NOT FOR PUBLIC USE

0404

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 88/129

3:00 p.m., August 26, 1988

M. Camdessus, Chairman

Executive Directors	Alternate Executive Directors
A. Abdallah	E. T. El Kogali
F. Cassell	
Dai Q.	
C. H. Dallara	C. S. Warner
	G. Seyler, Temporary
A. Donoso	
	A. M. Othman
	B. Goos
J. E. Ismael	
A. Kafka	
M. Massé	D. McCormack
	C. V. Santos
	J. K. Orleans-Lindsay, Temporary
	I. A. Al-Assaf
G. Ortiz	
J. Ovi	M. Fogelholm
H. Ploix	
G. A. Posthumus	
	I. Sliper, Temporary
G. Salehkhou	O. Kabbaj
A. K. Sengupta	L. E. N. Fernando
K. Yamazaki	
S. Zecchini	

C. Brachet, Acting Secretary
S. L. Yeager, Assistant

Also Present

IBRD: J. D. Shilling, Financial Intermediation Services; Y. Ansu, Africa Regional Office. Asian Department: M. J. Fetherston, S. M. Schadler. Exchange and Trade Relations Department: H. B. Junz, Deputy Director; M. Allen, C. Atkinson, A. P. De La Torre, M. A. El-Erian, G. G. Johnson, G. R. Kincaid, N. Kirmani, M. Nowak, C. M. Watson. External Relations Department: N. Worth. Fiscal Affairs Department: J. Diamond, A. H. Mansur. IMF Institute: O. B. Makalou. Legal Department: W. E. Holder, Deputy General Counsel; P. L. Francotte, A. O. Liuksila, J. K. Oh. Middle Eastern Department: P. Chabrier, Deputy Director; S. H. Hitti, M. Yaqub, M. Zavadjil. Research Department: M. Goldstein, Deputy Director; E. R. Borenzstein, N. R. Chrimes, M. P. Dooley. Secretary's Department: C. E. Wahlstrom. Treasurer's Department: D. Williams, Deputy Treasurer; J. E. Blalock, P. J. Bradley, I.-S. Kim, P. S. Ross. Western Hemisphere Department: S. T. Beza, Director; J. Ferrán, Deputy Director; E. R. J. Kalter. Bureau of Statistics: R. T. Stillson. Personal Assistant to the Managing Director: H. G. O. Simpson. Advisors to Executive Directors: N. Adachi, M. Al-Jasser, W. N. Engert, A. G. A. Faria, K.-H. Kleine, P. D. Péroz, M. Pétursson, G. Pineau, M. A. Tareen, A. Vasudevan. Assistants to Executive Directors: F. E. R. Alfiler, J. R. N. Almeida, E. C. Demaestri, S. K. Fayyad, V. J. Fernández, B. R. Fuleihan, J. Gold, S. Guribye, L. Hubloue, A. Iljas, J. A. K. Munthali, C. Noriega, L. M. Piantini, S. Rebecchini, A. Rieffel, C. C. A. van den Berg, D. A. Woodward.

1. DEBT SITUATION - DEVELOPMENTS, ISSUES, AND ROLE OF FUND

The Executive Directors continued from EBM/88/128 (8/26/88) their consideration of a staff report on issues in managing the debt situation (EBS/88/159, 8/4/88). They also had before them a background paper on recent developments in commercial bank financing and restructuring for developing countries (SM/88/172, 8/10/88).

The Deputy Director of the Exchange and Trade Relations Department recalled that Mr. Ovi had asked whether the staff's statement that "lifting participating banks out of payments-sharing agreements through novation... may be hard to generalize as it may not be upheld in some national jurisdictions" obviated any further discussion of the use of Article VIII, Section 2(b) as a disincentive to free riders. The staff had in mind instead the banks' own efforts to deal with the free-riders problem--for example, through Côte d'Ivoire's novation procedures; under those procedures, individual creditors could still engage in suits against the member country in its courts. The banks' efforts, however, were completely removed from any disincentives the Fund might be able to provide under its Articles of Agreement.

As for the staff's treatment of debt conversion efforts, and, in particular, the apparent short shrift given to the Chilean conversion effort, it was true that a large part of Chile's debt had been converted, although most had been converted to domestic debt rather than equity, the Deputy Director continued. The effort had also been unique in that it utilized returning flight capital. Moreover, it had depended on the existence of a relatively deep capital market, which was not available in some countries. It should also be pointed out that Chile, as well as other member countries of the International Finance Corporation, had been involved in mutual fund debt conversion.

Questions had also been raised regarding whether buy-backs could make a real difference for most debtors and whether the phasing suggested by the staff would place excessive pressure on creditors to provide concessions rather than facilitate the rapid restoration of debtors' creditworthiness, the Deputy Director noted. The latter question reflected some misunderstanding, because the normalization of debtor-creditor relations involved a restoration of claims to their full face value. The question instead concerned the effect of a buy-back on the expected price in the markets and whether that effect was transitory or would it result in a lasting increase in the value of remaining claims. Phasing was important in cases where a large-scale buy-back or asset exchange operation was being attempted and where the necessary funding needed to be mobilized. In that event, however, up-front agreement to the terms of the operation would be useful. Under those circumstances, a well-structured buy-back could be helpful not only for small debtors, but also for heavily indebted countries, if the market discount was sufficiently large.

In stating that the evaluation of financing assurances, including the concept of critical mass, might have to be more qualitative than quantitative, the staff had not intended that the present policy should be diluted in any way, the Deputy Director explained. The statement merely reflected the staff's concern that as the menu expanded and the diversity of financing techniques increased, it became more difficult to gauge both the amount and timing of the cash flows being generated. Also, banks' write-downs and debt conversion activities made it difficult to assess actual banking flows to indebted countries. Consequently, a more qualitative assessment of financing assurances was needed.

The reasons underlying the staff's view that the new understandings on banking regulations reached among the Group of Ten entailed a number of problems for the debt strategy had been delineated by Mr. Ismael, the Deputy Director observed. For example, those understandings would not take into account the differentiation in creditworthiness among countries at present or in the foreseeable future. Moreover, the tax deductibility of provisioning and write-downs posed a problem; at the extreme, if the market valued a claim at, say, 50, but it could be written down to zero for tax purposes, then there was no real incentive for banks to participate in debt reduction techniques which resulted in a capital gain.

On a related point, the staff's assessment of the future prospects for financing flows from different sources was considered too pessimistic by Mr. Dallara and too optimistic by Mr. Cassell, the Deputy Director noted. The staff agreed with those Directors who believed that large banking flows for general balance of payments purposes, such as those seen in the 1970s, were not likely to return soon and were not likely at all until the worth of the existing claims was assured. Instead, the banking community was trying to improve its balance sheets and was revising its business plans, which were substantially different from those of ten years ago. Thus, banks were looking to investment opportunities that had recently opened up as a result of deregulation, particularly in the United States and also with the prospect of a unified European market in 1992. Because of shrinking profitability, concerted lending to highly indebted countries had been reduced to the lower percentile of banks' current business plans. The staff therefore believed that official creditors, including the international financial institutions, might have to engage in bridging operations while both debtor countries' and banks' balance sheets were being reorganized and until normal spreads could be earned again on loans to highly indebted countries with debt-servicing problems.

With regard to the staff's recommendation regarding new mechanisms for aid coordination, she wished to reassure Directors that the staff considered the policy framework paper as the central coordinating mechanism, the Deputy Director commented. Nevertheless, for countries without policy framework papers, a means for coordination needed to be provided. That issue would be discussed fully in the forthcoming staff paper on aid agencies.

A number of questions had been raised regarding the competence of the staff to help countries optimize market opportunities in their financing plans, the Deputy Director recalled. The particular function envisaged by the staff was to help evaluate the financing options that were being developed between debtors and creditors not only with respect to the indebted country's future financial requirements but also in the context of its capacity to pay.

The question of how, within the principles that had been set out, the Fund could strengthen its ability to catalyze financing had been answered in part in the previous staff paper on the debt situation, the Deputy Director of the Exchange and Trade Relations Department remarked. It had also been discussed in conjunction with the revitalization of the extended Fund facility. On the latter occasion, Directors had considered that complementary financing organized in support of strong programs under the extended Fund facility would not only be helpful but, in an uncertain environment, would also help assure that the programs could be successful.

