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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 88/165

10:00 a.m., November 9, 1988

M. Camdessus, Chairman
R. D. Erb, Deputy Managing Director

Executive Directors	Alternate Executive Directors
	C. Enoch
	R. Comotto, Temporary
Dai Q.	Zhang Z.
	Di W., Temporary
	C. S. Warner
	A. Rieffel, Temporary
	J. Prader
E. T. El Kogali	
E. V. Feldman	R. J. Lombardo
L. Filardo	M. A. Fernández Ordóñez
M. Finaish	
M. R. Ghasimi	O. Kabbaj
G. Grosche	B. Goos
	E. Kiriwat
B. Jalan	L. E. N. Fernando
A. Kafka	J. Hospedales
	C. L. Haynes, Temporary
Mawakani Samba	C. V. Santos
	I. A. Al-Assaf
	M. Al-Jasser, Temporary
	M. Fogelholm
	D. Marcel
	G. Serre, Temporary
G. A. Posthumus	G. P. J. Hogeweg
	C.-Y. Lim
K. Yamazaki	N. Adachi, Temporary
S. Zecchini	S. Rebecchini, Temporary

L. Van Houtven, Secretary and Counsellor
D. J. de Vos, Assistant

Also Present

IBRD: T. P. Jones, Africa Regional Office. African Department: E. L. Bornemann, Deputy Director; E. A. Calamitsis, Deputy Director; G. E. Gondwe, Deputy Director; B. W. Ames, J. S. Ballali, C. Enweze, C. A. François, I. Kapur, B. R. H. S. Rajcoomar. Asian Department: P. R. Narvekar, Director; A. Singh, T. Watanabe. European Department: M. Guitián, Deputy Director. Exchange and Trade Relations Department: L. A. Whittome, Counsellor and Director; J. T. Boorman, Deputy Director; H. B. Junz, Deputy Director; A. Basu, R. A. Feldman, S. Kanesa-Thasan, P. Leeahtam, L. W. Pauly, S. Watanabe. External Relations Department: R. W. Russell. Fiscal Affairs Department: S. K. Chand. IMF Institute: O. B. Makalou. Legal Department: F. P. Gianviti, General Counsel; W. E. Holder, Deputy General Counsel; P. L. Francotte, A. O. Liuksila, J. K. Oh. Middle Eastern Department: K. Gerhaeusser. Research Department: A. D. Crockett, Deputy Director. Treasurer's Department: T. Leddy, Deputy Treasurer; D. Gupta, D. V. Pritchett. Western Hemisphere Department: D. C. Ross. Bureau of Statistics: G. A. T. Donely. Personal Assistant to the Managing Director: H. G. O. Simpson. Advisors to Executive Directors: P. E. Archibong, M. B. Chatah, W. N. Engert, M. Eran, A. G. A. Faria, P. D. Péroz, S. P. Shrestha, A. Vasudevan, R. Wenzel, J. E. Zeas. Assistants to Executive Directors: P. E. Archibong, F. E. R. Alfiler, E. C. Demaestri, F. El Fiky, S. K. Fayyad, B. R. Fuleihan, P. Gorjestani, S. Guribye, A. Hashim, M. Hepp, J. Heywood, Hon C.-W., L. Hubloue, A. Iljas, J. M. Jones, M. A. Kyhlberg, K.-H. Kleine, K. Kpetigo, C. Y. Legg, V. K. Malhotra, R. Marino, T. Morita, J. K. Orleans-Lindsay, L. M. Piantini, S. Rouai, J.-P. Schoder, M. J. Shaffrey, C. C. A. van den Berg.

1. LENDING IN PARALLEL WITH FUND ARRANGEMENTS

The Executive Directors considered the staff paper on lending in parallel with Fund arrangements (EBS/88/221, 10/26/88).

Mr. Yamazaki made the following statement:

> My authorities have long supported the central role of the Fund in assisting the adjustment efforts of developing countries, including the implementation of the debt strategy. To strengthen this role, Japan agreed to extend an SDR 3 billion loan to the Fund in 1986 and to contribute substantially to the enhanced structural adjustment facility in 1987. Furthermore, Alternate Governor Sumita reaffirmed the support of Japan for the Fund in his speeches at the Annual Meetings in Berlin.
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> In keeping with this policy, Japan has developed a new initiative, namely, parallel lending. As the Chairman stated in Berlin, perseverance with adjustment efforts by the indebted countries themselves is a prerequisite for solving the debt problem. However, as the Chairman also pointed out, the lack of adequate financing has hindered the pursuit of such adjustment efforts. Japan, therefore, hopes that this initiative will provide an impetus to those countries that undertake far-reaching medium-term adjustments and eventually to the solution of their debt problems in the context of sustained growth.
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> With respect to the modality of the initiative, the staff has produced an excellent paper to which I have nothing to add. I would like only to reiterate some of the main elements of the initiative for emphasis.
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> - Parallel lending will be additional to any financing, needless to say, including that from Japan, that would otherwise be provided to the recipient country.
>
> - Parallel lending is completely untied; it could be used to accelerate economic reforms and finance higher levels of imports and investment, thus permitting higher rates of economic growth than would otherwise be possible.
>
> - Parallel lending will be disbursed in line with Fund arrangements upon continued satisfactory performance under the arrangement; no other policy condition will be required.
>
> - Parallel lending will not require any departure from existing Fund policies and practices in the provision of information to creditor groups.
>
> - Parallel lending will not expose the Fund to any financial risk.

- Parallel lending will not imply any preferential treatment of the Export-Import Bank of Japan in the settlement of arrears.

I would like to express my hearty appreciation to the staff, who helped and worked with my authorities to bring this initiative to fruition. I also extend my gratitude to the Chairman, for his encouragement and support.

The Chairman said that, with the concurrence of Mr. Yamazaki, and for what he understood were mainly presentational reasons, he wished to propose that the discussion be postponed. The delay would not pose a problem as the main purpose of the discussion would be for the Board to take note of the proposal by the Government of Japan.

Mr. Grosche inquired what was meant by presentational reasons, and wondered when the item would be discussed.

The Chairman noted that during the past few days, Directors had put questions to Mr. Yamazaki and to himself, thus underlining their desire to have answers before the Board considered the staff paper. Fuller preparation before the meeting would be useful in fostering as much consensus as possible.

Mr. Yamazaki emphasized the Government of Japan's unaltered intention of proceeding with its effort to support the adjustment efforts of developing countries, but noted that the proposal was a voluntary initiative requiring the fullest possible understanding and support of Fund members. Under its normal procedures, the Board would meet again at the end of November to consider the item, but with the understanding that no problems would emerge, he suggested that earlier consideration might be warranted.

Mrs. Filardo observed that, although she would support the postponement, it might be useful for the Japanese authorities to hear Directors' reactions to the staff paper. It would be important for her chair to know the date of the delayed discussion.

