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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 85/3

3:00 p.m., January 9, 1985

J. de Larosière, Chairman

Executive Directors	Alternate Executive Directors
	L. K. Doe, Temporary
C. H. Dallara	
	H. G. Schneider
	X. Blandin
	T. Alhaimus
H. Fujino	M. Sugita
G. Grosche	B. Goos
J. E. Ismael	
R. K. Joyce	L. Leonard
	H. A. Arias, Temporary
	A. K. Juusela, Temporary
	A. S. Jayawardena
E. I. M. Mtei	A. Abdallah
	B. Jensen
	J. E. Suraisry
P. Pérez	
J. J. Polak	
A. R. G. Prowse	A. V. Romuáldez
G. Salehkhou	
	T. A. Clark
S. Zecchini	N. Coumbis
Zhang Z.	Wang E.

L. Van Houtven, Secretary
R. S. Franklin, Assistant
J. C. Corr, Assistant

Also Present

D. A. Dunn, IBRD. African Department: G. E. Gondwe, Deputy Director; F. d'A. Collings, J. M. Jiménez, M. Sidibé, J. D. Simpson. Asian Department: W. G. L. Evers. Exchange and Trade Relations Department: W. A. Beveridge, Deputy Director; J. T. Boorman, S. Kanesa-Thasan, M. Nowak. External Relations Department: A. M. Abushadi. Fiscal Affairs Department: W. R. Mahler, D. C. McDonald. Legal Department: G. P. Nicoletopoulos, Director; Ph. Lachman, S. A. Silard. Middle Eastern Department: A. S. Shaalan, Director; P. Chabrier, Deputy Director; P. L. Clawson, F. Drees, S. Geadah, S. H. Hitti, S. Kawar, K. Nashashibi, M. Yaqub. Research Department: N. M. Kaibni. Secretary's Department: J. W. Lang, Jr., Deputy Secretary. Treasurer's Department: H. O. Habermeier, Counsellor and Treasurer; D. Berthet, D. Gupta, W. E. Hermann, T. B. C. Leddy. Bureau of Statistics: R. K. Basanti. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: D. Hammann, S. M. Hassan, E. M. Taha, A. Vasudevan. Assistants to Executive Directors: E. M. Ainley, H. Alaoui-Abdallaoui, W.-R. Bengs, M. B. Chatah, Chen J., G. Ercel, C. Flamant, G. D. Hodgson, Z. b. Ismail, J. M. Jones, A. K. Juusela, H. Kobayashi, M. Lundsager, R. Msadek, K. Murakami, E. Olsen, D. J. Robinson, C. A. Salinas, L. Tornetta, A. J. Tregilgas, A. H. van Ee, B. D. White.

1. KENYA - STAND-BY ARRANGEMENT

The Executive Directors continued from the previous meeting (EBM/85/2, 1/9/85) their consideration of a request from Kenya for a stand-by arrangement equivalent to SDR 85.2 million (EBS/84/261, 12/12/84; and Sup. 1, 1/8/85).

Mr. David A. Dunn, IBRD, was present for the discussion.

The staff representative from the African Department recalled that a number of Directors had questioned the staff's strategy in dealing with a possible request by Kenya for a purchase under the compensatory financing facility. An amount of SDR 57 million had been assumed as a purchase and had been included in the balance of payments calculations and in the table of purchases from the Fund; as a result, the purchase--if made--could not be used to reduce the financing gap. In reviewing the possibility of a purchase under the compensatory financing facility, the staff had felt that the best shortfall period would be between July 1, 1984 and June 30, 1985. In order to be able to bring a purchase request to the Executive Board, the staff needed six months of actual import and export data, and that information should be available to the staff sometime in April or May 1985.

The amount likely to be requested under the compensatory financing facility had been taken into account in the decision on the amount of access to be requested under the stand-by arrangement, the staff representative observed. The compensatory financing facility purchase would fall within the first half of calendar year 1985 and, in conjunction with drawings under the proposed stand-by arrangement during the period, would help to create a front loading of Fund resources to Kenya. The approach he had outlined was being adopted on the understanding that most of Kenya's financing needs for calendar year 1985 would fall during the first half of the year when payments for the bulk of needed grain imports would be required.

A number of Directors had pointed to the statement in Appendix V of the staff report indicating that the World Bank had not been completely satisfied with the degree to which Kenya had met the conditions of previous structural adjustment loan arrangements, the staff representative continued. Despite that dissatisfaction, the full amount of the previous structural ajustment loans had been disbursed to Kenya, and discussions on a third such loan were continuing, although the likelihood of agreement and disbursement of resources within the present calendar year was not great. Directors should be assured that there were no policy inconsistencies between the recommendations of the Fund and World Bank, although difficulties arose from time to time that because of their nature, could not be avoided. For example, during the 1983/84 fiscal year, the Government of Kenya, in order to meet the targets and ceilings under the previous Fund stand-by arrangement, had been forced to carry out four complete reviews of its budget during the year. Unfortunately, the lack of available personnel and time had made it impossible to follow the

Bank's wishes and to feed each review into the forward budget and into the development plan to see what impact the changes might have in other areas. Certainly, such an exercise would have been possible if so much time and manpower had not been devoted to the budget reviews themselves.

