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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 88/162

3:15 p.m., November 2, 1988

M. Camdessus, Chairman

Executive Directors	Alternate Executive Directors
	C. Enoch
	Shao Z., Temporary
	A. Rieffel, Temporary
	J. Prader
E. T. El Kogali	
	M. Hepp, Temporary
	R. Marino, Temporary
	M. B. Chatah, Temporary
	O. Kabbaj
	B. Goos
J. E. Ismael	E. Kiriwat
	L. E. N. Fernando
	L. M. Piantini, Temporary
	C. L. Haynes, Temporary
	K. Kpetigo, Temporary
	I. A. Al-Assaf
	M. Fogelholm
	G. Serre, Temporary
	G. P. J. Hogeweg
	C. Y. Legg, Temporary
	N. Adachi, Temporary
	S. Appetiti, Temporary

L. Van Houtven, Secretary and Counsellor
L. Collier, Assistant

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2. Federated States of Micronesia - Technical Assistance . . . . Page 9

Also Present

IBRD: R. Fennell, Africa Regional Office. African Department: E. L. Bornemann, Deputy Director; N. Abu-zobaa, D. J. Donovan, M. T. Hadjimichael, J. Kakoza, P. J. P. Szymczak. Exchange and Trade Relations Department: A. Basu, E. Brau, G. R. Kincaid, H. J. G. Trines. Fiscal Affairs Department: B. Nijathaworn. Legal Department: A. O. Liuksila, J. K. Oh. Treasurer's Department: T. Leddy, Deputy Treasurer; D. Berthet, J. E. Blalock, P. J. Bradley, P. S. Ross. Advisor to the Managing Director: A. K. Sengupta. Personal Assistant to the Managing Director: H. G. O. Simpson. Advisors to Executive Directors: P. D. Péroz, M. Pétursson, R. Wenzel. Assistants to Executive Directors: J. Heywood, J. M. Jones, J.-P. Schoder.

1. LIBERIA - OVERDUE FINANCIAL OBLIGATIONS - REVIEW FOLLOWING DECLARATION OF INELIGIBILITY

The Executive Directors continued from the previous meeting (EBM/88/161, 11/2/88) their consideration of a staff paper (EBS/88/224, 10/28/88) on the further review of Liberia's overdue financial obligations to the Fund following the declaration of Liberia's ineligibility to use the general resources of the Fund on January 24, 1986.

Mr. Hogeweg said that he agreed with the thrust of the comments of the speakers at the previous meeting. The need for Liberia to take appropriate comprehensive policy measures had been expressed mainly in the context of arrears to the Fund, which was appropriate. But it was also necessary to stress that it was in Liberia's own long-term interest to implement the correct policy package and to pay its arrears to the Fund, thereby normalizing relations with creditors.

Moreover, he endorsed the statement by Mr. Goos regarding the fact that the willingness of the authorities to embark upon an adjustment program would be a crucial trigger for the intensified collaborative approach, Mr. Hogeweg commented. If appropriate measures were not taken by Liberia, the Board would have to consider other actions endorsed by the Interim Committee.

Mr. Serre noted that his chair was deeply disappointed that the authorities' intention, expressed on various occasions, to make regular and significant payments to the Fund had not been fulfilled, although payments to other creditors had been made. Such discrimination was reprehensible considering the preferred creditor status of the Fund. Moreover, he reminded the authorities that the continuing failure to settle Liberia's arrears placed a financial burden upon members and reduced Fund resources needed to help others. Therefore, he strongly urged the authorities to resume the normal service of debt to increase Liberia's credibility among the international financial community.

He could only express deep concern about the further deterioration of Liberia's economic and financial situation, as described by the staff, Mr. Serre observed. Real GDP was estimated to have declined, inflation had accelerated, and financial savings had decreased. In addition, distortions in exchange rate, domestic pricing, and interest rate policies had caused misallocations of resources and had discouraged productive investments. Public finances had not been sufficiently constrained to restore domestic and external confidence.