The Chairman made the following concluding remarks:

Executive Directors welcomed the staff paper and its illustrative, albeit stylized, scenarios. They noted that for countries to regain appropriate access to international capital markets on a nonconcerted lending basis, there must first be a restoration of confidence among both foreign and domestic savers. Policy efforts of highly indebted countries have increasingly, if at times unevenly, been oriented toward this end.

Nevertheless, the resolution of the debt problem remains remote for a number of countries and, although individual situations vary greatly, economic prospects for many of them remain a source of concern, Directors observed. Despite the recent good performance referred to in the latest report on the world economic outlook, the external environment remains uncertain, especially as regards exchange and interest rate developments and trade practices. In this connection, appropriate economic policies in creditor countries are of the essence. Adjustment has to be universal.

As regards the financing terms and conditions of new lending to countries with debt-servicing difficulties, Directors noted that there have been significant changes in recent years, with a multiplication of financing options and the inclusion in bank packages of some debt-reduction instruments. However, private creditors still tend to be excessively focused on the short term, and their actions, including attempts in certain cases to disengage themselves from collaborative efforts, may thus not always reflect the mutual medium-term interests of debtors and creditors. Several Directors also commented that spontaneous general purpose bank financing would be unlikely to resume on a large scale and that nondebt-creating capital flows as well as trade and project-related lending would have to increase. Accordingly, a number of Directors pointed out that financing packages might increasingly have to include market-based techniques to reduce the outstanding stock of debt alongside the provision of new money, although new money would still be of primary importance. In the view of several Directors, greater flexibility in bank agreements to allow the direct use of buy-backs or debt exchanges should be recommended.

Directors observed that the menu of options should be carefully adapted to the needs of each country. For some countries, political cohesion and support of adjustment may come under pressure as the rate of growth that can be financed on traditional terms, and without a rapid buildup in debt, is insufficient. For these countries in particular, all of the main debt-reduction items in the menu, such as buy-backs, debt exchanges, and debt-equity swaps offer the possibility of slowing the accumulation of debt and debt-servicing obligations while facilitating attainment of a higher growth path. Speakers, however, stressed that broadening of the menu should be at the initiative, and is primarily the responsibility, of the debtor countries.

Other countries, Directors noted, were not likely to be able to grow out of their present level of debt and dispense with concerted financing within the medium-term projection period. With a return to normal financial relations thus remote, it might be necessary to envisage a buy-back of bank debt or the negotiation of a progressive, more fundamental exchange of claims.

Directors also noted that in some cases, when the level of debt implied continued reliance on debt renegotiation over the medium term, a progressive and more fundamental reorganization of external liabilities might be indicated. In that context, some Directors stressed that the difficulties associated with the high levels of debt of some countries, particularly in an uncertain economic environment, hindered their adjustment efforts.

A third group of countries is already close to re-entering the market for voluntary financing, many Directors pointed out. For some of these countries, debt-reduction techniques such as expanded debt-equity schemes, debt-debt exchanges, or limited buy-backs may still prove a useful avenue to improve their debt profile and help support the resumption of capital formation and economic growth that is now under way.

It was noted, however, that in all cases it would be important for programs to ensure that the resources freed by market-based debt-reduction mechanisms be applied to financing a recovery of investment as a first priority.

The fuller use of appropriate financing techniques and the further evolution of the menu approach could also benefit from some adjustment of selected regulatory provisions, and from greater consistency and predictability in the tax, regulatory, and accounting environment, several Directors noted. In this regard, some Directors expressed concern about the potential implications of the approach presently developed among the Group of Ten, and suggested some refinement to take better account of the differentiation in countries' creditworthiness and progress.

Uncertainties in the world economy could undermine the further development of the debt strategy, Directors remarked. Some Directors urged debtor countries to use available market techniques, such as hedging, to protect their economies against exogenous shocks; other Directors, however, stressed the costs and limits of such protective devices.

For low-income countries and a small group of middle-income countries, official debts are the primary concern, Directors commented, although some of these countries also have important levels of bank debt and can benefit from the development of additional financing techniques. Directors welcomed the recent broad expansion in the availability of concessional resources to support adjustment and development in the low-income countries, noting, however, that more effective coordination among providers of concessional finance remains of great importance. The evolution of a menu approach to concessional debt rescheduling in the Paris Club was also welcomed, although several Directors suggested that an increase in aid flows was of great importance. In view of the expansion of available official external financing, it now lies with these countries to implement policies that will allocate resources effectively to increase investment and growth, several Directors considered.

Directors noted the importance that creditors give to the phasing of financial support in parallel with policy implementation. They agreed that the broadening of the menu, and in particular the inclusion of techniques to reduce debt, will make the quantification of financing assurances for Fund arrangements increasingly complex. In this connection, it has been suggested that the Fund should examine the methodology for properly quantifying the equivalency between debt reduction and new money. This being said, the inclusion of qualitative assessments makes the securing of such assurances no less vital than before.

Overall, most Directors remarked that the debt strategy remains valid, but that there is a continuing need for it to evolve so as to respond flexibly to changing circumstances. The strategy is becoming, and indeed must become, yet more diversified in its instrumentation in order to fit individual situations. But there is also a need for all actors to continue to contribute actively to this strategy. Commercial banks need to continue to discharge their responsibilities. Indebted countries have to persist with growth-oriented adjustment policies, and in many cases, to make up for past slippages in the implementation of these policies. And industrial countries, for their part, cannot escape their responsibility for creating and maintaining a propitious external environment for indebted countries' macroeconomic and structural adjustment efforts.

Directors stressed that the role of the Fund remains primarily to help countries formulate growth-oriented adjustment and financial programs and, together with the World Bank, to support further these countries' efforts through catalyzing new lending as well as through lending under their own authority and in line with their respective mandates. If requested by the member country, the Fund might also assist in devising financing scenarios on which debt management policy and negotiations with creditors could be based. Some Directors noted that the Fund's role was even more crucial in an environment of rising interest rates.

The Chairman then made the following personal comments on the debt situation:

The preceding remarks on the debt situation of course may have to be qualified somewhat in the light of our forthcoming discussion on the world economic outlook. This being said, there appears to be broad agreement that the debt strategy is evolving in a desirable direction and that the principles of the strategy and its case-by-case, cooperative, and market-oriented approach are still valid. Yet, it also has to be recognized that there is some uneasiness about the persistence of the debt problem and that a number of Directors feel a sense of urgency in addressing it.

For its part, the Fund has recently done a good deal to respond to the evolving debt situation, particularly by reshaping its lending facilities. The Fund certainly can be counted on to continue monitoring the evolution of the debt situation, to address problems as they arise, and to provide assistance to heavily indebted countries--for instance, through the revitalized extended Fund facility--in support of stronger medium-term structural and financial adjustment programs. But the Fund cannot be alone in that endeavor. Indeed, members have to bear in mind that, as the Interim Committee pointed out in its April 1988 communiqué, "the Fund...together with the World Bank, could not be expected to take on the financing role that should fall to private and other official creditors."

The Fund will have to persist in pressing reluctant members of the banking community to continue providing the moderate amounts of new money that are vital to the working of the cooperative strategy. Whenever banks refuse to participate in financing packages in support of debtor countries' adjustment efforts, they in effect add fuel to the arguments of those, academics and others, who are advising countries not to meet their foreign obligations. Indeed, such bank reluctance only serves to undermine the debt strategy.

But exhorting the banks to do more is not sufficient. The Fund must also urge official creditors to take expeditiously all possible steps to ameliorate the situation. It is important, for instance, to reduce the delays in resuming export credit cover following agreements on debt rescheduling. Bilateral initiatives--such as those taken by some European countries in support of a financing package in early 1988--even if limited in scope, are also important. To that extent, the readiness of national authorities to provide financial support parallel to that from the Fund, to which allusion has been made, can only be welcome; I urge Directors to encourage their authorities to consider what they can do more generally to increase their support for debtor countries' adjustment efforts. The Fund, for its part, stands ready to help integrate the overall flow of bilateral external assistance into the design of financial programs and gap-filling exercises.

Finally, it is important to reassure those members undertaking strong, sustained adjustment that there is indeed light at the end of the tunnel. In this connection, the data underlying the medium-term scenarios for individual heavily indebted countries is enlightening; it appears that, in five years, debt/export ratios could be reduced by as much as 30 percent in certain cases--although unfortunately not in all--even assuming no reliance on debt reduction schemes. The Fund can make a significant contribution to countries' attainment of reduced debt service burdens, but only if other players in the debt strategy live up to their respective responsibilities.