In response to a question by Mr. Ismael, the staff representative remarked that, for the second consecutive year, the ratio of development expenditures to GDP would rise. However, while the trend would continue, Directors should be cautioned not to expect major increases in the ratio in the near future. The Kenyan authorities had found it necessary to increase the level of their maintenance expenditures, which would of course be reflected in the current budget. A significant number of physical and other assets had not been utilized to their maximum, largely because the level of maintenance expenditure had not been adequate over the past few years. By redressing that situation, the authorities would be providing beneficial effects akin to what might result from additional investments.

The growth of current expenditures during the current fiscal year--excluding drought expenditures--was below the rate of price increase and reflected, to a great extent, higher interest payments and expenditures on pensions, the staff representative continued. The authorities had taken a very strict stance on all other discretionary current expenditures in order to keep them at a minimum.

On Mr. Dallara's specific reference to the slow pace of import liberalization and its relationship to the exchange rate, the staff representative remarked that the actual flow of imports easily exceeded what the system in place would have allowed if it had been strictly enforced. There were no longer any complaints of shortages in Kenya of the sort that had been raised several years previously; and it was the staff's view that the exchange rate had been brought to an approximately correct level. The Kenyan authorities felt that given the appropriateness of the exchange rate, it did not necessarily follow that a faster depreciation would in the end promote the higher level of exports. Indeed, they had evidence that many of the nontraditional exports were being affected not so much by price considerations as by restraints in other markets and by the inability of Kenyan entrepreneurs to gain the institutional backing necessary to compete in the international market. The staff was nonetheless continually reviewing the appropriateness of the exchange rate.

Those who viewed the projected 4 percent rate of growth of income for 1985 as rather weak should perhaps consider the figure in context, the staff representative commented. By comparison with many other African countries, a 4 percent growth rate was a good performance, all the more so at a time when the country was facing a drought situation. The Kenyan authorities were of course not complacent about the projected level of growth; but neither would they view it as insignificant.

The questions on the staff's analysis of the current account deficit over the medium term focused to some extent on a general issue, the staff representative said. As a rule, developing countries needed to attract foreign financing from abroad and, in so doing, tended to run current account deficits. Kenya had in the past been very careful in its effort to attract such capital and, as was clear from the description of Kenya's debt, had been particularly successful in attracting concessional and long-term capital. The amount of assistance that Kenya had received over the long term had exceeded the level of 3.5 percent of GDP that the staff was targeting for the medium term; and there had been periods in the 1970s when the inflow of new capital had reached nearly 5 percent of GDP. Against that background, the staff felt confident that the program target for capital inflows would be met and might even be exceeded if the Kenyan development plan were to move forward more rapidly than expected at present.

The staff's assumptions regarding the recuperation of the Kenyan economy from the drought had been questioned by some Directors, the staff representative recalled. Upon consulting agricultural experts in Kenya, the staff had learned that with respect to grains, if seeds were available and the planting was done on schedule, the agricultural sector would recuperate quickly in a period of normal rainfall. In the two years prior to the drought, production of grains in Kenya had exceeded the local requirements; and the projections for the year ahead could hardly be called optimistic since, if fulfilled, the output would not even fully meet domestic demand.

The Deputy Director of the Exchange and Trade Relations Department, remarking first on the issue of Fund/Bank collaboration, observed that a clarification of the differences in approach of the two institutions to the question of the pace and extent of import liberalization and the degree of exchange rate depreciation in Kenya might help to shed some light on broader differences and similarities in approach in other areas. The Bank staff had made it quite plain that it would have preferred a faster pace of liberalization of imports in Kenya and, to ease the process, would have welcomed a somewhat faster rate of depreciation of the Kenyan shilling. However, it was not easy for the two institutions to quantify whatever differences might exist. A fair degree of import liberalization had already taken place in Kenya over the years, and further progress was in prospect. Unfortunately, Kenyan policies in the area of import liberalization often had a "stop-go" quality about them directly related to the emergence of foreign exchange crises and their subsequent resolution. Only two years previously, a severe foreign exchange crisis brought about by an attempted coup had caused massive capital outflows and had necessitated a drawdown in the central bank's net foreign assets. Clearly, in those circumstances, the Kenyan authorities had had the right--which they had excercised--to tighten import policies on the basis of a severe balance of payments problem. While the Fund had regretted the necessity for such action, it had understood the reasons behind it. Currently, Kenya was experiencing another balance of payments crisis; and, while the authorities had given assurances to the staff that they would proceed with import liberalization, it was clear at least to the Fund that they would encounter some practical problems in moving too quickly toward those goals at a time when drought-related concerns were being given priority. In a related area, the World Bank was at present attempting to assist the Kenyan authorities in studying ways of replacing quantitative import restrictions with tariffs, although progress toward that end had been slow. Of course, given the sensitivity of the subject, it was understandably difficult to persuade a country to throw its "infant" industries open to import competition without knowing the consequences of such an action. Those matters aside, the most fundamental distinction between the Fund and Bank staffs concerned the awkwardness for the Fund to press at present for more rapid import liberalization when the program itself was not yet financed.