Mr. Enoch said that he had a number of questions with respect to the proposals by Japan. He hoped very much that there would be a discussion in the Board, which was the appropriate forum to consider the proposals. He could support the postponement.

Mr. Zecchini said that he could support the delay, as long as the meeting was rescheduled to a date allowing all Directors who were present to attend.

The Chairman noted that Directors' interest in having an early discussion conveyed a strong message to the authorities. He asked Mr. Yamazaki what he considered would be an appropriate time frame for postponing the discussion.

Mr. Yamazaki responded that the discussion should be held when a more fundamental understanding had been reached on the proposal.

Mr. Fogelholm asked if a more comprehensive statement by the Japanese chair was being prepared, or whether, in view of what he understood to be the significant interest by Directors in the role of the Fund in the scheme, the staff was going to present an additional paper.

The Chairman emphasized that the purpose of the meeting was simply to note the intentions of the Government of Japan, and that no changes would be made to current Fund practices. In welcoming the Japanese initiative, the Interim Committee had requested that the proposal be studied. He and the authorities believed that parallel lending would be an important contribution to the debt strategy and thereby to the solution of the debt problem. It was important for Directors to note the authorities' intentions and to appreciate that parallel financing would constitute additional funding in support of existing adjustment programs. In view of the authorities' acute sense of the need for consensus, they wanted all relevant details to be taken into account by Directors before the Board discussed parallel lending. At that time, he would answer any questions on the role of the Fund, which, in any event, would not change.

Mr. Kafka said that he supported the postponement, but suggested that Directors be advised well in advance of the date of the rescheduled meeting because of their interest in obtaining clarifications on that occasion. Moreover, if his assumption was correct that, in its discussions with the Japanese authorities, the staff had not simply performed the secretariat function of noting the authorities' intended operational procedures, but had offered advice, then he was afraid that the staff had again made a grave procedural error. Instead of presenting Directors with a structured paper, it would have been preferable for the staff first to have obtained Directors' views, either individually or in groups, of the general nature of the Japanese proposal, before engaging in a nonsecretariat exchange of ideas with the authorities. The current situation represented a lamentable repetition of the attitude taken by the staff when it negotiated a review of the General Arrangements to Borrow without taking care first to obtain Directors' attitudes.

The Chairman agreed that early notification of the rescheduled meeting was necessary, and re-emphasized that parallel lending was entirely a Japanese initiative. Whether the staff had made a procedural error could be discussed when the substance of the proposal was being considered, as it was extremely difficult to separate the substance of the issue from its form.

Mr. Kafka asked whether or not the staff had in fact performed a purely secretariat role. If not, then his observation vis-à-vis the staff's procedure might be justified, and should be taken up when the matter was reconsidered.

The Chairman responded that the staff's role had gone beyond the secretariat role, but as Mr. Kafka had suggested, the procedural matter could be taken up later.

Mr. Posthumus considered that the procedure laid out in the staff paper did not appear to follow the usual Fund practice. His point was purely a procedural one, and had nothing to do with the proposal by the Government of Japan.

The Chairman noted that Directors' comments would facilitate preparation for the rescheduled meeting on the Japanese initiative.

2. GHANA - 1988 ARTICLE IV CONSULTATION, AND ENHANCED STRUCTURAL ADJUSTMENT ARRANGEMENT

The Executive Directors considered the staff report for the 1988 Article IV consultation with Ghana and Ghana's request for an enhanced structural adjustment arrangement (EBS/88/207, 10/13/88), together with a policy framework paper (EBD/88/273, 9/29/88). They also had before them a statistical annex updating the previous background paper on recent economic developments in Ghana (SM/88/242, 10/31/88).

The Managing Director made the following statement:

> There follows for the information of Executive Directors the text of a memorandum that I have received from the President of the World Bank to serve as the basis for my statement on the matter to the Board. This text summarizes the main points covered by the Executive Directors of the Bank and IDA in their October 20, 1988 discussion in Committee of the Whole of a paper entitled "Ghana: Policy Framework Paper, July 1988-June 1991."
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> The Directors commented favorably on the progress that had been achieved under the Government's Economic Recovery Program and expressed their support for its continuation as outlined in the policy framework paper. The Directors had praise for Ghana's macroeconomic policies, notably its movement to a flexible and realistic exchange rate and its commitment to a prudent fiscal and monetary stance. The Directors noted that economic growth exceeded 5 percent a year on average since 1984, and that despite inclement weather, economic growth in 1987 reached 4.8 percent. This was considered an example of adjustment with growth and a measure of the resilience that the economy had achieved as a result of the economic reforms. The Directors cautioned, however, that the agenda for the future, as described in the policy framework paper, remains an ambitious one, and will require strong implementation capacity and an adequate level of external assistance.

The Directors expressed some concern that the program laid out in the policy framework paper could strain the administrative capacity of the Government. However, it was noted that in many instances the program represented a continuation of reforms that had been initiated earlier, and therefore would not add to the administrative burden of the Government. Nevertheless, the Government recognized the need for new skills and improved implementation capacity in key government agencies and departments, and was inducting new skilled staff at senior levels, expanding training programs, and providing improved logistics. To help the Government in its efforts, the Bank's technical assistance project approved last year by the Board is financing programs to strengthen the analytical and managerial capabilities of central ministries. In addition, the Public Enterprise Project, also approved by the Board last year, is financing technical assistance to the Government's State Enterprises Commission, which is responsible for the divestiture program and the rationalization of the state-owned enterprise sector.

The Directors observed that the achievement of a 5 percent growth target depended on continued increases in investment and savings, and in particular, a strong response from the private sector to the new policy environment. In this respect, they noted that the authorities would need to strike an appropriate balance between the stabilization and growth objectives of the program. As far as the policy environment was concerned, the liberalized foreign exchange and trade system, improvement in tax policy and administration, increases in cocoa producer incentives, and efforts to enhance the efficiency of the financial sector, are all expected to play a part in stimulating private sector investment. Recent evidence shows that these policies are achieving their desired effect both in agriculture and in manufacturing. The public investment program, on the other hand, will be constrained by the dampening influence of lower international cocoa prices on government revenues. It is, nevertheless, also expected to grow in the future, and will emphasize the rehabilitation of economic and social infrastructure in order to support the supply response from the private sector.

The Directors expressed a concern about the employment prospects of those being retrenched from the civil service and the public enterprise sector, and asked about the progress of PAMSCAD--the program of actions to mitigate the social costs of adjustment. The staff responded that with continued economic growth of at least 5 percent a year, and with incentives favoring labor-intensive investments particularly in agriculture and small-scale industry, the demand for labor in the economy was expected to be sufficiently strong to absorb the staff redeployed from the public sector. In addition, to ease the transition for redeployed staff, the Government is providing a compensation package, training, and counseling. As far as PAMSCAD was concerned, the staff indicated that donors' pledges made at the conference last February were in the process of being translated into flows. On their part, the Government was in the process of putting the management and implementation arrangements into place. The task of implementing this important and complex program, however, would not be easy. The Government remained strongly committed to delivering the intended benefits as soon as possible.