2. SUDAN - OVERDUE FINANCIAL OBLIGATIONS - REVIEW FOLLOWING DECLARATION OF INELIGIBILITY

The Executive Directors considered a staff paper and proposed decision on the further review of Sudan's overdue financial obligations to the Fund following the declaration of its ineligibility to use the general resources of the Fund effective February 3, 1986 (EBS/88/179, 8/23/88).

Mr. El Kogali made the following statement:

My Sudanese authorities have asked me to reiterate their deep concern with regard to the problem of Sudan's overdue financial obligations to the Fund. They understand the implications of overdue obligations for the Fund and the entire membership and regret that they have not been able to settle or reduce the outstanding arrears because of the severe shortage of foreign exchange. They will continue to explore all possible means to clear the arrears and are willing to consider, with the Fund and the donors, all available avenues which could lead to the settlement of the arrears.

The severity of the economic problems facing the Sudanese economy and the authorities' continued effort to address them were reviewed by the Board only three months ago when Directors discussed the 1988 Article IV consultation with Sudan (EBM/88/86 and EBM/88/87, 5/27/88). At that time Directors had the opportunity to comment on the implementation of the authorities' Program of Action for 1987/88. It was noted that most of the policies incorporated in the Program of Action were implemented by the authorities, including an exchange rate adjustment, improved incentives for agricultural production, increases in prices of socially sensitive commodities and measures to raise budgetary revenues. In addition, the role of the private sector was enhanced by the introduction and expansion of an "own-resource system," which generated about $480 million to finance imports. Moreover, structural measures were initiated in the areas of parastatal reforms, price and profit decontrols, and improvement of financial intermediation. A shortfall in aid disbursements and security problems made it difficult for the authorities to contain growth in expenditures within the program targets.

To consolidate and build on the progress achieved, the National Unity Government which took office last May accorded top priority to the reinforcement of adjustment efforts and economic reforms. Accordingly, the Four-Year Development Program was finalized with the objective of reducing financial imbalances and putting the economy in the path of sustained growth. To achieve its objectives, the program embodied a comprehensive package of supply-side policies and demand-restraint measures.

The 1988/89 budget adopted by the Parliament in late June 1988 constitutes the first phase of the Four-Year Program, and it contains the bulk of the measures, including a wide range of structural reforms such as the liberalization of price and profit controls, deregulation of export trade, reforms of the parastatal sector, restructuring of the budget, and enhancing the role of private sector. The following are some of the specific measures announced in the budget speech that are being implemented:

(1) Removal of all price controls except for five basic commodities, including sugar and bread, and ten items which would be removed after a certain period of time.

(2) Deregulation of export trade, including removal of the monopoly of the oilseeds company to allow the private sector to compete in procurement and export of oilseeds and oilseed cakes, streamlining export registration procedures, and abolishing export licensing and minimum export prices.

(3) Divesting public enterprises that imposed a heavy financial burden on the public finances, such as the Blue Nile agricultural schemes, White Nile agricultural schemes, and SATA shoe company.

(4) Selling to the public the government-owned commercial banks and hotels.

(5) Restructuring the parastatal sector according to the Program of Action that was worked out with the World Bank.

On a request by the authorities, a staff team visited Khartoum last June to discuss the Four-Year Development Program and the policy package included in the 1988/89 budget. The mission also carried with it a draft policy framework paper to discuss with the Government in Khartoum. My authorities found their discussion with the staff very helpful in further sharpening the focus of adopted policy measures and in introducing complementary measures to strengthen the adjustment process. For example, in addition to the above-stated policies, the following are some of the specific measures proposed by the mission and accepted by the authorities:

(1) Increase in the prices of sugar and bread to generate additional revenues for the budget.

(2) Assessment and collection of corporate taxes on current year basis.

(3) Adoption of a system to withhold income tax from exporters, importers, and wholesalers, introduction of presumptive income tax at a minimum flat rate to be imposed on small taxpayers, movement toward a more generalized sales tax and shift of emphasis from central to regional taxation.

(4) Expansion of the coverage of excise duties, and conversion of specific duty rates to ad valorem.

(5) Automatic adjustment of charges and tariffs to inflation rate and improvement of billing and collection procedures.

(6) Tightening controls on extrabudgetary expenditures. Measures are being introduced to authorize the Bank of Sudan not to cash any government checks with no funds.

(7) Allowing commercial banks to compete with private dealers to attract remittances at a free competitive rate.

(8) Limiting wage increases in 1988/89 to not more than Lsd 440 million.

(9) Increasing procurement prices for the 1988/89 season by about 30.5 percent, with similar increases in land and water charges in the irrigation schemes.

(10) Reviewing the compensatory rate system to ensure its appropriateness, and introduction of instruments such as government bonds with adequate return to mop up the excess liquidity in the banking system.

In short, the authorities and the staff agreed on all areas with the exception of the staff's proposal of a large outright adjustment in the exchange rate and an immediate pass-through of its effect to all prices. The authorities agreed in principle with the staff on the importance of exchange rate adjustment as a policy tool. However, they stressed that its implementation should take into account the prevailing sociopolitical and economic situation. The authorities pointed out that in view of the prevalence of structural rigidities and distortions and the failure to implement complementary policies, the series of repeated devaluations in the past--including the 40 percent devaluation last October--has not been effective and as a result, devaluation has been associated in the public mind with the continued deterioration of the economy, the increase in prices, and the lowering of the standard of living of the Sudanese people. Consequently, devaluation has become an unpopular and politically sensitive issue. The authorities believe that mobilization of public support for the implementation of the difficult structural measures would require avoiding an outright devaluation at this time. They therefore suggested an alternative approach that they believe will address the price aspect of a devaluation and export competitiveness, and ensure a free rate for remittances, while avoiding the political sensitivities of an outright devaluation. Their approach consists of three elements:

(1) Expansion of the "own-resource financing system" of imports and allowing commercial banks to compete with private

dealers to attract remittances at a free competitive rate determined by the banks on a weekly basis.

(2) Establishing an incentives system for exports, which will in effect make most exports competitive, to be financed through the imposition of a levy on imports.

(3) Substantial increases in the prices of the basic commodities with administered prices, such as bread, sugar, and benzine oil, to enhance budgetary revenues.

The authorities view this approach as a transitional arrangement to be replaced by an appropriate exchange rate adjustment as soon as the situation allows. The staff was not convinced that such an arrangement would work and insisted on a large outright devaluation with an immediate and complete pass-through of its effect to prices.

The Minister of Economy and Foreign Trade and the State Minister of Finance visited Washington last month and held extensive discussions with the staff and management with the hope of resolving the difference of views in the area of exchange rate policy and finalizing an agreement on a comprehensive adjustment program that will have the support of donors and creditors and help Sudan to settle its arrears to the Fund and address the deep-seated economic and financial problems. The Ministers also met with a number of Executive Directors to explain their views. Unfortunately, it was not possible to reach a complete agreement on the remaining issue. Nonetheless, the authorities thought the discussions were useful and instructive, and they emphasized that they would continue with their adjustment program and remain in full consultation with the Fund staff and management in the hope that an agreement will ultimately be reached.

Directors are aware of the unprecedented torrential rains and the resultant flooding of rivers which hit Sudan in the last few weeks. The flooded Nile has already exceeded its 1946 record peak of 17.1 meters, and the most critical period of floods might come in the first week of September. This natural disaster has caused deprivation and suffering for a large proportion of the population as well as damage to property and infrastructure on a massive scale. About 1.5 million people have been rendered homeless, with 58 deaths and about 200 injuries. Reports also indicate that more than 150,000 homes, hundreds of school buildings, several utility poles, railway tracks, bridges, roads, and about 200,000 acres of cotton fields have been destroyed. The capital city of Khartoum and six provincial cities, among others, were declared disaster areas and shortages of all basic consumer goods prevail resulting in the intensification of the already high rate of inflation. In the affected areas where drainage and sewage facilities have been disrupted and water has been contaminated, there is reportedly real danger of an outbreak of epidemic diseases. To make matters worse, Sudan is also facing invasion by desert locusts. The Government has appealed to the international community for help. It is unfortunate that the Fund is not in a position to help in alleviating the difficulties through extending assistance because of Sudan's ineligibility to use Fund resources. There is no doubt that the already difficult situation has been further aggravated, that the Government's efforts to cope with the disaster and reduce human suffering remain the focus of attention and that this preoccupation will have implications for the implementation of adjustment measures and, in particular, containment of expenditure growth.