The matter of access policy in the Kenyan case had been raised by one or two Directors, the Deputy Director recalled. The staff did not have a rigorous quantitative model that produced figures on the basis of which it could confidently recommend precise levels of access. Of course, the staff recognized that Kenyan use of Fund resources had already been considerable and that further use was likely. In that respect, the staff had wanted to limit access somewhat under the proposed program; and, while some might consider 60 percent of quota on the high side, it was certainly possible to justify even greater access on the basis of Kenya's balance of payment need. In that respect, in making its recommendations, the staff had made certain assumptions about a possible purchase under the compensatory financing facility in establishing the total amount of Fund resources to be committed in the Kenyan case.

Mr. Clark inquired about the extent to which a tighter domestic credit ceiling might affect private sector behavior; in particular, he wondered whether it might not encourage larger private sector inflows and smaller outflows.

The staff representative from the African Department replied that in establishing the credit ceilings, the staff had wanted to ensure that sufficient resources were generated within the economy for the private sector. As in the past, it was likely that the full amount of credit available for use by the private sector would not be utilized, unless there was a buildup in private sector activity. Since there had been little in the way of capital flows to the private sector--other than trade financing--over the past few years, the staff had seen no need to feed that element into the calculations.

Mr. Joyce remarked that whatever the nature or extent of the differences in approach to the Kenyan economy by the Fund and the World Bank, the authorities of the country were experiencing difficulty in knowing which way to turn, having been subject to different policy prescriptions from two different institutions, both of which had provided or might be providing resources to the country.

Mr. Dallara agreed with Mr. Joyce that while there was nothing wrong in the two institutions coming to somewhat different views on, say, the pace of import liberalization in Kenya, those differences did pose awkward choices for the member. It was not the business of the Fund to comment on what should or should not be the basis for Bank programs. However, where differences of view existed, programs in the Fund should be brought forward only after considerable discussion had taken place between the staffs and managements of the two institutions to see whether a common view could be developed.

While on the matter of the pace of import liberalization in Kenya, Mr. Dallara stated that he was sympathetic to the problems experienced with respect to the coup in 1982 and, more recently, as a result of the drought. Certainly those difficulties had required some adjustment in the thinking of the authorities--and perhaps even in the thinking of the Fund staff and management--with respect to the pace of relaxing restrictions in the trade and payments systems. Nonetheless, beginning with the extended arrangement in the mid-1970s, and in various stand-by arrangements since that time, the Fund had been talking about a progressive relaxation of trade and payments restrictions. Given the long period during which Kenya had been relying on Fund resources, he was troubled that the authorities had apparently given a secondary priority to liberalization of the trade and payment system; and he had some reservations about the proposed program in that respect.

Mr. Suraisry commented that despite his earlier commendation of the efforts the Kenyan authorities had been making to improve the operations of the public enterprises, he was concerned that there had been delays, including legal delays, in progress toward that end; those were among the major problems that the authorities would have to tackle in the future.

The Chairman, noting that Directors had focused sharply during the course of the discussion on the issue of Fund/Bank collaboration in Kenya, asked whether Directors would agree to invite the World Bank staff representative--who was already present in the room--to comment on the Bank's concerns in Kenya.

The Executive Directors agreed to hear from the World Bank representative.

Mr. David Dunn, IBRD, observed that the World Bank fully supported the program presented by the Fund staff to the Executive Board at the present meeting. He agreed with the indication of the Fund staff that there was no inconsistency in the policies and measures that had been recommended by the two institutions, even if there might have been some disagreement about the pace of implementation of certain of those policies.

Relationships at the staff level in the Fund and Bank were very positive, Mr. Dunn continued. Over the past several years, frequent consultation between the two staffs had taken place and, occasionally, staff members from each institution had participated in missions mounted by the other. In 1983, a Fund staff member had assisted a World Bank mission in Kenya reviewing the import liberalization measures that, at the time, had

had to be revised because of exigencies in the foreign exchange situation. The World Bank had requested and received help from the Fund staff in working out a new program, which had been incorporated in the Bank agreement.

Programs of both the Fund and the Bank had worked in the same direction, Mr. Dunn remarked. The Bank had asked for more rapid implementation of export promotion programs, improvements in the forward budget, and improvements in the trade regime of the sort that were consistent with the policy measures recommended by the Fund. Discussions toward a third structural adjustment loan with the World Bank were continuing. While not at the stage of a formal negotiation with the Government of Kenya, the Bank was nonetheless actively maintaining a dialogue with the authorities on the question of the loan.