Despite important external assistance, the authorities had not made significant progress toward achieving a decisive turnaround in the economic and financial performance, Mr. Serre remarked. In view of that situation, there was room for some skepticism regarding the possibility of Liberia's adopting a comprehensive economic recovery program in the near future.

Mr. Marino observed that economic developments in Liberia were viewed with great concern by his chair. The sharp drop in the prices of the country's two main export commodities over the past six years and a loose fiscal policy had contributed to Liberia's current precarious economic situation. In spite of recent efforts to strengthen public finances, the need to implement further corrective action persisted. A renewed effort to curb extrabudgetary expenditures seemed indispensable to ease the overall budgetary position. It was also very important that the authorities proceed promptly to reform the exchange rate system.

The recent payment made by Liberia to the Fund and the authorities' arrangement to ensure regular monthly good-faith payments were welcome developments, Mr. Marino commented. However, he regretted the Liberian authorities' failure to provide assurances regarding additional payments to the Fund. The highest priority should be given to settling arrears with the Fund, and he urged the authorities to cooperate with the Fund in finding a viable solution to that situation. He supported the draft decision as amended by Mr. Rieffel.

Mr. Legg made the following statement:

> I fully share the frustration expressed by all previous speakers at the failure of the Liberian authorities, despite repeated encouragement from this Board, to adopt a comprehensive program of economic performance which might then provide the basis on which to clear the arrears to the Fund and, of course, to other external creditors. I also endorse the comments made by Mr. Hogeweg regarding the importance of this to Liberia itself.
>
> It is clear that this case of arrears has reached the point where an easy or imminent solution is particularly difficult to envisage; the tragedy of such intractable cases is that the opportunity for a relatively painless and clean-cut solution was missed long ago by the authorities. It is a sad commentary that we have now reached the point where many Directors, quite understandably, feel it necessary to begin to talk about remedial actions, and it is a sad reflection on the authorities if this proves to be the only option they leave us with.
>
> First, I understand the importance that Mr. Rieffel and Mr. Enoch attach to the figure of US$100 million in usable foreign exchange resources quoted in the 1988 Article IV staff report. Nevertheless, I agree with Mr. Goos that the appropriate test for us must be the "willingness to cooperate" with the Fund. While this necessarily involves a qualitative judgment on the part of the Board, that is preferable to the dangers of trying to arrive at some mechanistic quantitative assessment of ability to pay, although I suspect that to date the Liberians would fail either test.

Second, it must be emphasized that this test of "willingness to cooperate" depends in part on evidence that the authorities are attaching the highest priority to repaying the Fund, not just a high priority or a treatment that is no worse than that afforded other creditors. This is my understanding of the principle of the Fund's preferred creditor status. It is in both the Fund's and the member's best interests for the authorities to clear arrears to the Fund at the earliest possible juncture even if this is at the temporary expense of other creditors. While welcome, token good-faith payments, even if they happen to be regular, fall a long way short of meeting this test.

Third, I agree with the comment made by Mr. Enoch that an early Board discussion on the modalities of implementing a collaborative approach to resolving the arrears problem is highly desirable. The merit of bringing forward the planned discussion, which is tentatively scheduled for late January 1989, is being considered by this chair in the context of the forthcoming discussion of the work program. Finally, I have no difficulties with the various proposed amendments to the draft decision.

Mr. Fogelholm said that he agreed with the sentiments expressed by other Directors. Developments in Liberia had been discouraging, and prospects were not promising. He went along with those speakers who had suggested that in the case of no further positive developments, the Board would be forced to start discussing remedial actions. He supported the proposals to amend the decision, notably those put forward by Mr. Rieffel and Mr. Enoch.