The Directors asked how inflation is to be reduced under the program from about 40 percent in 1987 to 6.6 percent by 1991. The staff responded that buoyant agricultural production, accompanied by prudent fiscal and monetary policies, will serve to dampen inflation significantly in 1988. This momentum is expected to be maintained over the next two years with close control over growth of the money supply and maintaining an overall fiscal surplus which would be used to retire part of the Government's debt to the banking system.

The Directors commented that the reforms in the financial sector would be central to the success of the overall program. They pointed to recent changes in the banking law and improvements in supervision of the banking system. They also emphasized the importance of the proposed financial restructuring of the banks, without which the appropriate role of the financial sector--that of mobilizing and allocating financial resources efficiently--could not be accomplished.

The Directors commented on the progress being made in the Government's efforts to reduce the size of the state-owned enterprise sector. With the support of technical assistance financed by the World Bank, the program is expected to accelerate in the coming years. The Directors noted, however, that the pace of the program would depend on the interest shown by investors, both domestic and foreign, and on the capacity of the financial sector to provide the necessary support to handle such transactions.

The Directors viewed Ghana's fragile external payments position with some concern, especially in light of the uncertainty in the international price of cocoa. They commended the Government for its efforts to diversify its export base, but noted that these measures would yield greater benefits if the trade policies of the industrial countries were to be less protective. In addition, the Directors emphasized that Ghana would be in need of a substantial net inflow of external resources. In this connection, they commented favorably on the external support that Ghana has received for its reform efforts, and urged the donor community to continue its support for what is probably the most ambitious and long-lasting reform program in sub-Saharan Africa.

Mr. Ghasimi made the following statement:

The comprehensive and well-balanced staff papers have provided a candid assessment of economic and financial performance in Ghana since the introduction in April 1983 of the Economic Recovery Program, which has gained international recognition.

Since 1983, Ghana has been a regular user of Fund resources. Three stand-by arrangements, two compensatory financing drawings, an extended arrangement, and a structural adjustment arrangement have all supported the most far-reaching structural and financial adjustment program undertaken in sub-Saharan Africa. The authorities have been able to reverse the severe trend toward economic decline and to lay the foundation for sustainable growth and a viable external position, and have judiciously maintained a high level of commitment to adjustment.

As a result, over the past four years, Ghana has registered an impressive overall economic performance, characterized by real GDP growth averaging 6 percent a year, sizable improvement in the balance of payments position, consolidation of the public finances, and a significant reduction in the inflation rate.

Such significant performance was made possible through the vigorous implementation of a wide range of structural reforms accompanied by prudent fiscal and monetary policies aimed at gradually reducing state intervention in the economy and revitalizing market forces. These reforms include: substantial liberalization of the exchange and trade system; sizable adjustments to the exchange rate, followed by the implementation of flexible exchange rate policy; increases in producer prices, particularly for cocoa; elimination of most price and distribution controls; gradual rehabilitation of the economic and social infrastructure; and implementation of supportive reforms in the area of the civil service, financial sector, and public enterprises.

Despite the substantial improvement achieved since 1983, the authorities are cognizant of the fact that the economy is still vulnerable to adverse developments in the international environment and is hampered by major structural and financial problems, including a high rate of inflation; a constrained internal environment characterized by inadequate savings, insufficient incentives, and infrastructural bottlenecks; and a heavy external debt service.

The authorities believe that, beyond the correction of macroeconomic and financial imbalances, the most challenging task remains that of sustaining growth, stemming from the country's own capacity to generate more savings, and to increase investment while relying more on private sector initiative. This task should be assessed against the background of a country in which the government, like those in most developing countries, plays the major role in investment, consumption, and employment. In this context, the authorities have updated the structural and financial adjustment program, which currently covers the period 1988-91.

In updating their medium-term program, the authorities remain committed to achieving the following objectives: to persevere in their efforts to further reduce inflation; to achieve a viable balance of payments position; to sustain growth in a supportive environment for private initiative; and to build on the experience gained in poverty alleviation in order to mitigate further the social costs of adjustment.

To achieve these objectives, the authorities are determined to carry out effectively the appropriate structural and financial policies that are detailed in Table 2 of the policy framework paper. Since the Board had an opportunity to assess the adequacy of Ghana's adjustment program in April (EBM/88/63, 4/22/88), I will confine my remarks to highlighting some elements of the program that are related to the authorities' major areas of concern.

The resurgence of inflationary pressures in 1987, stemming mainly from adverse weather conditions, highlighted the need for further decisive actions to protect the adjustment process and, most importantly, to alleviate its impact on the standard of living of the population. Concomitantly, despite the authorities' efforts to liberalize the economy and to increase incentives, the performance of the private sector continues to be weak. To rectify these deficiencies, the authorities are intending to implement monetary and fiscal policies in a manner that will help to bring inflation under control and, at the same time, to reinvigorate private investment and savings.

In this connection, the Government's objective is to reduce the rate of monetary growth and to maintain credit expansion to the productive sector at a level commensurate with the projected growth in nominal GDP. To attain these goals, the Bank of Ghana will intervene more actively to regulate monetary expansion and to reduce excess reserves of commercial banks. In so doing, the Central Bank will gradually rely on indirect controls and seek to improve the operations of the auction market for treasury bills. Such policies will be complemented by a gradual elimination of the Bank of Ghana's financing of the operations of the Cocoa Board, and also by the reduction of government net financing from the banking system. The cornerstone of the authorities' actions in the monetary area will be the implementation of a comprehensive financial sector reform to tackle the institutional and financial deficiencies of the banking system and to improve its potential role in financial intermediation. It is envisaged that these actions will allow the banking system to provide the private sector with the required financing, in line with its leading role in stimulating investment.

In the fiscal area, the authorities will pursue the consolidation of public savings through the rationalization and strengthening of controls, the monitoring of government expenditures, as well as through the progressive introduction of revenue measures as part of the ongoing reform of the tax system geared toward promoting more equity and efficiency. A major emphasis will continue to be placed on the implementation of the public investment program to improve investment efficiency and to rehabilitate the country's economic and social infrastructures.

The authorities will also pursue their strategy of improving incentives for efficient sectors through further exchange and trade liberalization, a flexible exchange rate policy, and higher producer prices, particularly for cocoa.

It hardly needs emphasizing that the achievement of the program targets in the area of public savings, and the implementation of structural reforms in the financial sector, state enterprises, and the price system, will be crucial for mobilizing domestic savings and for increasing investment. However, the slow response of the private sector to the progressive liberalization of the economy, and problems generated in the industrial sector, have created some concern.

Apart from reducing inflationary pressure and enhancing the private sector's initiative, alleviating the social costs of adjustment remains among the authorities' major objectives. It can hardly be denied that, despite the gains achieved since 1983, much remains to be done to protect further the poorest and most vulnerable groups in Ghana. Furthermore, the challenge of coping with the crucial problem of unemployment persists, and is further aggravated by the adverse impact of the ongoing civil service and state enterprise reforms.

