2(a), and, in the meantime, grants approval of their retention until the end of December 1986.

Decision No. 8352-(86/124), adopted
July 30, 1986

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/86/123 (7/28/86) and EBM/86/124 (7/30/86).

4. SOMALIA - OVERDUE FINANCIAL OBLIGATIONS - REPORT AND COMPLAINT UNDER RULE K-1 AND NOTICE OF FAILURE TO SETTLE TRUST FUND OBLIGATIONS

1. The complaint of the Managing Director dated July 21, 1986 on Somalia in EBS/86/159 (7/22/86) is noted. It shall be placed on the agenda of the Executive Board for August 25, 1986.

2. The notice of the Managing Director in EBS/86/159 (7/22/86) on the failure by Somalia to fulfill obligations under Decision No. 5069-(76/72) on the Trust Fund is noted. The notice shall be placed on the agenda of the Executive Board for August 25, 1986.

3. The Fund urges Somalia to become current in its financial obligations to the Fund promptly and to avoid thereby the need for the Fund to take remedial action.

4. Consideration of the complaint in accordance with Rule K-1 and of the notice particularly affects Somalia. The member shall be informed by rapid means of communication of this matter and of its right to present its views through an appropriately authorized representative.

Decision No. 8353-(86/124) G/TR, adopted
July 29, 1986

5. RULES AND REGULATIONS - OFFICIAL HOLIDAYS - AMENDMENT OF RULE B-4

Rule B-4 of the Rules and Regulations shall be amended by deleting November 11 from the list of weekdays that are not business days of the Fund, and adding the Friday following the fourth Thursday in November at the appropriate place in this list.

Adopted July 28, 1986

6. EXECUTIVE BOARD TRAVEL

Travel by an Advisor to Executive Director as set forth in EBAP/86/182 (7/25/86) and by an Assistant to Executive Director as set forth in EBAP/86/183 (7/25/86) is approved.

APPROVED: April 15, 1987

JOSEPH W. LANG, JR.
Acting Secretary

Managing Director's Concluding Remarks at Informal Meeting
on Principles of Burden Sharing and the Fund's Income Position
July 17, 1986

Although we need to look at the language, the principles I outlined at the outset of this afternoon's meeting are accepted, but the mechanism for FY 1987 and FY 1988 is different.

The agreed principles are:

First, the consequences for the Fund which stem from the problem of overdue financial obligations should be shared between debtor and creditor member countries. Second, the burden sharing in principle should be applied in a simultaneous and symmetrical fashion inasmuch as the Articles of Agreement make possible the full application of this principle. Third, the remuneration coefficient would be raised to 100 percent of the interest rate on the SDR.

The principles governing burden sharing shall remain in effect as a temporary understanding, as long as the problem of overdue financial obligations which gave rise to the need for burden sharing at present continues.

The compromise on the financing mechanism for FY 1987 and FY 1988 is as follows:

(1) The remuneration coefficient will be increased to 100 percent, effective February 1, 1987; until that time the coefficient will move according to the existing formula.

(2) The income for FY 1986 in excess of target--SDR 26 million--remains part of reserves; it will not be deemed as income for FY 1987.

(3) As a reserve effort in FY 1987 and FY 1988 the target will be increased from 5 percent to 7.5 percent; there will be burden sharing, without refunding.

(4) The FY 1988 reserve target of 7.5 percent may be raised beyond that figure if needed; burden sharing will apply above 5 percent and amounts in excess of 7.5 percent will be refundable.

(5) If the problem of overdue financial obligations remains serious, or in the absence of a decision by the Executive Board on provisioning, the strong presumption is that the reserve target will be set at 7.5 percent after FY 1988.

(6) Net income above 5 percent will be placed in a special line of "reserves."

The mechanism will be in place for two years; afterwards, the Board will take a new decision.

As for the 85 percent floor to the rate of remuneration, if the remuneration coefficient is moving toward that limit the situation will be reviewed in advance to determine what action the Fund should take; the Board will reach a decision in light of the circumstances at that time. The existing safeguard clause continues, to avoid a vacuum.

The feasibility will be studied of adjusting, in the context of the operational budget, the share of the United States in total remunerated positions with a view to mitigating the share of the United States in the amount of burden sharing to be assumed by the creditor countries.