The staff representative from the African Department said that, as emphasized by some speakers, the determination of Liberia's ability to pay involved several judgmental elements; at present, the staff could only indicate some quantitative information that would be relevant in making such an assessment. Liberian exports had been valued at approximately L$400 million annually at the time the staff report for the 1988 Article IV consultation had been prepared, and the staff believed that the amount remained roughly unchanged, although exports might be slightly higher because of the recent sharp rise in the world price of rubber. At that time, the staff had estimated that approximately US$100 million of foreign exchange earnings was available to the authorities under the existing exchange rate system, representing essentially captive sources of foreign exchange earned by public enterprises and taxes paid in foreign exchange direct to the Government. Under a floating exchange rate system, that amount could be quite different, as the authorities could intervene on the exchange market to buy foreign exchange from commercial banks for official purposes. However, under present policies, the figure remained at about US$100 million. It was difficult to address the question of whether Liberia could, therefore, pay more to the Fund. Essentially, those resources were spent according to the authorities' priorities, which were influenced by economic, political, social, and other factors. It was not easy for the staff to dictate to the authorities what their priorities should be. However, the staff was of the clear view that the existing priorities could be reordered to provide the opportunity to make larger payments to the Fund without having a significant adverse effect on the growth prospects of the economy.

The effect of assistance provided by other creditors on Liberia's arrears problem was also a judgmental matter, the staff representative commented. However, the staff could provide some factual information with respect to inflows. Liberia was in arrears to most multilateral institutions, which therefore had provided no new assistance, with the exception of the UNDP. In the case of most official creditors, because Liberia's nonadherence to several Paris Club agreements in the past had led to the emergence of significant arrears, new disbursements had not taken place, although small amounts of technical assistance had been provided.

Regarding Liberia's major creditor--the United States--the position was somewhat different in that Liberia had made debt service payments to ensure that it remained broadly eligible for disbursements of new funds, the staff representative from the African Department commented. Continued U.S. bilateral assistance to Liberia was mainly in the form of commodity aid--notably rice, as well as some other goods--under the P.L. 480 program, which was an important part of the country's imports. Technical assistance provided under the U.S. Operational Experts (OPEX) project had been instrumental in illuminating the size of Liberia's budgetary problem and had been effective in ensuring that the, albeit strictly limited, revenue resources that actually were received by the Ministry of Finance were properly accounted for.

Mr. El Kogali said that he would convey to his authorities the interest expressed by Directors in the case of Liberia. He of course hoped that the situation would improve.

The Chairman said that in his communication to the authorities summarizing the discussion, he would try to convey in a positive manner the exceptional sense of urgency prevailing at the present stage of Liberia's overdue financial obligations. Directors had remarked on the need for the authorities to take credible action during the next three months to eliminate Liberia's long-standing arrears. Otherwise, the Executive Board, in applying the collaborative strategy, would necessarily have to turn to remedial actions.

The staff representative from the Legal Department said that with the suggested amendment by Mr. Enoch, the second sentence in paragraph 2, would read: "The Fund welcomes the recent payment by Liberia but notes with regret that Liberia has not fulfilled its expressed intention to make regular payments to the Fund while it has made substantial payments to other creditors." The third sentence in that paragraph would remain unchanged.

In paragraph 3, it had been agreed that the reference in the first sentence to welcoming the economic policy steps taken by Liberia would be deleted. The second sentence in that paragraph, as amended by Mr. Rieffel, would read: "In keeping with the guidance provided by the Interim Committee at its September 1988 meeting, the Fund expresses its continued readiness to assist Liberia in the formulation of such a program as one critical step in pursuing the intensified collaborative approach to the elimination of Liberia's arrears to the Fund."

Mr. Goos wondered whether the amended second sentence should not end after the word "program," without referring to the intensified collaborative approach. That approach, which was tantamount to the provision of international financial support, should be extended only to those countries in the process of making a serious effort to normalize relations with the Fund and other creditors. Unfortunately, in the present case, there were no apparent efforts in that direction.

The Chairman suggested that as Liberia was aware of the Interim Committee's discussions, it would be appropriate to refer to that approach which--while collaborative in nature--incorporated both rewards and disincentives.