In this respect, to achieve an annual growth rate of 5 percent during the program period seems crucial. This is especially important in the case of Ghana where the population growth rate remains high, at 3.3 percent a year. Furthermore, the implementation of the special program of actions to mitigate the social costs of adjustment (PAMSCAD), or, in other words, systematically the needs of the poorest groups in the short term, is of paramount importance. In this respect, the authorities are encouraged by donors' financial support for the proposals contained in the PAMSCAD, and believe that acceleration of disbursements would be critical if timely implementation of this program is to be sustained.

Through the firm implementation of domestic adjustment policies, the authorities will seek to alleviate the country's vulnerability to adverse external developments over the medium term. However, they are concerned by the prospect of depressed world market conditions for cocoa, which would constrain their efforts to reduce the relatively high debt service ratio. While the authorities stand ready to take the required corrective actions, they believe that their adjustment efforts should continue to be supported by substantial grants and by official external assistance on highly concessional terms.

Mr. Enoch made the following statement:

The staff papers under consideration clearly demonstrate the Ghanaian authorities' continuing commitment to the process of stabilization and adjustment. The papers demonstrate, too, that if appropriate policies are pursued with vigor and determination, the goal of growth with adjustment is attainable. The authorities are to be commended for their management of the economy over the past year and for their welcome resolve to continue with, in the words of the Memorandum from the President of the World Bank, what is "probably the most ambitious and long-lasting reform program in sub-Saharan Africa."

In 1987, the authorities had to contend with a significant deterioration in the terms of trade and with adverse weather conditions early in the year. Despite these challenges, Ghana's economic performance was generally satisfactory. Real output growth was above the programmed level; and the stagnation of cocoa exports had been offset by sharply higher gold and timber sales. Furthermore, a substantial improvement in the capital account generated a comfortable overall balance of payments surplus, allowing the authorities both to reduce external arrears and to build up international reserves.

Against this background, the authorities pressed ahead with a series of crucial structural reforms designed to strengthen the responsiveness and efficiency of the economy and to foster sustainable, noninflationary growth over the medium term. Even though the delays encountered in implementing the state enterprise reform program suggest that the authorities' administrative capacity was severely stretched, the list of achievements detailed in the staff paper is impressive.

However, despite the substantial gains that have been made over the past four years, Ghana continues to face major structural problems, as the authorities fully recognize. And, while the performance of the economy in 1987 was satisfactory in many respects, a number of less gratifying features should be noted, particularly the rate of inflation and the disappointingly low level of investment. As the staff paper makes clear, the current weakness of cocoa prices, the heavy debt service burden confronting the authorities in 1988 and 1989, and the ever-present danger of "adjustment fatigue" suggest that the Economic Recovery Program is currently at a crucial stage.

Therefore, I strongly support the authorities' request for a three-year arrangement under the enhanced structural adjustment facility to replace the existing extended Fund facility. This conversion will not only improve the maturity profile of Ghana's debt; it will also, given the size of the proposed arrangement, significantly increase total Fund support for Ghana over the next two years, allowing an accelerated buildup of international reserves and thus reducing the program's vulnerability to external shocks. As the staff's medium-term scenarios demonstrate, a further collapse of cocoa prices, or a weakening of the momentum of reform could, nevertheless, still lead to the emergence of financing gaps.

Looking at the medium-term program in more detail, it is clear that the authorities have again set themselves a heavy agenda of reform. While the main focus of the staff paper is on the key structural adjustment measures in the program, an essential prerequisite for success will be the maintenance of sound macroeconomic policies.

In this context, the projected fiscal surpluses over the program period are extremely welcome, not only for providing a firm underpinning for monetary policy, but also for leaving room for an expansion of the private sector, which will play a vital role in sustaining growth. Looking beneath the overall fiscal projections, it is encouraging that the authorities intend to continue the process of tax reform. The expected decreasing dependence of the budget on taxes on international transactions is especially welcome.

The need to keep the Government's current expenditure under firm control cannot be overstressed. Thus, while the authorities are right to stress the importance of reducing the disparity between civil service and private sector wage levels to improve morale and productivity in the public administration, steps to increase civil service pay need to be accompanied by measures to improve the incentive structure within the civil service and to eliminate overstaffing.

Prudent budgetary policies, along with tight credit control, should secure the targeted deceleration in the inflation rate. The persistence of excess reserves in the banking system over the past few years is a cause for concern, and it is gratifying to note the authorities' intention to make more active use of the central bank's discount and lending rates, to unify the treasury bill market, and to phase out the central bank's involvement in financing the operations of the Cocoa Board. These measures, together with the recent liberalization of interest rates, should buttress the authorities' efforts to control credit.

Early financial sector reform and a return to positive real interest rates are essential prerequisites for the increasing mobilization of private sector resources, and for the prospective rise in private sector investment from the very low level recorded in 1987. The authorities should not underestimate the task ahead of trying to reinvigorate the private sector. Important elements in achieving such a revitalization will be the substantial commitment of resources to improving the transport infrastructure envisaged under the public investment program, and also the maintenance of producer prices at levels providing adequate incentives. However, I note from Chart 2 of the Statistical Annex (SM/88/242) that, at least for cocoa, the relationship between real producer prices and output has not been particularly strong over the past few years.

The staff rightly lays much emphasis on the need to achieve convergence of the exchange rates of the auction and foreign exchange bureaus. While the measures that the authorities have taken to widen access to the auction and to increase the number of exchange bureaus are welcome, my understanding is that the gap between the two rates has widened significantly over the past few weeks. This widening underlines the importance of the steps the authorities intend to take to expedite convergence, including the abolition of the import licensing system--which, in practice, has acted as a brake on auction demand--and the extension of funding eligibility to transfers of profits and dividends. Both of these measures are usefully included as structural benchmarks in the program.

Given the vulnerability of the balance of payments projections to adverse external developments, further gradual exchange rate adjustment is clearly essential. While skillful use of the forward market has helped the authorities to mitigate the worst effects of the slump in world cocoa prices in 1988, the current account prospects for 1989 and beyond will depend heavily on continued growth in nontraditional exports, and particularly on the projected doubling of gold export receipts in U.S. dollar terms. I wonder whether the latter is a realistic central case scenario, rather than perhaps an optimistic scenario.

Despite the projected medium-term deterioration in the current account, I agree with the staff that, if the authorities continue to show the same commitment to stabilization and adjustment that they have demonstrated in the past, sufficient external assistance will be forthcoming over the next few years to allow Ghana to attain a viable balance of payments position by the end of the program.