As to why the Bank was not satisfied with progress thus far on the structural adjustment program, even though the Fund was prepared to go ahead with a stand-by arrangement, Mr. Dunn noted that the policy agendas of the two institutions were somewhat different. One area in which the Bank had not been satisfied fully with the progress to date by the Kenyan authorities was that of population control. Although Kenya had one of the most forward-looking policy stances on population control of any sub-Saharan African country, the Bank was troubled somewhat by the translation of the Government's policy intentions into action. In particular, the Bank was not satisfied with the pace of increase in the budgets of operating ministries for dealing with family planning matters, the adoption of specific family planning targets, and the introduction of family planning concepts into the education curriculum.

Another aspect of policy conditionality of concern to the World Bank involved the development of an energy investment strategy and program, Mr. Dunn commented. To date, the World Bank had not received from the Kenyan authorities a satisfactory investment strategy and program that took into account alternatives for regional energy development. Also worrying had been the slow progress in completing the study on grain marketing in Kenya. The Government had recently taken some new steps in grain marketing, including creating the Grain Growers Cooperative Union, which was meant to replace the National Cereals Production Board. It would take time to measure the effect that change would have.

With regard to those areas of policy that tended to overlap both Fund and World Bank programs, Mr. Dunn said that the Bank was generally in agreement with statements in the staff paper regarding, for example, the need to move more quickly toward incorporating parastatals into the forward budgeting process and the need for a more vigorous program of export promotion. The Bank was also looking forward to further moves toward import liberalization, a matter that he hoped would be stressed by the Fund at the time of the mid-term review of the program in June.

Mr. Abdallah observed that the Kenyan authorities placed considerable emphasis on their relations with both the World Bank and the International Monetary Fund. On the whole, those relations had been constructive, warm, and fruitful. Unfortunately, sometime during 1984 something had happened to the relationship with the World Bank which still left something to be desired. An attempt had been made during the most recent Annual Meeting to re-establish the traditional relationship but that effort had not been totally successful. Later, in November 1984, the World Bank's Vice President for Eastern and Southern Africa had visited Kenya; and from all accounts, it appeared that all misunderstandings that might have arisen in the past had been cleared up. Indeed, the Kenyan authorities had understood at the time that a structural adjustment loan or some quick disbursing loan would be extended to Kenya shortly. The lack of movement toward such a loan had thus been a disappointment to the Kenyan authorities, who believed that no fundamental differences of view existed between them and the World Bank staff. On the matter of population control, for example, so much progress had been made that a number of Kenyan religious leaders were accusing the Government of having been too vigorous in attempting to propagate birth control. The authorities were as anxious to move forward on that front as any lending institution would be; if insufficient resources were at present being provided to the ministries for that purpose, it was only because the money was being claimed by other needs related to the drought. There were of course a number of unresolved issues relating to the question of grain marketing, although those could certainly be worked out if the cloud of misunderstanding could be lifted. He hoped the authorities, the Bank, and the Fund would work together to restore the sound relationship that had existed in the past between Kenya and the World Bank.

In response to those who had questioned the pace of import liberalization in Kenya, Mr. Abdallah noted that the shops at present were experiencing no shortages, which suggested that restrictions were not particularly tight or that goods were entering the country through unapproved channels. He added that many Kenyan importers had been unable to discard the inventory habits that had been acquired during the heyday of the East African Community, even though the Community had ceased to exist in 1978.

In remarking on what it called a lack of financial control over the public sector enterprises in Kenya, the staff had perhaps presented a gloomier picture than the facts would warrant, Mr. Abdallah commented. He stressed that there were no public enterprises over which there was no accounting control. In the past, there was no centralized supervision over the entire public sector, and there was a general expectation that the Exchequer would always be able to bail out enterprises which incurred losses, however heavy. The general attitude had changed completely, such that parastatal institutions were expected to pull their own weight and those incurring losses were unlikely to be defended. A related matter concerned divestiture or "privatization" of the public sector enterprises. There were those who felt that if it were decided to sell the public sector enterprises to the private sector, the auction must be open to all bidders in order to obtain the best prices. Others felt that if open bidding were allowed, the public sector enterprises might pass into the hands of nonresidents who are stronger financially. While foreign investors in Kenya were currently welcomed as a matter of policy, there was also a desire to retain Kenyan assets in Kenyan hands as far as possible.

As indicated by the staff, a commission had been appointed to review public sector salaries in Kenya, Mr. Abdallah continued. Wages in the public sector at all levels were clearly lower than those in the private sector, and a continuation of the policy of wage restraint in the civil service was already having some effect on retention of high-level manpower. This impact was also spilling over to parastatals where maximum salaries had also been set.

The proposed stand-by arrangement could be viewed as a bridging operation toward an extended arrangement and a structural adjustment program with the World Bank under which Kenya's serious structural problems would be tackled, Mr. Abdallah said. The donors' meeting scheduled for February 4 should produce the financial support required to make the stand-by arrangement effective.