Once the crises are over, the authorities intend to reinforce their adjustment measures and continue their efforts to become current with the Fund. They, however, remain committed in principle to the policy reforms required to restore the viability of the economy. In their assessment and comments, I hope Directors will take fully into account the exceptionally difficult problems facing Sudan under the changed circumstances.

Extending his remarks, Mr. El Kogali said that the previous day he had received the following telex from his Sudanese authorities:

During the past few months it has been the Government of Sudan's goal to reach an accord with the Fund staff on a set of policy measures to restore the economy to a healthy condition and begin a process which it was hoped would result in repayment to the Fund of Sudan's overdue financial obligations. During June and July we moved far in this direction--announcing in the budget very strong new policies--liberalizing prices, opening the economy up to greater private sector involvement, further reduction in subsidies, and exerting tighter controls in the financial areas. Although a final accord was not reached in the talks [with the Fund staff] held in July in Washington, the Government felt that agreement was close at hand as basic objectives and direction of policies had been agreed.

In the past three weeks, however, the tasks of policy reform and mobilization of financial assistance have been overshadowed by the human tragedy, which is ongoing in Sudan, caused by the unprecedented rains and floods. As the Board will know from the staff paper and the international press, Sudan has witnessed a destruction of property on a massive scale and millions of inhabitants have been left homeless. The full extent of the devastation will only become clear in the coming weeks when an assessment of the damage to crops and infrastructure can be made. It is clear, however, that the disaster has lowered the country's potential for recovery from its economic crisis, and the effects may well be catastrophic if correct policies are not applied and sufficient international assistance for a speedy rebuilding of the economy is not forthcoming. The international community has responded promptly to the immediate needs of those suffering. The next stage, in our view, is to restore the critical infrastructure--the roads, railway, water, power distribution, medical and social services--and embark speedily on production enhancement policies to maximize the benefits of the rainy conditions and fertility of the soil. In this way it is hoped to boost domestic supplies and exports and allow the economy to recover from the impasse of the last few weeks. It is recognized that the new situation does not detract from the importance of policy reforms and the process that is being followed to eventually enable clearance of the Fund arrears. However, at this juncture, it should be appreciated by the Executive Board that circumstances have changed radically and it will take some time for the country to recover. The Government needs to assess the damage caused by the floods, set priorities for international assistance, revise foreign exchange allocations, and reformulate budgetary policies. The strong comprehensive policies envisaged previously cannot therefore be immediately fully implemented. A more favorable environment for reform will obtain when the position of the flood victims has been ameliorated and the immediate obstacles to production have been removed. For this, the Government will, during the coming weeks, be seeking urgent assistance from development institutions and the international community.

In respect of Fund arrears, the Government intends as soon as possible to resume the process of reaching understandings on policies. It is hoped that such policies will be the basis for Sudan and the international donors to jointly find a solution to this long-standing problem.

Mr. Al-Assaf made the following statement:

The Board has had an opportunity to examine a number of cases of overdue obligations to the Fund in the last few days. It would be regrettable if this concentration of cases over a short period of time leads us to conclude that all cases of arrears are essentially similar. While there is similarity, of course, in terms of the impact of arrears on the usability of the Fund's resources and the financial costs imposed on the rest of the membership, there is none in terms of the attitudes and responses of countries in arrears and their efforts to resolve their difficulties. In this last respect, the willingness of the Sudanese authorities to cooperate with the Fund toward finding a solution to their domestic and external imbalances has been clearly demonstrated in a number of ways. It can be seen in their readiness to maintain a constant dialogue with the Fund at all levels. More significantly, it has been seen in their implementation of a courageous and comprehensive program of action. This program has been able to maintain the momentum of an adjustment process based on the minimum net external financing.

The staff report and Mr. El Kogali's statement illustrate the comprehensive and far-reaching character of the policy measures being implemented in Sudan. In this context, while I understand the difficulties involved in determining the future course of exchange rate policy and administered prices, I tend to favor the authorities' approach, which is based on the adoption of a transitional arrangement. According to Mr. El Kogali, this arrangement will lead to the appropriate exchange rate adjustment.

In view of the current plight of the Sudanese people owing to torrential rains and floods, I was tempted to suggest a postponement of this review until a time when our discussion and decision could have a meaningful impact. However, after further consideration, I now believe that the discussion today provides an excellent opportunity to call on the international community to help the Sudanese Government in alleviating the impact of these natural disasters. In this regard, I would suggest that paragraph 3 of the proposed decision should be revised to read:

> The Fund notes with regret the impact on the Sudanese economy and people of the recent floods in Sudan, expresses its sympathy for the victims of this natural disaster, and calls upon international donors to intensify their emergency and relief assistance. The Fund welcomes the continued efforts of the authorities to address the macroeconomic and structural adjustment needs of the economy, and urges them to maintain and clarify their efforts in this direction. The Fund hopes that the adjustment efforts on the part of Sudan will encourage a timely and constructive response from Sudan's donors and creditors, and all other countries that can help Sudan, to the authorities' request for expanded external financial assistance.

This revised text is intended first to reflect the need for immediate emergency assistance in this area, and second, to recognize the authorities' efforts in adopting and implementing a far-reaching and comprehensive program of adjustment. It should be noted that the last part of the proposed paragraph is a reiteration of paragraph 3 of the decision on Sudan's overdue obligations approved in May 1988.

In conclusion, I would like to express my authorities' deep sympathy and support for the Sudanese Government and people in the present tragic circumstances.

Mr. Warner made the following statement:

First and foremost, my authorities extend their sincere sympathy to the people of Sudan as they try to cope with the damage and losses suffered in the recent floods. It is unfortunate, in light of this adversity, that the Board must concurrently address one of its most complex cases of overdue obligations. Yet the timing of this discussion offers an opportunity to reaffirm the importance that the Fund attaches to the full and timely implementation of the adjustment measures outlined by Mr. El Kogali.

At the time of the Board's last review of Sudan's overdue obligations (EBM/88/86 and EBM/88/87, 5/27/88), Directors were hopeful that discussions between the Fund and Bank staffs and the Sudanese authorities would lead to agreement on a strong and comprehensive adjustment program for the fiscal year beginning July 1. While it appears that there was broad agreement on many elements of such a program, it is deeply regrettable that the authorities were not able to agree on exchange rate reforms--and a few related measures--necessary to complete a program that would justify exceptional support from the international financial community.

In the weeks ahead, it will be necessary to give immediate attention to the task of recovering from these floods. In this regard, I understand that the World Bank will be involved in assisting in the recovery effort, and I would appreciate receiving any information on the Bank's plans. If the Bank is sending a mission to assess the flood damage, it may be appropriate for the Fund staff to join this mission in order to assess the implications of the recovery effort for Sudan's program for 1988/89, and to help the authorities find ways to return quickly to the adjustment path outlined in the draft policy framework paper prepared by the staffs of the Fund and the Bank earlier this year. Further progress in implementing the macroeconomic and structural reforms contained in the draft policy framework paper are required to establish a firm foundation for future economic progress. Indeed, the damage caused by the recent flooding heightens the need for urgent action and may even create an opportunity for the authorities to obtain additional internal and external support for the implementation of difficult adjustment measures.

To ensure that time is not lost in responding to the authorities' efforts, I would like to repeat our earlier suggestion that a support group be established for Sudan. The recent disaster makes such a step more urgent than ever. Furthermore, the Fund must continue to work on a financing framework for Sudan to ensure that donors and creditors will be in a position to provide the support needed once Sudan has established a satisfactory track record. The financing arrangements that will be needed are complex and perhaps unprecedented. At this point, it is impossible to know what is feasible, and workable arrangements will be arrived at only after giving all participants a chance to react to hypothetical scenarios that show each participant how its contribution relates to those of others. Launching this process would not commit any participant to provide financing in any amount or form. The longer the Fund waits to launch the process, however, the more it undermines the ability of bilateral creditors and donors to support a strong adjustment program for Sudan.

As Sudan works to recover from the flood and to implement needed economic reforms, it is hoped that the authorities will be able to find ways to demonstrate more convincingly their interest in meeting their financial obligations to the Fund. The need for such a demonstration is highlighted by the fact that Sudan paid only $8 million to the Fund while paying $19 million in debt service payments to other creditors in the first 11 months of the last fiscal year. The $35 million paid to bilateral official creditors also appears particularly large in view of the possibility of rescheduling those obligations following the adoption of an acceptable economic program.