A simple comparison of the projections contained in the most recent staff paper with the projections presented earlier this year at the time of the first review under Ghana's extended arrangement (EBM/88/63, 4/22/88) reveals that the proposed program supported by an enhanced structural adjustment arrangement has only one significant effect on the Ghanaian economy over the medium term--it permits a more rapid buildup of international reserves, indeed, up to the equivalent of 16 weeks of imports by the end of 1991. In other important respects, the existing and proposed Fund-supported programs are identical. For instance, GDP growth, the inflation rate, the budget surplus, and overall balance of payments projections are all exactly the same under the new program as was projected under the previously agreed program supported by the extended and structural adjustment facilities.

Of course, reserve accumulation is a very important aspect of an enhanced structural adjustment arrangement and, as I argued earlier, in the particular case of Ghana, the larger stock of international reserves will clearly reduce the vulnerability of the program to external shocks. Nevertheless, it is worth asking the question, why is the rate of reserve accumulation built into the original program supported by the extended Fund facility perceived as insufficient? This question is all the more pertinent given that the proposed program supported by the enhanced structural adjustment facility contains much more realistic cocoa price assumptions than the existing program. While it may be true that the authorities are currently undertaking all of the adjustment measures that the Fund could reasonably recommend, it is therefore surely arguable that at least some of the additional enhanced structural adjustment facility resources could have been deployed to accelerate clearance of external arrears, instead of being used exclusively to increase reserves.

These questions are posed in a genuine spirit of inquiry and in the hope that the Board can gain a clearer picture of the expected impact of enhanced structural adjustment facility resources on the Ghanaian economy. It would be useful if future staff papers could bring out more sharply the anticipated economic effects of the proposed use of particular amounts of that facility's resources. Greater transparency and consistency in presentation could considerably aid Board scrutiny of future enhanced structural adjustment arrangements.

However, that being said, I am in no doubt that given the authorities' impressive record of achievements and commitment to further reform, they are deserving of the full support of this institution. The attainment of balance of payments viability combined with strong growth over the medium term would represent a really remarkable turnaround from the nadir reached in 1983; an example to many other countries struggling with the first difficult steps on the road to adjustment; and a record for the authorities, and, indeed, for the Fund, to be proud of.

The Chairman noted that the similarity of the projections under the current extended arrangement and the anticipated enhanced structural adjustment arrangement was not surprising, as the former represented a strong program.

Mr. Kiriwat said that he was in broad agreement with the staff's analysis and its appraisal of the Ghanaian economy, and commended the authorities for their successful efforts at structural adjustment under their Economic Recovery Program. He supported the proposed decisions.

As noted by the staff, the progressive liberalization of the Ghanaian economy had increased the incentives for production, exports, savings, and investment, Mr. Kiriwat observed. Meanwhile, judicious macroeconomic policies had helped to reduce the internal and external imbalances. It was gratifying to observe that, with the authorities' vigorous implementation of structural and financial policies in 1987, the basic macroeconomic objectives of the medium-term program for that year were broadly realized.

Nevertheless, Ghana still faced major structural and financial problems, which could be resolved only through intensified reform efforts over the medium term, Mr. Kiriwat cautioned. He agreed with the staff that, in pursuing the reform program, the authorities would need to monitor closely developments and prospects in a number of key areas. For instance, it was essential that the savings effort be strengthened so that real GDP growth would not be constrained by inadequate domestic savings. Appropriate measures should also be adopted to control inflation. Moreover, Ghana's external payments position was vulnerable to developments in the international environment, particularly to world cocoa prices; thus, for the reform program to succeed, it needed to be supported by official development assistance on highly concessional terms.

He supported the proposed decision to extend an enhanced structural adjustment arrangement to Ghana, Mr. Kiriwat stated. The country had made positive strides in its structural adjustment efforts over recent years, and therefore deserved the Fund's further financial support to help its economy recover. He was confident that the authorities would continue to implement the program with commitment and determination.

Mr. Prader said that, at the Board discussion of the 1987 Article IV consultation (EBM/87/68, 5/4/87), Directors had generally expressed satisfaction with, even admiration for, the steadiness of the authorities' adjustment efforts and the results achieved theretofore. Directors should not hesitate to repeat themselves and commend the authorities for continuing, and even strengthening, the adjustment process.

In his opening statement, Mr. Ghasimi had pointed to the long and fruitful history of Fund involvement with Ghana, Mr. Prader remarked. Such close cooperation must have been the reason why it was difficult to find much of a difference in tone or content between Mr. Ghasimi's opening statement and the staff paper. The staff paper demonstrated the consistent and comprehensive macroeconomic and structural policies that the authorities had implemented. Yet, despite the tremendous achievements obtained thus far, concerns were emerging over the effectiveness of the authorities' policies. Those concerns involved the time lag between the application of adequate economic stimuli by the Government and the appropriate private sector responses. The urgency of promoting private sector crowding in was clearly great in view of the substantial transitional and adjustment costs that Ghana faced. Moreover, there was no doubt that the final benefits of a market-oriented production process greatly outweighed the unavoidable short-term adjustment costs; the Board had to address Ghanaian concerns on that point.

In the latter respect, experience with adjustment programs showed that it indeed took some time to obtain the planned results, particularly the longer, more comprehensive, and substantial the programs were, Mr. Prader commented. The authorities should not overlook the very positive response coming already from the private sector, in the form of both a substantial acceleration in the flow of foreign direct investment and a repatriation of foreign exchange holdings, which were being used mainly for investment. Another aspect of the need to promote private sector crowding in was the authorities' state enterprise reform, which he supported strongly. The divestiture programs had to be thoroughly planned and carefully implemented to ensure the full preparation of that excellent means of integrating the domestic and foreign private sectors into the new pattern of resource allocation in Ghana.

While continuing to implement the adjustment program, great attention should be paid to price developments, Mr. Prader emphasized. Rising inflation was the only cause for concern in the adjustment picture thus far, as it could profoundly undermine the confidence of foreign and domestic economic agents in the prospects for the successful implementation of Ghana's development policy. He fully agreed with the authorities on the crucial importance of the special program of action to mitigate the social costs of adjustment, because that effort protected and fostered the social consensus favoring the authorities' adjustment policies. In that connection, the tripartite committee of government, labor, and private employers was an important confidence-building measure, and he thus urged the authorities to continue the process of tripartite discussion.

With respect to Ghana's request for an enhanced structural adjustment arrangement, the Board had to address the question of the sustainability of Ghana's balance of payments, Mr. Prader considered. The staff paper stated that, "according to the baseline scenario underlying the program, Ghana could attain a viable balance of payments position by the end of 1990." That assertion could be questioned in view of the projected current account deficit for the early 1990s. Indeed, a deficit on current payments of 7 percent of GDP, excluding official transfers, was substantial by international standards. Nevertheless, it must also be noted that more than half of that deficit was covered by official transfers, and that the remaining financial gap was more than covered by exclusively concessional long-term capital inflows. The authorities were thus assuming an important financial intermediary function between foreign capital providers and the domestic sector. In the case of Ghana, Directors could be reasonably sure that the economic returns of foreign-financed domestic investment largely outweighed the costs of foreign debt. That conclusion had one major prerequisite, namely, the continued implementation of the consistent and wide-ranging adjustment program.