The Chairman, summing up the discussion thus far, noted that all Directors had commended the Kenyan authorities for their commitment to adjustment and for their willingness to take additional steps to ensure that the consequences of the drought would not derail the proposed program. At the same time, it was clear that a number of problems--particularly structural problems--remained. Continued progress toward trade liberalization, more effective control over the public sector enterprises and further improvements in population control and grain marketing arrangements were considered essential for the future, above and beyond the need for continued cautious demand management policies and flexible exchange rate policies. In that regard, he had been ecouraged to hear from Mr. Abdallah that there were no fundamental differences of view between the Kenyan authorities and the World Bank about the measures needed in the areas he had mentioned. Still, differences with respect to the pace of implementation of those measures should be reconsidered.

It was clear that the Fund's timely intervention in the face of the current drought situation was crucial to preventing an unraveling of the adjustment effort that the authorities had been undertaking for a number of years in Kenya, the Chairman continued. It was appropriate that the Fund should provide support in the form of a stand-by arrangement, which might indeed be viewed as a "bridge" toward a more medium-term approach, which could be attempted only once the immediate crisis had been dealt with. At the same time, it was clear that the current account deficit projected for 1985, including official grants, was not sustainable, even assuming a more normal pattern of rainfall. And, if the rainfall assumptions turned out to be optimistic, further adjustment would be inevitable. Of course, appropriate financing of the expected balance of payments gap for 1985 must be found. Given the debt situation in Kenya and the uncertainty about some aspects of the medium-term projections, the authorities could not afford the type of financing that might overload the economy's debt service profile. Hence, it was essential that the participants in the early February donors' conference were fully aware of Kenya's situation and of the importance attached to the resources they might provide.

Kenya was among those countries in Africa where, over the next few years, the Fund would be a net taker rather than a net provider of resources because a number of loans would be coming due, the Chairman remarked. In that regard, he had been surprised by the implication in a recent speech by a senior World Bank official that the Fund would be creating insurmountable problems in Africa because the financial profile of the institution's activities there would lead to a situation of negative transfers in the years after 1985/86. The Fund was aiding Kenya in pressing circumstances in which the World Bank was still considering further action; and if the Fund had not been actively involved in Kenya, the authorities might not have followed the sort of strong economic policy to which they had been committed over the past several years. Having heard an indication that the World Bank was satisfied with the proposed program and Fund intervention in Kenya, he assumed that the Bank would understand that the monetary resources being provided by the Fund would at some point have to be repaid. The period for repayment was defined by the policies of the institution and decisions on its instruments, and the World Bank was well aware of those points.

The Executive Directors then took up the proposed decision on Kenya's request for a stand-by arrangement.

Mr. Fujino asked for clarification of the requirement of "satisfactory arrangements" to finance Kenya's balance of payments deficit expected in 1985.

The Deputy Director of the Exchange and Trade Relations Department considered that the definition of "satisfactory arrangements" would have to take into account the terms and conditions of the financing. In that regard, the Chairman had earlier stressed the importance of ensuring that a significant proportion of the financing was on concessional terms. The original decision in EBS/84/261 had been revised at the last minute, in part because the timing of the donors' conference and the negotiations on the Eurocurrency loan had been postponed. The hope had been that financing from both sources would have been secured by the time of the Board meeting, thus obviating the need for a decision in principle; but the option outlined in Supplement 1 had had to be excercised when it had become clear over the weekend that the program would not be fully financed by the time of the Board discussion.

Mr. Fujino said that it was his understanding that decisions in principle should be adopted only in exceptional cases; he hoped the Fund was not making its decision dependent on actions to be taken by the commercial banks.

 Corrected: 3/19/86

The Chairman observed that the approach that was being recommended to Directors was in line with the outcome of the Board discussion several weeks previously in which it had been agreed that, where "substantial uncertainties remain with regard to the financing of a program and if management believed that in such exceptional circumstances approval in principle would assist the member in reaching agreement with its creditors, the procedures would be used." Both conditions had been met in the Kenyan case; there was uncertainty with respect to the financing of the balance of payments gap, and the authorities felt that a decision, if only in principle, would be helpful in their negotiations on the Eurocurrency loan and might encourage a positive response from the donors' conference. In the circumstances, staff and management had felt that it was more appropriate to put forward a decision in principle than to ask the Board to approve a decision outright when financing for the program was not yet available.

The Executive Board then adopted the following decision:

1. The Government of Kenya has requested a stand-by arrangement for a period of one year for an amount equivalent to SDR 85.2 million.

2. The Fund approves the stand-by arrangement set forth in EBS/84/261, Supplement 2, subject to paragraph 3 below, and waives the limitation in Article V, Section 3(b)(iii).

3. The stand-by arrangements shall become effective, not later than 30 days after the date of this decision, on the date on which the Fund finds that satisfactory arrangements have been made for the financing of the expected balance of payments deficit in 1985.