In order to reflect better the Fund's concern about Sudan's payment record, I would like to propose amending the second sentence of paragraph 2 of the proposed decision to read: "The Fund notes that only modest payments have been received from Sudan in the past year, while substantial payments were made to other creditors."

I would also suggest amending the second sentence of paragraph 3 to read as follows: "The Fund hopes that, following immediate relief efforts, the authorities will intensify their efforts to address the structural imbalances of the economy through sustained implementation of a comprehensive adjustment program, which is a necessary element of the intensified collaborative approach to the resolution of the problem of Sudan's arrears to the Fund."

Mr. Sengupta made the following statement:

I shall make only three points on Sudan because I agree with the general tenor of the discussion. First, I share fully with Mr. El Kogali and other members of the Board the concern about the victims of the recent natural disaster in Sudan and hope that the international community will respond promptly and in an adequate manner to Sudan's call for assistance. It is a pity that the Fund cannot participate in the emergency effort because of Sudan's overdue obligations. This situation highlights the need for a country to remain current with the Fund, because it is precisely at a time of crisis that the Fund could be of great assistance in accordance with its purposes as set out in its Articles of Agreement. I hope that the problem of Sudan's arrears will be resolved quickly to allow the Fund to play its full role. In the meantime, even though the Fund is not able to provide financial support, I hope it will be ready to provide all other assistance to help the authorities to implement appropriate policies.

Second, the decision should include an explicit reference, as did the previous decision, to the Fund's hope that donors and creditors will respond with adequate support if Sudan engages in appropriate adjustment efforts. On this point I agree with Mr. Al-Assaf's suggested modification of the decision. The last sentence of Mr. Al-Assaf's amendment, namely, "The Fund hopes that the adjustment efforts on the part of Sudan will encourage a timely and constructive response from Sudan's donors and creditors, and all other countries that can help Sudan, to the authorities for expanded external financial assistance," can also accommodate the concerns expressed by Mr. Warner.

I would like to take this opportunity to pay special tribute to the Saudi Arabian authorities for the extremely helpful role they are playing with respect to Sudan. The Saudi Arabian chair, and in particular, Mr. Nimatallah, has been making a sincere effort to help formulate a proper Fund approach to countries which are in arrears, and the Saudi Arabian authorities have demonstrated their readiness to help those countries which are doing their best to implement properly formulated adjustment policies. It is praiseworthy that in spite of its own current difficulties, Saudi Arabia is playing such a principled and helpful role in Sudan.

Third, I understand that the main obstacle to agreement on a comprehensive adjustment program for Sudan is the question of exchange rate depreciation. Here, I have sympathy for the staff's position. The exchange rate should reflect the fundamentals of an economy, and an attempt should be made to flexibly adjust the exchange rate so that the balance of payments situation can move toward an equilibrium without explicit or implicit subsidization. It appears that the authorities do not basically disagree with the staff's approach; however, they want to move slowly toward exchange rate adjustment and, in the meantime, use comprehensive budgetary subsidies to increase the effective exchange rate for exports. Thus, the disagreement is one of principle: the authorities accept the need for raising the effective exchange rate on exports but are opposed to devaluation because repeated devaluations in the past have not been effective. If the budget cannot bear the burden of subsidization, the staff should be able to demonstrate that fact to the authorities. Similarly, if the supply response in Sudan to exchange rate changes is slow, the staff should take that into consideration in recommending the timing and magnitude of the devaluation. It is fairly well established that the expenditure-switching impact of devaluation takes time to work out, and the elasticities are greatly dependent upon the structural features of the economy. The methods that have been suggested by the authorities are not the only ones available, and I am sure that the staff could suggest alternative methods of exchange rate adjustment that would be both feasible and optimal, given the state of the Sudanese economy. This problem of exchange rate depreciation should not be allowed to become a stumbling block in reaching an agreement regarding the adjustment program; the authorities and the staff should discuss this subject further, with the staff adopting a little more sympathetic attitude toward the problems of implementation facing the authorities, which will ultimately determine the feasibility of any policy recommendation. The authorities may also like to review their position, since an appropriate exchange rate policy will be beneficial to Sudan's balance of payments position and will permit the finalization of the adjustment program. If the authorities were confident that their efforts to adopt such a program would be responded to immediately and adequately by donors and creditors with sufficient financial support not only to solve the arrears problem with the Fund but also to set Sudan on a path of sustained development, I am sure the authorities' commitment to the collaborative approach will increase. In that spirit, I support the proposed decisions, with the amendments suggested earlier.

The Chairman remarked that Mr. Sengupta's views on the ease of reaching agreement on an appropriate exchange rate for Sudan were perhaps somewhat too optimistic. While, in general, there now appeared to be a growing consensus between the staff and member countries on certain key elements of adjustment programs--for example, fiscal and interest rate policies and structural measures--major difficulties and real stumbling blocks often remained to be overcome in reaching agreement on exchange rate policies. It was difficult, for example, to convince some countries that the exchange rate should reflect economic fundamentals. Nevertheless, the Fund must continue to strive to find proper solutions in that key area of policy instrumentation in support of adjustment.

Mr. Othman stated that for a number of years, the task of economic management in Sudan had been rendered exceedingly difficult by a host of noneconomic factors, including severe drought conditions, the unrest in the South, and a large presence of refugees from neighboring countries. The adverse impact of those factors on the performance of the economy had recently been aggravated by severe flooding which, in addition to causing substantial human suffering, had led to considerable damage to the country's infrastructure. It was understandable that the authorities' attention would focus on immediate relief efforts in the wake of the recent devastating calamity. It was encouraging that once the relief needs were attended to, the authorities intended to reinforce their adjustment and reform measures aimed at placing Sudan's economy on a viable course and normalizing its relations with the Fund.

There was little doubt that the resolution of the serious financial and economic problems facing Sudan required the sustained implementation of a comprehensive growth-oriented adjustment program, Mr. Othman considered. There was also agreement that such a program should include strong financial measures, as well as structural reforms to rehabilitate the country's infrastructure and eventually to unlock the growth potential of the economy. In that regard, he was encouraged by the steps taken by the National Unity Government to build on the progress achieved under the Program of Action. He was also encouraged by the progress that had been achieved thus far in the negotiations between the staff and the authorities on the draft policy framework paper, and he hoped that a complete understanding on policies could be reached in the near future. In that regard, he welcomed the authorities' intention to resume the process of reaching understandings on policies once circumstances permitted in order to have in place a necessary element for the development of an intensified collaborative approach to the resolution of Sudan's arrears to the Fund; namely, a comprehensive adjustment program. As pointed out by the authorities, a more favorable environment for reform should be obtained once the immediate consequences of the floods had been dealt with.

Equally necessary to the resolution of Sudan's arrears to the Fund was an exceptional effort on the part of creditors, donors, and all countries which could help Sudan, Mr. Othman commented. The Fund's role in that exceptional effort was central, as it was difficult to think in the present circumstances of another party which had a better chance of putting together the necessary elements of a viable solution. An exceptional effort on the part of all concerned was needed, but it should be recognized that the stakes were high. The success of an intensified collaborative approach in the case of Sudan would demonstrate that even the most difficult case of overdue financial obligations to the Fund could be overcome if the member in arrears was willing to cooperate in finding a solution and if others were likewise willing to cooperate in finding such a solution. He supported the proposed decision, as amended by Mr. Al-Assaf.

Mr. Cassell remarked that he joined other Directors in expressing great sympathy to the Sudanese people for the recent disaster. There could be little doubt that whatever the international community did, the recent flood was bound to add a further burden to an already difficult situation.

The disaster had increased the need for the urgent implementation of a comprehensive program of adjustment, and it would be no service to anyone concerned if the disaster became an excuse for dodging the issues at hand, Mr. Cassell considered. That was said with some reservation, because Sudan's situation was extremely tragic. The indications that adjustment measures would be delayed was both disappointing and worrying in that context, because, in a sense, adjustment could never really be postponed: the only choice was an orderly adjustment or an enforced and, very often, disorderly one. Of course, significant additional donor assistance, which was now even more vital to Sudan's recovery, could only be made available in tandem with reform efforts that promised clear progress. The prospect of Fund assistance, which would have been particularly helpful in the present circumstances, had receded even further with the authorities' deferral of efforts to clear arrears.