What were the reasons for choosing a gradual restoration of normal relations with foreign creditors, instead of reducing external payments arrears more quickly to obtain greater leeway for any unforeseen financial needs, Mr. Prader inquired. Perhaps the issue raised by Mr. Enoch about whether part of the enhanced structural adjustment arrangement resources could be used for the clearance of arrears, instead of for the buildup of reserves, should be discussed. The issue obviously involved differing, but not openly discussed, conceptions of the use of the enhanced structural adjustment facility, particularly in the context of the planned review of the latter by the Board.

Mr. Santos made the following statement:

> It is gratifying to read that, on the whole, the process of adjustment with growth in Ghana remained firmly on track for the fourth successive year since the coming into effect of the country's Economic Recovery Program.
>
> As analyzed in the staff report and confirmed by Mr. Ghasimi's opening statement, the authorities have been able to reverse the severe trend toward economic decline of the early 1980s. Real GDP is estimated to have increased by about 5 percent in 1987, translating into an improvement of 1.5 percent in real per capita income. Government operations, as in the previous year, are estimated to have been in surplus equivalent to 0.5 percent of GDP, while the overall external payments position changed significantly into a surplus, reflecting considerable net inflows of both short- and long-term

capital. These achievements, including the compliance with all of the performance criteria under the extended arrangement and all of the structural benchmarks under the first year of the structural adjustment arrangement, are commendable.

The staff stated that, despite the considerable progress of recent years, Ghana still faces structural and financial problems that can only be resolved through further determined actions over the medium term. I endorse this view and therefore welcome the authorities' decision to pursue and intensify their reform efforts, as spelled out in their new policy framework paper covering the period 1988-91. The main policy objectives, namely, to sustain the momentum of growth at an average annual rate of 5 percent, with a relatively low rate of inflation, and to achieve a viable balance of payments position by the end of the decade, seem appropriate.

While the policy framework attempts to combine both macroeconomic and structural elements with an emphasis on growth, the social content of the proposed program to be supported by the enhanced structural adjustment facility gives the framework impressive credibility. It is encouraging that the authorities have already initiated actions under PAMSCAD--their program of actions to mitigate the social costs of adjustment--to address the specific needs of vulnerable groups by developing and restructuring basic services in the areas of health, education, and housing.

It would appear from what has been outlined in the policy framework paper that the continued implementation of the envisaged measures will impose a heavy administrative burden on the authorities. Judging by Ghana's favorable track record on program implementation, I do not see this as a serious constraint. Nevertheless, the authorities should intensify their efforts to reduce and eliminate any administrative bottlenecks and to strengthen the institutional framework in which financial and structural adjustment is taking place.

The staff has outlined some of the important areas in which close monitoring of developments and accelerated progress are called for, such as the mobilization of adequate savings for investment, the proposed reform of the financial sector, the rehabilitation and improvement of the operations of key state-owned enterprises, and adherence to the timetable for state enterprise divestiture. Substantial progress in these areas will be vital for sustaining the momentum of growth and for reducing macroeconomic imbalances over the medium term.

Given that the medium-term external outlook is highly vulnerable to adverse international developments, which might lead to substantial financing gaps, it is clearly in order for the authorities to seek better financial terms and conditions in support of their adjustment effort. In this connection, the authorities have demonstrated prudence in deciding to cancel the extended and structural adjustment arrangements and to substitute an enhanced structural adjustment arrangement in their place.

The fragility of the economy to adverse external developments clearly underscores the importance of the authorities continuing to persevere with their financial reforms. While structural policies have to be strengthened to bring about the required changes, a restrictive demand-management stance will have to be continued. It is clear that such an overall policy stance will be crucial for mobilizing the highly concessional external financial resources necessary for the proposed program, which merits Fund support under the enhanced structural adjustment facility as well as the support of other multilateral and bilateral creditors and donors. I support the proposed decisions.

Mr. Goos said that he continued to be impressed with Ghana's adjustment effort, both in terms of the encouraging results achieved thus far and the authorities' ambitious policy undertakings in requesting an enhanced structural adjustment arrangement. Ghana's performance was exemplary for many African and non-African countries.

Ghana's continued adjustment effort certainly merited the support of an enhanced structural adjustment arrangement, particularly given the strength of the structural content under the proposed arrangement, Mr. Goos remarked. However, as was the case with the preceding extended and structural adjustment arrangements, he remained concerned about the appropriateness of the pace of macroeconomic adjustment, particularly the substantial increase in the external current account deficit, the concomitant heavy reliance on external financing, and the substantial accumulation of external debt. Of course, although it could be argued that external resources should be used for productive purposes as long as they were available, and despite his recognition that critical and strategic external variables were expected to improve over the coming years, he could not but wonder--in view of the vulnerability of the economy to external developments demonstrated clearly by the staff's sensitivity analysis--whether a more prudent macroeconomic course would have been preferable to what seemed like a forced approach to maximizing growth. His concern was underlined by the projection that price pressures would remain quite substantial for the time being, indicating the continued existence of considerable financial imbalances.

Against that background, the authorities should give high priority to improving further the domestic economic fundamentals with a view to strengthening the resilience of the economy to unexpected developments, Mr. Goos considered. In that connection, he fully endorsed the staff's advice that the authorities should further concentrate on increasing domestic savings, while cautioning that attention should not be limited to the public sector, but also focus on the private sector. The need for a comprehensive savings effort led directly to the issue of interest rates, which, unfortunately, remained highly negative in real terms. Reiterating his comments made at previous Board discussions on Ghana, he urged the authorities to reconsider their attitude to interest rate levels and to gear monetary policy toward the restoration of remunerative interest rates. Achievement of positive interest rates could perhaps be facilitated by the early introduction of more market-oriented instruments of credit control, and would certainly benefit from timely and forceful rehabilitation of the financial sector. The authorities were aware of the problem and had made encouraging steps in the right direction, but needed to make a stronger commitment to achieving positive real interest rates.

The resilience of the economy could be further strengthened by increasing the efficiency of resource utilization, Mr. Goos observed. The program was geared to achieving substantial further progress in that respect, but a crucial area in which progress seemed to be lagging somewhat was the exchange market, in which the existing dual system might contribute to considerable distortions. He therefore encouraged the authorities to move toward an early unification of the exchange markets and to adopt a timetable to that end. Moreover, while endorsing the authorities' intention to continue a flexible exchange rate policy, he wondered whether that policy should be understood as implying real effective depreciations in addition to those of the past few years ranging from 20 percent to 60 percent. There were some indications of the possible detrimental impact of such depreciations on the private sector. Was the relatively slow response of the private sector to adjustment measures thus far, referred to by Mr. Ghasimi in his opening statement, related to the inflationary effect of continued large depreciations as well as to the possible negative effect of exchange rate instability on investment decisions and the relative attractiveness of domestic and external assets? The exchange rate policy might also be behind the recent surge in durable consumer goods imports, particularly European luxury cars, which had been a matter of concern to the authorities. If residents expected continued depreciations, they could also expect continued increases in the value of those cars and therefore be prepared to pay extraordinary prices for such vehicles. Residents might thus be using the imported European cars as a type of store of value or speculative asset. Those considerations underlined the importance of not using the exchange rate instrument beyond the point at which the competitiveness of an economy was restored, and gave rise to some doubts about the standard argument of accompanying progressive import liberalization with significant real effective devaluations.