Decision No. 7884-(~~84~~ 85/3), adopted
January 9, 1985

2. SUDAN - OVERDUE FINANCIAL OBLIGATIONS TO THE FUND - REPORT AND COMPLAINTS UNDER RULE K-1 AND RULE S-1 AND NOTICE OF FAILURE TO SETTLE TRUST FUND OBLIGATIONS - INITIAL CONSIDERATION

The Executive Directors gave initial consideration to the Managing Director's complaints under Rule K-1 and Rule S-1 relating to Sudan's overdue financial obligations and a notice of failure to repay a Trust Fund loan (EBS/84/262, 12/12/84). They also had before them a proposal to give substantive consideration to the complaints and notice on February 8, 1985 (EBS/85/6, 1/7/85).

Mr. Jayawardena commented that less than one month had elapsed since the issuance of the Managing Director's report and complaints under

Rule K-1 and Rule S-1. Was that procedure in accordance with the understandings reached by the Executive Board on the treatment of overdue financial obligations?

The staff representative from the Treasurer's Department noted that the report and complaints by the Managing Director relating to Sudan had been issued on December 12, 1984--four weeks before the date of the present meeting. On a calendar-month basis, the one-month period would have ended on a weekend, when Executive Board meetings were not normally scheduled.

Mr. Mtei stated that he could do no better than read his Sudanese authorities' communication to him concerning their outstanding obligations to the Fund. The telex read as follows:

> Sudan would wish to assure the Board that it accords the highest priority to the settlement of its outstanding obligations to the Fund and recognizes the importance of early settlement, both for the institution and for Sudan. Nevertheless, it should be stressed that the present regrettable situation has developed as a result of of a number of factors which were unforeseen at the time when Sudan entered into a stand-by arrangement with the Fund in mid-1984, and which have been largely beyond the control of the national authorities. These factors, including the effects of severe drought on agricultural production and exports and the low levels of disbursement of foreign aid, have been discussed fully in recent Board discussions. They have given rise to a situation of extreme stringency in foreign exchange, which has led not only to an interruption in debt service payments, both to the Fund and to other creditors, but also to sharp curtailment of imports of essential and strategic commodities.
>
> In an effort to arrest the deterioration in the foreign exchange situation, the Sudanese authorities have requested technical assistance from the Fund to assist in formulating appropriate policies which will allow Sudan to discharge its international obligations. The policy memorandum produced by the Fund staff is presently being considered by the authorities and a policy package is expected to be announced in the near future. It should be emphasized that a major conclusion of the staff memorandum is that, under the new circumstances facing Sudan, domestic adjustment alone cannot bridge the imbalance between foreign payments and receipts in the coming year and that the country must adopt policies aimed at attaining viability of the balance of payments in the medium term. In the short term, a balance in the foreign exchange position is only possible with additional international assistance.
>
> From previous discussions of Sudan's situation, it will be evident to Directors that payments to the Fund constitute a very large element in Sudan's debt servicing obligations. This

> position will continue for some years beyond the clearance of the present arrears. The forthcoming obligations to the Fund are shown in the table on page 4 of EBS/84/262. These payments alone account for 25-30 percent of projected exports over the next three years. The Sudanese authorities believe that, while this debt burden will cause severe problems in the short term, payments to the Fund and to other international creditors can be effected through determined adjustment policies domestically and assistance from the international community.

He also wished to comment personally on how the pressing issue of overdue obligations might be handled with more fruitful results, Mr. Mtei continued. The case before the Executive Board was a reflection of a real problem that the international community had to address and that was likely to grow, rather than lessen, in the immediate future. The external debt service burden facing Sudan, and possibly other small countries in Africa, was well beyond what it was rational to expect those countries to bear. As the staff pointed out, the Sudan's annual debt service obligation would exceed $1 billion for approximately six years to come, an amount equivalent to about 120 percent of the total export proceeds of the country and about 40 percent of its GDP. Annual obligations to multinational institutions alone--which did not reschedule debt--was about 50 percent of Sudan's total export proceeds.

He did not intend to question the ultimate responsibility of Sudan to honor its obligations, Mr. Mtei said. Indeed, the communication from his Sudanese authorities demonstrated that they were fully committed to honoring those obligations. However, the exceptional hardship that Sudan was facing warranted special consideration on the part of its creditors and the international community as a whole. The Sudanese case called for a more pragmatic and innovative approach as provided for in the Articles of Agreement. Article V, Section 7(g) indicated that the Fund could give a debtor country a longer period to discharge a repurchase obligation if payment on the due date would result in exceptional hardship to the member. Section 8(e) of the same Article referred to the possibility of payment in a member's own currency with respect to obligations to settle charges.

In relation to the staff's recommendation in EBS/85/6 that the normal period of one month should be allowed between the Board's initial consideration of a complaint and its substantive disposition, Mr. Mtei considered that the staff should state what circumstances would warrant departure from the normal practice. Sudan was in a most difficult situation, and there was a case for the Fund to adopt a more flexible approach.