In view of the increased urgency of adjustment, discussions should quickly be resumed with the authorities, Mr. Cassell continued. Every effort should be made to clear the impasse over exchange rate adjustment. On Mr. Sengupta's point regarding the heart of the disagreement--namely, the question of devaluation--he tended to agree with the staff; the authorities' alternative to an outright devaluation did not seem to be appropriate. There also seemed to be some difference of opinion on the budgetary impact of that alternative, which would be financed by an import levy. He strongly agreed with the staff's conclusion that an export subsidy would not adequately address the fundamental issues. Sudan's previous unhappy experience with the effects of devaluation did not so much call into question the value of exchange rate adjustment as it illustrated the dangers of devaluing without addressing at the same time fiscal and other distortions in the economy. He also wondered whether the pervasiveness of a parallel economy, which was encouraged by inappropriate official exchange rates, was in fact imposing the costs of devaluation on the Sudanese economy, without providing the benefits of an outright change in the exchange rate. He had some hope that agreement could be reached because the present economic authorities in Sudan had displayed commendable realism and high standards of competence, and deserved the Fund's support.

Regarding the process that had been initiated to restore Sudan's economic fortunes and clear its arrears to the Fund, he shared the views expressed by Mr. Warner, Mr. Cassell commented. He could support the draft decision, as amended by Mr. Warner.

Mr. McCormack stated that he endorsed the proposed decision. He wished to convey the sympathy of his authorities to the people of Sudan for the damage and destruction caused by the recent torrential rains. It was understandable that in the present circumstances, the Sudanese authorities were not able to focus fully on economic policy matters and on continuing discussions with the staff.

However, even under those difficult circumstances, there was a high price to be paid for delaying the implementation of an appropriate policy framework and for further deferring adjustment, Mr. McCormack cautioned.

That fact was in part evidenced by the problems facing the authorities in effectively distributing aid to flood victims, which further emphasized the need to undertake major economic reforms and restructuring at the first possible opportunity.

The staff and Mr. El Kogali had both indicated that there was considerable agreement on the required adjustment strategy, Mr. McCormack noted. He hoped that on further reflection the authorities would agree that an appropriate exchange rate was an essential part of an overall package of reforms and that substitutes for exchange rate action placed too high a burden on public finances to be tenable over the medium term.

Once again, it was disappointing that Sudan had made only a very small payment to the Fund since the last review of its overdue obligations, Mr. McCormack commented. He hoped that there would be greater, more regular payments in the coming months as evidence of Sudan's commitment to resolve its arrears problem.

Mr. Adachi remarked that he wished to convey to Mr. El Kogali the deepest sympathy of his authorities for the people of Sudan, who were suffering personal loss and physical hardship because of the recent floods. He fully agreed with Mr. Sengupta that the present emergency highlighted the need for every member to remain current with the Fund.

His authorities were disappointed by the unfortunate outcome of discussions between the Sudanese authorities and the Fund staff, Mr. Adachi added. Once again, he wished to urge the authorities to undertake a comprehensive adjustment program, including exchange rate reform, following the immediate relief measures.

Concerning the proposed decision, he hesitated to include a reference to "the intensified collaborative approach" before the Board had finalized the content of that approach, Mr. Adachi commented. Therefore, he supported the amendment proposed by Mr. Al-Assaf. Perhaps the Managing Director's letter to the Sudanese authorities could convey that the Board was still discussing the intensified collaborative approach.

Mrs. Ploix stated that her authorities wished to express their sympathy to the Sudanese Government during a critical period of deprivation and suffering for a large proportion of the country. She agreed with Mr. Cassell and Mr. McCormack that immediate efforts had to focus on emergency relief measures, and she hoped that the difficulties that the authorities were facing would not distract them from the need for strong and comprehensive adjustment, which was the sole means to solve the deep-seated problems of Sudan. In that regard, she welcomed the latest measures implemented by the authorities after the staff mission to Khartoum last June, which could be considered a first step toward the adjustment process.

To intensify those efforts, and in view of the recent difficult period when prices had risen further, she strongly urged the authorities to adopt the staff's proposal for a large outright adjustment on the exchange rate, Mrs. Ploix remarked.

With regard to the problem of arrears, she urged the authorities to make payments to the Fund from Sudan's own resources so as to demonstrate their commitment to discharge their obligations, Mrs. Ploix commented. She supported the proposed decisions, with the amendments suggested by Mr. Sengupta.

Mr. Salehkhou remarked that the staff paper, Mr. El Kogali's statement, and the telex received from the Sudanese authorities underlined the gravity of the present situation and the extent of the damage resulting from the recent floods and the invasion by desert locusts. He joined other Directors in expressing the deep sympathy of his authorities to the Sudanese Government and victims of the disaster, and he also appreciated the Fund's expression of sympathy as reflected in the proposed decision. However, in his view, the Fund could and should do more than extend mere expressions of sympathy. The Fund's emergency facility had seldom been used; he could not think of a more deserving candidate for the use of that facility than Sudan.

Approval of an emergency facility for Sudan would encourage the authorities to redouble their efforts, improve the Fund's image, and promote its cooperative character, Mr. Salehkhou considered. It would also encourage the international financial community to become more actively involved in supporting the authorities' adjustment efforts and help catalyze further financing by international creditors and donors. The emergency character of the facility should fully justify its exceptional use even by members with overdue obligations. Such use by Sudan would also complement the World Bank's efforts in this direction. He could support the draft decision, as amended by Mr. Al-Assaf, Mr. Salehkhou commented.

Mr. Goos said that he wished to associate himself with Directors' expressions of sympathy and regret with regard to the recent flood disaster. The disaster had underlined the urgency of a comprehensive economic adjustment effort. He was therefore somewhat concerned about the authorities' view that in the circumstances, they should postpone structural and macroeconomic adjustment and concentrate on immediate reconstruction, even though that view was understandable.

The progress that had been achieved in the negotiations between the staff and the authorities was extremely encouraging, but it would be advisable to come to an early conclusion on the remaining issues, particularly, the exchange rate, Mr. Goos considered. In his view, the approach proposed by the staff was the most appropriate one. With regard to the proposed decision, he could go along with Mr. Sengupta's suggestion to add the last sentence proposed by Mr. Al-Assaf, and he could also support the amendment of the third paragraph as proposed by Mr. Warner.

Mr. Ismael remarked that he was in agreement with the general tenor of the Board's discussion. He regretted the damage caused by the recent heavy flooding in Sudan, which had worsened the already weak performance of the economy during 1987/88, and had made the authorities' efforts to address Sudan's overdue obligations to the Fund more difficult. Following immediate relief efforts, the authorities could be expected to take appropriate steps toward restoring the economy with a medium-term perspective.

It was gratifying to note that an understanding had recently been reached between the authorities and the staff on some major policy areas that could form the basis for an appropriate comprehensive adjustment program, Mr. Ismael continued. He hoped that an understanding could also be reached on other key areas such as exchange rate policy and associated policies relating to administered prices and the budget. In that regard, Indonesia's experience suggested that if a devaluation was not accompanied by appropriate, consistent structural reforms within the framework of a comprehensive program, it would lead to another round of devaluations. He therefore believed that the adoption and persistent implementation of such a program would facilitate the provision of increased external assistance to Sudan, which would contribute to the resolution of its problem of arrears to the Fund. He supported the proposed decision, with paragraph 3 amended as suggested by Mr. Al-Assaf and Mr. Warner.

Mr. Dai said that he joined other Directors in expressing his deep sympathy for the Sudanese people's suffering owing to the recent unprecedented floods. That national calamity underlined the need for an accelerated implementation of Sudan's adjustment program, but, at the same time, it would also cause great difficulties for the implementation of that program. It was difficult to assess the impact of the disaster on the program. However, it was likely that fiscal expenditure on relief efforts would need to be increased greatly while revenues would be seriously affected. The shortage of supplies owing to the floods could well make price inflation even worse. In sum, the impact of the natural disaster on the adjustment program should be properly assessed so as to ascertain whether modifications were needed.

It was unfortunate that the Fund was not in a position to extend financial assistance to a member in urgent need of help, Mr. Dai observed. In view of Sudan's exceptional circumstances and its ineligibility to use the Fund's resources, he wondered in what other ways the Fund could render assistance.