He agreed with the observations of Mr. Enoch and Mr. Prader that the authorities would be well advised to accelerate the pace of external arrears reduction, which was clearly in their interest of normalizing relations with external creditors, Mr. Goos added. He supported the staff appraisal and the proposed decision.

Mr. Al-Jasser made the following statement:

Like previous speakers, this chair does not feel that it is being repetitive in reiterating its support for the Ghanaian authorities' valiant efforts at structurally adjusting and reforming their economy. The achievements of the past year are clearly impressive, especially in the areas of real economic growth, diversification of exports, and the observance of the performance criteria and benchmarks under the existing adjustment program, which is in its fourth consecutive year.

The essence of economic development is the institutionalization of the process of capital formation. A country has to unleash its innovative and entrepreneurial forces, and thereby to put into motion a mostly self-propelling and virtuous circle of saving, investment, and real per capita income growth. Efficient allocation of resources will ensue if this process is allowed to engulf all economic sectors and institutions.

Based on the previous factors, I fully support the authorities' determination to supplement their previous adjustment efforts and achievements with stronger actions at institutional reform, be it in the price system, civil service, public enterprises, or financial system. The latter, however, merits the authorities' special attention, because financial deepening is crucial for the mobilization of resources through increased savings, financial intermediation, and investment. The decision to revamp the commercial and development banks is a positive first step in the process of financial deepening.

In this connection, I would appreciate the staff's comments on the prospects of attaining the growth target for private sector investment in 1991 at a time when the growth of domestic credit to this sector is being reduced and the Government is paying off its debt to domestic banks. Under such circumstances, the feasibility of financial deepening is open to question. Moreover, inflation is most inimical to financial deepening, and hence to the increased savings and investment necessary for growth and development. The authorities would be well advised to give priority to their fight against inflation. In this respect, I would appreciate any staff comment on the significance of the nonmonetary sources of inflation in Ghana.

While agreeing with the fiscal objectives enumerated in the staff paper, I could not help but notice the staff's pervasive lumping of taxes on petroleum products with excise taxes on such frivolous and deleterious products as alcoholic beverages and cigarettes. I am sure that the staff does not consider the consumption of petroleum products injurious to the economy and society, and therefore wants to discourage it through overtaxation. I would appreciate the staff's comments on this, and especially on the importance, or lack thereof, of the affordability of petroleum products for the rehabilitation and long-term development of the transportation systems in Ghana and other developing countries.

Since I am in general agreement with the staff paper and appraisal, it will suffice to reiterate our commendation of the authorities' exemplary efforts, with the help of the staffs of the World Bank and the Fund, to develop the measures incorporated in the policy framework paper, which is an ambitious one. Implementing such an ambitious program requires vigilance and perseverance, especially in the areas of state enterprise reform, the fight against inflation, and the liberalization of the exchange and financial systems. Mr. Ghasimi's reaffirmation of the authorities' commitment to adjustment is welcome. I support the proposed decisions.

Mr. Fernando said that Ghana's economic performance, particularly the authorities' conduct of policy, gave Directors a clear signal that an enhanced structural adjustment arrangement would be timely and appropriate. The proposed program logically followed, and was consistent with, the current program supported by an extended arrangement, with the crucial difference that the cost of financing under the proposed program would be substantially reduced while the amount of financing would remain the same. He therefore supported the proposed decision on Ghana's request for an enhanced structural adjustment arrangement.

After five years of closely adhering to an adjustment program that had been consistently supported by the Fund, the scope for macroeconomic and structural adjustment remained considerable, Mr. Fernando continued. To an extent, such scope reflected the low base from which adjustment, particularly of a structural nature, had been undertaken. In part, it was also due to external factors that had complicated the authorities' task. The magnitude of the challenges lying ahead was reflected and facilitated by the several sectoral adjustment credits that had been arranged, and were being arranged, by the World Bank. If the enhanced structural adjustment arrangement ran its full course, Ghana would be supported by the Fund for a continuous period of eight years. In other words, the authorities' efforts could require sustained support stretching well into the outer years of the medium term and could require commitments from all external financial agencies, with a pivotal role to be played by the Fund. Ghana would have the responsibility of implementing and monitoring the program as well as maintaining the political and social consensus necessary to sustain that program's direction and momentum.

Was the program seriously threatened by the inadequate private sector response to adjustment measures thus far, Mr. Fernando wondered. Indeed, Ghana's ability to reach and maintain a respectable longer-term growth rate depended on increasing the very low level of investment. The good growth rate at present could be constrained in the years ahead as unused capacity was rapidly taken up by the current round of liberalization. In aiming to increase gross investment from under 11 percent of GDP to over 17 percent of GDP between 1987 and 1991, the private sector's contribution to investment would have to expand far more rapidly than the Government's share. A strong and realistic monetary policy would be necessary to restore conditions conducive to investment, as the tendency for gearing ratios to be high in countries with undeveloped capital markets such as Ghana, made the cost of credit an important factor in determining the private sector response to economic opportunities. Banking reform was also a priority at the current stage, as structural rigidities were tending to keep lending rates at artificially high levels.

While he noted the prospects for balance of payments viability in 1990, diversification of the export base would have to progress at a much faster pace than achieved thus far, Mr. Fernando considered. The medium-term scenarios and the sensitivity analysis for the balance of payments clearly showed Ghana's vulnerability to external developments. And, even though the mining sector's contribution to the export effort was noteworthy, the authorities should explore the prospects for broadening the export of agricultural commodities and processed goods. The authorities had rightly placed emphasis on export promotion through supporting product adaptation and development, but should also continue to provide the necessary incentives through appropriate monetary and exchange rate policies.

Given the likelihood of overall surpluses arising in Ghana's balance of payments, the question arose of whether to clear arrears more quickly, Mr. Fernando noted. In that context, he noted that Ghana's performance, and in some respects its overperformance, had largely been the outcome of strong adjustment despite an uncertain environment. The case for faster clearance would probably be stronger if the balance of payments benefited from exogenous developments markedly more favorable than at the time the program was drawn up. In fact, the authorities had been forced to take additional adjustment actions to keep the program on track. Moreover, the prospects for the main export item of cocoa were unfavorable. He saw considerable merit to the planned buildup of reserves, given the existing risks in Ghana's exchange market and the need to raise investment levels to secure the capacity of the economy to maintain the momentum of growth. The authorities should augment reserves in the event of better than expected developments, but should have the flexibility to determine the appropriate mix of policy in that area.