Mr. Fogelholm concurred that the intensified collaborative approach contained both rewards and disincentives, allowing the parties on both sides to decide what further steps should be taken. He agreed with the language proposed by Mr. Rieffel.

Mr. Goos said that he was concerned that the proposed formulation might refer implicitly only to the reward aspect of the collaborative approach.

The Chairman pointed out that his communication to the authorities would reflect the Board's frequent references to remedial actions--the disincentive aspect of the collaborative strategy. Liberia would at best be embarking on a collaborative approach at a very late stage in its accumulation of arrears and following a lengthy period during which there had been no meaningful attempt at adjustment, and the application of the strategy would necessarily be different from that in the case of other members.

Mr. Hogeweg said that he had understood that the intensified collaborative approach referred mainly to rewards and not so much to disincentives.

The Chairman said that the Interim Committee had adopted an intensified collaborative strategy that was predicated on both aspects, hinging on the evolution of the attitude of the member. If the sentence as drafted was misleading, it should be revised to make it clear that positive actions by the member were expected in the next few months.

Mr. Rieffel said that in interpreting the Interim Committee's actions, he had discerned a three-part strategy, the second of which was intensified collaboration and the third, remedial measures. If it was necessary to include language in the text that referred to both aspects of the cooperative strategy, perhaps an additional sentence would be helpful, rather than mixing the two thoughts in one sentence.

Mr. Enoch said that he supported the view of Mr. Rieffel and Mr. Hogeweg that the collaborative approach was an inducement; as such the reference was consistent with the rest of the text of the decision, and he could support it. Perhaps if a reference to remedial actions was needed, a sentence could be added stating that in the absence of the formulation of a program and the commencement of substantial payments to the Fund, the Board would consider remedial actions in line with those agreed at the Interim Committee meeting in September 1988.

The Chairman agreed that, for the sake of clarity, such a sentence would be helpful. However, the standard language of Executive Board decisions would have to be upheld. He could reproduce the wording suggested by Mr. Enoch in his communication to the authorities and in that way convey the Board's strong position regarding the need for positive action in the following three months.

Mr. Goos said that he could go along with the Chairman's proposal, but he requested the staff to find a formulation that would avoid ambiguity in forthcoming decisions in similar cases.

The Executive Board then took the following decision:

1. The Fund has reviewed further the matter of Liberia's continuing failure to fulfill its financial obligations to the Fund in light of the facts and developments described in EBS/88/224 (10/28/88).

2. The Fund deeply regrets the continuing failure by Liberia to settle its arrears to the Fund, which are placing a financial burden upon members and reducing Fund resources needed to help others. The Fund welcomes the recent payment by Liberia but notes with regret that Liberia has not fulfilled its expressed intention to make regular payments to the Fund while it has made substantial payments to other creditors. The Fund again urges Liberia to make prompt and full settlement of its overdue obligations to the Fund and stresses that settlement of these arrears should be given the highest priority.

3. The Fund emphasizes the urgent need for a comprehensive adjustment program aimed at addressing Liberia's pressing economic and financial difficulties. In keeping with the guidance provided by the Interim Committee at its September 1988 meeting, the Fund expresses its continued readiness to assist Liberia in the formulation of such a program as one

critical step in pursuing the intensified collaborative approach to the elimination of Liberia's arrears to the Fund.

4. The Fund will review the matter of Liberia's overdue financial obligations to the Fund again within three months from the date of this decision, in light of actions taken by Liberia in the meantime to settle its arrears to the Fund and to begin implementing a comprehensive adjustment program.

Decision No. 9014-(88/162), adopted
November 2, 1988

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/88/161 (11/2/88) and EBM/88/162 (11/2/88).

2. FEDERATED STATES OF MICRONESIA - TECHNICAL ASSISTANCE

In response to a request from the Micronesian authorities for technical assistance in the fiscal field, the Executive Board approves the proposal set forth in EBD/88/305 (10/28/88).

Adopted November 2, 1988

APPROVED: May 2, 1989

LEO VAN HOUTVEN
Secretary