The staff representative from the Legal Department explained that in the late 1940s, rules had been adopted to deal with cases where a member which was ineligible to use the Fund's general resources wished to make a purchase from the Fund. Article V, Section 4 of the Articles authorized the Board to set aside the legal effects of the ineligibility of a member, subject to satisfactory assurances from the member that the Fund's resources would be safeguarded. Furthermore, Rule K-4 of the Fund's

Rules and Regulations, which was adopted in 1946 and most recently amended in 1978, set out the following procedure concerning the use of the Fund's resources by ineligible members:

> "When any member that is ineligible to use the general resources of the Fund, or whose use of the general resources has been limited according to Rule K-2 above, requests the Executive Board to permit the resumption of the use of the general resources with or without special limitations and the Executive Board decides not to permit such resumption, a written report shall be presented to the member stating what further action is required before such resumption will be permitted."

Therefore, the Fund's Articles and Rule K-4 of its Rules and Regulations presented no legal obstacle at that level to a member's use of the Fund's general resources under the decision on the emergency facility, the staff representative from the Legal Department explained. The obstacle arose at the policy level: the Fund's policy on arrears to the Fund, which was adopted by a majority of votes cast by the Executive Board at EBM/85/26 (2/20/85), stated that if a member had an overdue financial obligation to the Fund, the Fund would not negotiate or approve either a stand-by or extended arrangement for the member, or the use of the Fund's general resources outside an arrangement, for example, in the first credit tranche, under the emergency decision, or under the special facilities. Since a purchase under the emergency procedures would be a drawing from the General Resources Account, it would not be possible for Sudan to draw under the emergency facility, under the existing decisions of the Board.

The Chairman remarked that in view of the present circumstances of Sudan--whether the very fragile financial situation or the effects of the recent natural disaster--the support of the international community should take the form of grants rather than of new loans. The amendment to the decision proposed by Mr. Al-Assaf rightly urged the international community to provide such grants to support Sudan's efforts at the present juncture.

The staff representative from the Middle Eastern Department confirmed that the World Bank was planning to field a mission to Sudan some time in September or early October to assess the damage owing to the recent floods and to work out a strategy for rehabilitating the country's infrastructure and mobilizing the resources needed. The Bank would not, however, be engaged in emergency relief operations. It was proposed that the Fund staff should participate in the mission with a view to evaluating the economic costs of the recovery effort.

The rationale for the staff's views on the exchange rate question had been eloquently set forth by Mr. Cassell, the staff representative from the Middle Eastern Department commented. He would add that the staff had already explained to the authorities in great detail how their alternative approach would lead to the same consequences in terms of budgetary costs as would an outright exchange rate adjustment. Owing to Sudan's narrow tax base and weak budgetary position, the authorities would have to accept an increase in prices under their alternative approach in order to generate the revenues needed to finance the export subsidy. In fact, because prices had been controlled for a long time at an artificially low exchange rate, an increase in prices was inevitable under either alternative. The staff had also proposed some schemes for the implementation of an exchange rate adjustment with lagged price adjustments, but that could not be pursued owing to the differences on the fundamental issues of the need and extent of exchange rate adjustment.

Mr. El Kogali remarked that, in general, the Fund's position on exchange rate reform was becoming a stumbling block for adjustment and reform in his part of the world. His authorities viewed the exchange rate as an element of national sovereignty rather than as a monetary tool of adjustment. Consequently, it would take time to convince them to move toward a more liberal and realistic view regarding the exchange rate. More specifically, the Sudanese authorities considered that the 40 percent devaluation in October 1988 had been ineffective, and they were genuinely seeking to understand, with the help of the Fund's staff, why the Fund's exchange rate prescriptions were not working in their part of the world. The Prime Minister had asked for information on effective devaluations in neighboring countries as well as on the behavior of inflation in Africa, Asia, and Latin America.

The Managing Director had stressed in several addresses that there were no ready-made programs in the cupboards of the Fund, Mr. El Kogali observed. But if a member's authorities proposed a program and reached agreement with the staff on 99 percent of that program, and the Fund's support was withheld because of the failure to agree on the remaining 1 percent, the authorities could not help but ask whether the program was their own or the Fund's. Moreover, his Sudanese authorities were committed to their adjustment program. The problem was how to tackle the immediate task facing them. In that connection, it should be recognized that when the most needy members were not eligible for the Fund's assistance in a time of crisis, the image of the institution suffered; it should not be surprising if people in those member countries came to feel that if the Fund would not come to help in a crisis, it should not come to give advice.

The Chairman remarked that in view of Sudan's situation, the more the international community could contribute through concessional assistance, through relief assistance, and through grants, the better. The right remedy was not further credit, but further grants. For that reason, the Fund would invite all possible donors to assist Sudan. But the Fund was not a donor and could not engage in activities, such as disaster relief, for which it had not been created. Certainly, the fact that the Fund could not be of immediate assistance to Sudan in the circumstances should not be perceived as an unfriendly attitude on its part.

On the negotiation of the program, the remaining issue on which the staff and the authorities could not reach agreement--namely, the exchange rate--was the central tool of adjustment, the Chairman observed. The exchange rate change indeed would have powerful effects in supporting a restoration of economic growth and in strengthening the external position. For that reason, there was no possibility for compromise in that key area of policy instrumentation. Moreover, it should be emphasized that there was nothing more counterproductive than a small, insufficient devaluation, whereby the member experienced only its adverse effects without reaping any benefits and, at the same time, found it increasingly difficult politically to devaluate further at short intervals in subsequent periods. A one-time devaluation to bring the exchange rate to its appropriate level was much preferable.

It should also be emphasized that the program to be agreed with the Fund had to be Sudan's program, the Chairman commented. The Fund did not intend to impose a program on a country or to act as a scapegoat for the discontent of its population. Consequently, the program had to be one that the authorities would be committed to and proud to implement. He was certain that agreement could be reached on such a program. He also looked forward to seeing the support group for Sudan set up expeditiously in order to take the appropriate bridging decision so that, at the proper time, the Fund could play its role in a collaborative strategy in support of Sudan's adjustment effort.

With regard to the proposed decision, Mr. Warner had suggested amending the second sentence of paragraph 2 to read: "The Fund notes that only modest payments have been received from Sudan in the past year while substantial payments were made to other creditors," the Chairman recalled. Mr. Cassell and Mr. McCormack had also supported that amendment.

Mr. Sengupta observed that according to the staff report, Sudan had made payments of $8 million to the Fund, $18 million to the World Bank, and $24 million to three Arab national funds, and that "these latter payments were made as part of an arrangement that resulted in de facto refinancing." He was concerned that the proposed amendment might raise questions regarding the implications of Sudan's payments to the Fund for the country's debt situation in the light of the fact that other creditors were refinancing Sudan's debt or providing other benefits. In the circumstances, it was sufficient to urge the authorities to give the highest priority to arrears to the Fund. He therefore preferred paragraph 2 as it was.

Mr. Fogelholm said that he supported the wording proposed by Mr. Warner because it had been used in other similar cases and it reflected the Fund's concern that it was not being accorded the highest priority as a creditor.

Mr. El Kogali commented that in repaying its creditors, Sudan had not acted in an arbitrary manner. Sudan's arrears were, in fact, becoming a problem in the conscience of the nation, and everyone wanted to eliminate that problem. But sometimes debt repayment also involved questions of survival or maintaining a country's reputation as a good customer. As his authorities had explained in the past, some repayments represented a deposit to get essential commodities or aid. On the basis of that explanation, the Board had, in the past, deleted a similar expression of regret. In any event, the implication of the proposed language was that Sudan was not giving priority to its obligations to the Fund: that was not the case.

Mr. Posthumus remarked that Mr. Sengupta's point was well taken, but he continued to support Mr. Warner's proposal because recent payments to the Fund, compared with those to other creditors, indicated that insufficient priority was being given to Sudan's overdue obligations to the Fund.

Mr. Goos said that he also supported the amendment proposed by Mr. Warner. He could see no other way to try to reinforce the Fund's preferred creditor status, even though it raised difficult questions, particularly in the situation of Sudan. But as a general policy, it was necessary to insist on being repaid on a priority basis.

Mr. Salehkhou observed that Mr. Sengupta's point implied that the proposed amendment was not factually correct insofar as repayments to other creditors also involved a rescheduling or refinancing. Also, the issue of according the Fund the highest priority was already incorporated in the draft decision; therefore paragraph 2 should remain as was.

The Chairman remarked that the proposed amendment to paragraph 2 was factually correct: the Fund had received only modest payments while substantial payments had been made to other creditors, even though those other payments involved refinancing elements. The Fund could not, of course, refinance its claims, but if it had been repaid, it would be in a position to resume financing for Sudan.