A further consideration was that Sudan's creditors also shared part of the responsibility for its difficulties by not having evaluated carefully the viability of the investment projects that they had financed and the debt service capacity of the client to whom they had extended loans, Mr. Mtei suggested. The loans had not not yielded the expected benefits for one reason or another and the creditors had financed projects that obviously did not contribute to the country's ability to service its debts in the long run. Therefore, the lenders should cooperate with the authorities to find a more realistic solution to the debt problem for which they bore some responsibility. On a previous occasion, he had suggested that such an approach could include the conversion of some bilateral official debts into grants and the rescheduling of commercial debts over several years with reasonable grace periods and provision to mitigate the high interest rates. The bilateral donors, who shared the responsibility, were not participating in the present Board discussion; nevertheless, the current piecemeal approach ignored the existence of a real problem and did not therefore represent a realistic and durable solution to the debt relief issue. Executive Directors should exert influence with their authorities so that the problem could be tackled in a more meaningful fashion.

Mr. Jayawardena said that the presentation of Sudan's overdue and forthcoming obligations in the table on page 4 of EBS/84/262 was highly misleading. At a previous meeting, there had been references to overdue obligations of SDR 917 million. He had discovered from the table that that figure represented the grand total of Sudan's obligations from the present to 1991. Projecting overdue obligations so many years ahead could serve no useful purpose. He hoped that the practice would be discontinued in future cases.

The staff representative from the Treasurer's Department observed that the amount of overdue obligations at the end of 1984, which was the subject of the present discussion, was indicated clearly in the paper. On previous occasions, a number of Executive Directors had requested that the staff provide an indication not only of obligations currently overdue but also of forthcoming obligations, in order that the Executive Board could have a sense of the magnitude of the potential problem. However, the projection of forthcoming obligations carried no implication that those obligations would in fact become overdue.

Mr. Prowse noted that the staff had stated that technical assistance had been requested by Sudan and that "discussions between the staff and the authorities are being held in response to this request and on the matter of early settlement of Sudan's overdue obligations to the Fund." He invited the staff to comment further on the state of those discussions.

The Director of the Middle Eastern Department replied that the discussions referred to in the telex to Mr. Mtei had been held in early December. However, the authorities had not made any statement at that time regarding the disposition of the overdue obligations. Since then, the Managing Director had sent a telex to the President of Sudan urging, inter alia, that the overdue obligations be discharged before the present meeting. The latest information from the Fund's resident representative in Sudan indicated that there were no further developments to report to the Executive Board. With regard to the special visit to assist in the formulation of appropriate policies, the staff had left with the authorities the outline of a program aimed at enabling the country to discharge its obligations. The authorities' comments on the proposed policies were still to be received. However, as Mr. Mtei had indicated, the President of Sudan was expected to announce major changes in economic policies within the next few days.

The staff representative from the Treasurer's Department, replying to Mr. Mtei's question on EBS/85/6, said that the Executive Board had not defined the circumstances that would warrant departure from the normal practice of allowing one month between initial consideration of a complaint and the Board's substantive disposition of the matter. Sudan was the first case to come to the Board following the Board's general discussion of the present procedures on November 19, 1984 (EBM/84/166 and EBM/84/167, 11/19/84), when it had been agreed that one month would be the normal period, but that the Board could decide to provide up to two months in a case if circumstances warranted. Therefore, there was little case history to look to for guidance.

Mr. Dallara noted that the complaints placed before the Executive Board were serious. The existing overdue obligations of Sudan were large by any measure, and, in the absence of prompt, decisive action, they would grow substantially in the period ahead. The situation ought to be a matter of concern to Sudan because, without a good working relationship with the Fund, the country could not secure the support that it desperately needed from the international financial community. It was also a matter of concern to the Fund's membership because, if the problem was not effectively addressed, it would affect the financial assistance that the Fund could provide to other countries. Therefore, the next review of Sudan's situation should be carried out as soon as possible and he supported the proposed decision to bring the question to the Executive Board for substantive consideration in one month's time.

The communication by the Sudanese authorities to Mr. Mtei, and Mr. Mtei's own comments, had been interesting, Mr. Dallara continued. He wished that he could say that he had been encouraged by the authorities' statements to the effect that they were fully committed to discharging their obligations to the Fund and that they considered the matter a high priority. However, the credibility of those statements had to be called into question. Sudan had not paid one SDR to the Fund since July 12, 1984. The Sudanese authorities had emphasized matters beyond their control, suggesting that such matters included lower level of foreign aid. His own authorities found it distressing that the level of foreign aid would be viewed by the Sudanese authorities as a matter beyond their control. The circumstances surrounding Sudan were a matter of frustration to his authorities because they had every wish to provide assistance to Sudan but the country's current policy stance did not enable them to do so. He hoped that the Sudanese authorities fully realized the gravity of the situation facing them and that they would take prompt, decisive action in the period before the Board's substantive discussion of their overdue obligations.