Mr. Sengupta said that he fully shared the Chairman's views, but he also wished to avoid the implications of an explicit reference to the payments made to other creditors. He would prefer instead to add "as a preferred creditor" to the last sentence of paragraph 2, which would read: "The Fund urges the authorities to give the matters of settlement of Sudan's arrears to the Fund the highest priority as a preferred creditor."

Mr. Fogelholm recalled that during a previous discussion, the Legal Department had indicated that it was unclear what "preferred creditor" meant, and for that reason, wording similar to that used in paragraph 2 had been agreed. The formulation had been used in discussions on overdue obligations with respect to Peru, Somalia, and others, where a similar situation had arisen. He therefore preferred to keep the final sentence of paragraph 2 as was.

The staff representative from the Legal Department confirmed Mr. Fogelholm's recollection: in previous discussions, the Board had decided on the formulation, "to give ... the Fund the highest priority." Although under international law the Fund did not have a particular status as a "preferred creditor," it could call on a member to afford it the highest priority in the case of payments to creditors.

Mr. Cassell remarked that the addition of the words "the preferred creditor" was not helpful with respect to the question at hand. Mr. Warner's proposal was a factual statement, and was a better way to record what had actually happened.

Mr. Warner remarked that the proposed amendment reflected his authorities' concern about establishing clearly the course of action that the Fund intended to pursue with respect to overdue obligations so as to discourage members in arrears from making selective judgments regarding the repayment of their creditors. Moreover, if Sudan had been current with the Fund, the Fund would have been able to respond to its current emergency. That fact underlined the need to establish the Fund as the preferred creditor.

The Chairman observed that a majority of Directors supported Mr. Warner's amendment to paragraph 2. He was sure that Mr. El Kogali would explain fully to his authorities the concerns underlying the amendment.

Mr. Al-Assaf commented that if a factual statement was being sought, the words "substantial payment to others" should be deleted because if those payments were broken down, it was likely that the payment to the Fund would be greater than any other single payment. It was not fair to compare the payment of one institution to the gross amount paid others or to characterize the payment as only a modest amount.

The Chairman suggested that actual figures could be used instead of the qualifying words "modest" and "substantial."

The Executive Directors accepted the proposed amendment to paragraph 2, including the Chairman's suggestion, without further discussion.

The Chairman noted that several Executive Directors had agreed, without reservation, to the amendment of the first sentence of paragraph 3 as proposed by Mr. Al-Assaf. The sentence would read: "The Fund notes with regret the impact on the Sudanese economy and people of the recent floods in Sudan, expresses its sympathy for the victims of this natural disaster, and calls upon international donors to intensify their emergency and relief assistance." In view of Directors' comments, he suggested that the word "deep" should be added before "regret."

Mr. Goos remarked that while he had great sympathy for the difficult situation in Sudan, he wondered whether the Fund was in a position to call upon the international community to intensify its emergency and relief assistance. He also wondered what was the extent of the assistance to Sudan.

The staff representative from the Middle Eastern Department explained that the staff had no firsthand information on the flow of assistance to Sudan. According to press reports, 90 percent of the aid received thus far had been provided by Saudi Arabia and other Arab countries. Although there were initially some snags in the distribution of relief assistance, the latest information indicated that the aid was flowing to the appropriate channels.

Mr. El Kogali observed that there was growing controversy between the European press and the Sudanese authorities over the misinformation being telexed abroad regarding Sudan's capacity to absorb aid. People were dying of hunger; there was no clean water; everything was destroyed--the whole capital had been submerged; and four million people were homeless. In that situation, it was really not acceptable to speak of Sudan's capacity to utilize aid flows. The Government had put all its human resources into the relief effort; the army, the prison force, and the police force were working together with numerous relief organizations to get assistance to those most in need of it. The main problem was one of logistics. For example, there were not enough trucks to transport goods from the airport to the flooded areas. The answer to that problem was even more help from the outside world.

Mr. Al-Assaf noted that the call upon others reflected similar language adopted a few days earlier in the decision on Haiti's overdue obligations.

The Chairman recalled that Mr. Adachi had objected to the reference in the second sentence of paragraph 3 to "the development of an intensified collaborative approach" because the discussion of that approach had not been completed. Also, Mr. Warner had proposed that the same clause should be amended to read: "a comprehensive adjustment program, which is a necessary element of the intensified collaborative approach to the resolution of the problem of Sudan's arrears to the Fund."

Mr. Warner remarked that, in fact, the Fund had been engaged in an intensive collaborative effort with the Sudanese authorities; consequently, any reference to that approach did not involve a question of interpretation.

Mr. Adachi commented that for the record, he was concerned about the inconsistency between the proposed decision on Sudan and that adopted for Viet Nam. He wished to make it clear that the phrase in question did not refer to the intensified cooperative approach proposed by the staff or by management.

The Executive Directors accepted the second sentence of paragraph 3, as amended. They also accepted without discussion, Mr. Al-Assaf's proposal for the final sentence of paragraph 3.

Mr. El Kogali remarked that he wondered whether the three-month review period referred to in paragraph 4 of the proposed decision allowed sufficient time for the authorities and donors to address Sudan's immediate problems and work toward a solution to Sudan's overdue obligations.

The Chairman commented that from the perspective of the collaborative strategy, the three-month review period was preferable because it would permit an assessment of where the donors, Sudan, and the Fund actually stood at an early date.

Mr. Warner observed that a three-month review period would also give the Fund an opportunity to review the findings of the joint Bank-Fund mission to Sudan. At the same time, it would be able to focus on the support group prospects that he had discussed earlier. Those were the principal points of the rationale for the three-month review period. It was certainly not intended to put salt on a difficult wound.

Mr. El Kogali said that with that understanding, he could agree to a three-month review period.

The Executive Board then took the following decision:

1. The Fund has reviewed further the matter of Sudan's continuing failure to fulfill its financial obligations to the Fund in light of the facts and developments described in EBS/88/179 (8/23/88).

2. The Fund deeply regrets the continuing failure by Sudan to settle its arrears to the Fund, which are placing a financial burden upon other members and reducing Fund resources needed to help others. The Fund notes that payments equivalent to only SDR 6.3 million were received from Sudan in the period July 1987-May 1988, while payments estimated to be equivalent to SDR 145 million were made to other creditors. The Fund urges that the authorities give the matter of settlement of Sudan's arrears to the Fund the highest priority and take all necessary actions in this respect.

3. The Fund notes with deep regret the impact on the Sudanese economy and people of the recent floods in Sudan, expresses its sympathy for the victims of this natural disaster, and calls upon international donors to intensify their emergency and relief assistance. The Fund hopes that, following immediate relief efforts, the authorities will intensify their efforts to address the macroeconomic and structural imbalances of the economy through sustained implementation of a comprehensive adjustment program, which is a necessary element for the development of a collaborative approach to the resolution of the problem of Sudan's arrears to the Fund. The Fund hopes that the adjustment efforts on the part of Sudan will encourage a timely and constructive response from Sudan's donors and creditors, and all other countries that can help Sudan, to the authorities' request for expanded external financial assistance.

4. The Fund is discussing its policies on arrears to the Fund. It will review the matter of Sudan's overdue financial obligations to the Fund again and consider further action within three months from the date of this decision in light of those discussions and of actions taken by Sudan in the meantime to settle its arrears to the Fund, and to formulate and begin implementing a comprehensive economic adjustment program.

Decision No. 8964-(88/129), adopted
August 26, 1988

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/88/129 (8/26/88) and EBM/88/130 (8/29/88).

3. BHUTAN - INTERIM ARTICLE IV CONSULTATION DISCUSSIONS - DECISION CONCLUDING 1988 ARTICLE XIV CONSULTATION

1. The Fund takes this decision in concluding the 1988 Article XIV consultation with Bhutan, in the light of the 1988 staff report on the interim Article IV consultation discussions with Bhutan conducted under Decision No. 5392-(77/63), adopted April 29, 1977, as amended (Surveillance over Exchange Rate Policies).

2. The restrictions on the making of payments and transfers for current international transactions described in SM/88/170 are maintained by Bhutan in accordance with Article XIV, Section 2. The Fund encourages the authorities to administer these restrictions in a liberal manner. (SM/88/170, 8/8/88; and Sup. 1, 8/16/88)

Decision No. 8965-(88/129), adopted
August 26, 1988

APPROVED: March 21, 1989

JOSEPH W. LANG, JR.
Acting Secretary