Mr. Suraisry said that he agreed with Mr. Dallara that the case before the Executive Board was serious. Sudan's arrears to the Fund were large and growing rapidly. Furthermore, there was no indication that the authorities were taking steps to eliminate them. The situation served no one's interests. As his chair had stated on previous occasions, overdue obligations could damage the Fund's liquidity and undermine its central role in the international financial system. They were not fair to other members, nor did they help Sudan, which required considerable international support to get its economy on track. Equally worrying, Sudan had sizable obligations falling due to the Fund in the coming three years. Unless corrective measures were taken, the prospect that those payments would be made on schedule appeared slight. It was therefore essential that the authorities adopt a comprehensive adjustment program without delay to deal with their deep-seated problems and to settle their obligations to the Fund. While such an approach presented difficulties, there was no time to lose. It was the only viable option. He supported the proposed decision and hoped that Sudan would do everything possible to become current in its obligations. In that regard, the communication by the Sudanese authorities to Mr. Mtei had been encouraging. He hoped that the Fund would be ready to provide technical assistance and advice to the authorities in their efforts.

Mr. Grosche stated that he had noted the Managing Director's complaints and that he supported the proposed decision to take up the substantive discussion of Sudan's case in one month. If the case was not settled smoothly and swiftly, there would be serious implications for the Fund's policy approach in Africa and elsewhere. Perhaps the Fund had overextended itself in Sudan and in some other countries in recent years; greater stress might therefore have to be laid on the catalytic role of the Fund in the future.

Mr. Clark said that he supported the proposed decision. He understood that if Sudan made no payments by the end of the present financial year, its arrears on charges would exceed SDR 50 million. The most recent paper on the Fund's income position (EBS/84/235, 11/19/84) indicated that the net income for FY 1985 would be about SDR 34 million. It seemed bizarre to show in the accounts a figure for income that was exceeded by the interest arrears of one country, let alone the total arrears of all members.

Mr. Leonard recalled that on the occasion of the 1984 Article IV consultation with Sudan (EBM/84/187, 12/19/84), his chair had expressed its deep concern about the country's overdue obligations to the Fund. Sudan's case had many disturbing features that added to the concerns expressed by Directors about the growing incidence of arrears and the implications for the Fund's financial role. Despite those disturbing features, the standard procedures agreed by the Executive Board should apply to Sudan, as to other members with overdue obligations. Accordingly, he supported the proposed decision.

Mr. Polak said that he agreed with the comments made by Mr. Grosche and supported the proposed decision.

Mr. Fujino commented that the existence of overdue payments was a serious matter. Sudan's overdue payments to the Fund amounted to almost SDR 83 million, a substantial amount. Although the country was facing serious balance of payments difficulties, other countries in similar situations had made stringent efforts to meet their obligations to the Fund, considering that as members of such an important institution, those obligations were of the highest priority. In the circumstances, he could not but support the proposed decision. He hoped that the authorities would take all possible and necessary measures to discharge their overdue obligations as promptly as possible.

Mr. Blandin remarked that he fully agreed with the comments by Mr. Dallara. He supported the proposed decision.

Mr. Zecchini stated that he also supported the proposed decision.

Mr. Prowse said that he supported the proposed decision. It would not be in the interest of the member to postpone the Board's substantive consideration of the issue for more than a month. It appeared that the papers before Executive Directors constituted all the material to be provided by the staff on that occasion. However, a number of important issues had not been treated as fully as might have been expected. First, the Executive Board should consider carefully how the situation in Sudan had arisen, what the role of the Fund had been, and what lessons could be drawn from it. Second, greater consideration needed to be given to the ways in which Sudan might be expected to meet its external obligations, including those to the Fund. The short answer might be that the authorities should quickly implement an adjustment program and seek debt rescheduling, and the like. He hoped that those important issues would be given fuller consideration at the next meeting and that the staff would provide its analysis in that regard.

Mr. Jayawardena stated that he supported the proposed decision and the comments made by Mr. Prowse.

Mr. Schneider commented that, although he had listened with care to the remarks by Mr. Mtei, it remained disappointing that no action had yet been taken by Sudan. Therefore, he supported the proposed decision.

Mr. Juusela expressed his support for the proposed decision.

The Executive Directors then took the following decision:

1. The complaints of the Managing Director dated December 12, 1984 on Sudan, in EBS/84/262, December 12, 1984 are noted. They shall be placed on the agenda of the Executive Board for February 8, 1985.

2. The notice of the Managing Director in EBS/84/262, December 12, 1984 on the failure by Sudan 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 February 8, 1985.

3. Consideration of the complaints in accordance with Rule K-1 and Rule S-1 and of the notice particularly affects Sudan. 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. 7885-(85/3), adopted
January 9, 1985

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/85/2 (1/9/85) and EBM/85/3 (1/9/85).

3. AUSTRALIA - TECHNICAL ASSISTANCE

In response to a request from the Australian authorities for advice on tax reform proposals, the Executive Board approves the proposal set forth in EBD/85/1 (1/3/85).

Adopted January 9, 1985

4. TUNISIA - TECHNICAL ASSISTANCE

In response to a request from the Sudanese authorities for a review of the country's tax system, the Executive Board approves the proposal set forth in EBD/85/2 (1/3/85).

Adopted January 9, 1985

APPROVED: October 23, 1985

LEO VAN HOUTVEN
Secretary