Mr. Serre commended the authorities for monitoring the adjustment program introduced in 1983, under which impressive progress had already been achieved. Such progress was the result of the stringent implementation of appropriate structural and financial policies and of the authorities' pragmatism, which were really worth noting.

He agreed with the objectives of the program and with the measures taken to reach those goals, and was in agreement with the remarks made by Mr. Ghasimi in his opening statement and with those of other Directors, Mr. Serre commented. In particular, the medium-term strategy of the policy framework paper was well suited to developing the growth potential of the economy, including diversifying the productive base. Moreover, it was gratifying that the social impact of the program had been taken into consideration. He shared Mr. Goos's concern on the further effects of the authorities' flexible exchange rate policy; even though it had certainly supported the adjustment, he wondered whether it might not ultimately have the effect of restraining local and foreign investors. He was interested to hear the staff's opinion on that point, and fully supported the proposed decisions.

Mr. Rieffel made the following statement:

I am impressed by the performance of the Ghanaian economy since the 1987 Article IV consultation, and I strongly support the conversion from the structural adjustment and extended arrangements to an enhanced structural adjustment arrangement. The authorities are to be commended for their persistence in implementing far-reaching macroeconomic and structural reforms over the past five years, and for their courage in tackling sensitive problems, such as the excessive size of the civil service.

I hope that the doubts voiced in the past about the growth benefits of the authorities' impressive effort have been put to rest with the results of the past year and the projections for the future. Ghana has been a good model of growth-oriented adjustment, and, hopefully, the lessons that can be learned from this case will be featured prominently in the staff's next review of conditionality.

Looking backward, I have nothing to add to the staff's assessment of performance under the structural adjustment arrangement and the extended arrangement. These arrangements have created a promising foundation for the new enhanced structural adjustment arrangement. Looking forward, I have no specific comments on or questions about the first program under the proposed enhanced structural adjustment arrangement, but I do have a few related to the policy framework paper, and Ghana's priorities and objectives over the medium term.

The staff paper notes that "most" price controls will be eliminated by June 1990. A footnote identifies eight categories of goods for which there are controls--apart from public utility tariffs--but I could not find any more concrete indication of which controls will be phased out and which will remain. Would the staff agree that it is both desirable and feasible to phase out controls on all eight categories of goods by June 1990?

The priority given to state enterprise reform is welcome; the acceleration in the pace of that reform effort is one of the most important features of the program under the enhanced structural adjustment arrangement. Furthermore, one of the major challenges during the next three years will be to implement reforms in the financial sector, including the shift from direct credit controls to indirect ones.

It is disappointing that there is no explicit deadline for achieving the unification of the exchange rate, which should be feasible before the middle of 1990. The authorities should make this objective explicit in their second annual program under the enhanced structural adjustment facility.

In the past, my chair has expressed the view that enhanced structural adjustment arrangements should, in general, lead to full liberalization of payments and transfers for all current transactions. Therefore, it is gratifying to see this objective featured prominently in Ghana's enhanced structural adjustment arrangement.

The staff paper projects aid commitments of $530 million a year over the next three years. Is this not a rather large amount relative to the country's limited absorptive capacity?

The staff paper estimates that Ghana's debt service ratio will be 75 percent in 1988. Is there any other country in the world that has such a high ratio and yet is not seeking debt relief? This phenomenon provokes two thoughts. First, almost half of Ghana's debt service payments in 1988 were received by the Fund. The Fund accepted a major risk when it extended credit to Ghana in the mid-1980s, and it is fortunate that Ghana has made such effective use of this credit. Such a risk is one that I would not want the Fund to take again in the foreseeable future. Second, this case provides a good answer to the small group of Fund members that are in arrears to the Fund and have complained about making net repayments to the Fund.

There seems to be no discussion in the staff paper of Ghana's ability to repay the Fund the substantial amounts of credit that will be made available under the enhanced structural adjustment facility. I continue to believe that all staff papers supporting a request for the use of Fund resources should include an explicit analysis of the member's ability to make repurchases. In fact, my authorities seriously considered abstaining from approving this request because of the absence of such analysis.

The summary table in the policy framework paper does not give any indication of which measures will be monitored in Fund arrangements and which will be monitored in World Bank operations. I continue to believe that it would be useful to make explicit in these tables the respective monitoring roles of the Fund and the World Bank.

With respect to the enhanced structural adjustment arrangement, a greater degree of front-loading might have been justified in this case. It would be interesting to have an explanation of the factors that led the staff to arrive at the pattern of phasing that has been proposed. In addition, the first arrangement contains only one structural performance criterion. Given the importance of structural reforms in programs supported by enhanced structural adjustment arrangements, more than one structural performance criterion should be included in the arrangement. The specific criterion selected in this case is not very appropriate. The staff paper states that the import licensing arrangements have become "largely superfluous," but in making the elimination of these licensing arrangements a performance criterion, the staff seems to have selected a rather insignificant reform. I will certainly expect to see better use of structural performance criteria in the second annual program under this enhanced structural adjustment arrangement.

The authorities are to be congratulated for their rapid progress along the road to sustainable growth and a viable balance of payments position. I support the proposed decisions.

Mr. Lim made the following statement:

I agree with the staff's assessment and have no difficulty in supporting the draft decisions.

On the occasion of the previous review of Ghana's progress under the extended arrangement in April (EBM/88/63), this chair noted that there was obvious merit for Ghana, given its serious debt-servicing difficulties, to look to replace the undrawn portions of its extended arrangement with an enhanced structural adjustment arrangement. More important, Ghana's praiseworthy record of performance under a succession of Fund-supported programs since 1983, and its clear commitment to continuing with this process, make it a good candidate for an enhanced structural adjustment arrangement. Ghana is rightly considered to be a Fund success story, one of only a few in sub-Saharan Africa. Its willingness to take the tough decisions needed to restore financial stability, and then to build on this by persevering with a farsighted and comprehensive package of structural reforms, provides something of a model for many other economies in the region to emulate. The authorities are therefore to be commended for their performance through 1987.

The only cause for concern is the outcome for the inflation rate of close to 40 percent. While a sharp increase in retail prices was expected, and there is apparently some optimism that a downward trend in inflationary pressures will prevail, it is difficult not to overemphasize the significant threat posed by inflation to the success of Ghana's long-term adjustment strategy.

In his opening statement, Mr. Ghasimi drew attention to the limited response, so far, of the private sector to the progressive liberalization of the economy. Together with the staff's various medium-term balance of payments scenarios, which highlight the vulnerability of Ghana's external position to changes in cocoa prices and import volumes, this response underscores the fragile nature of the achievements to date.

Ghana's external vulnerability serves to emphasize, inter alia, the continuing importance of domestic demand management if the delicate balance between adjustment and growth is to be preserved. It requires careful adherence to the constraints on public sector current expenditures, in the context of the restructuring of the civil service and the reform of the budgetary processes.

On the revenue side of the budget, I have no difficulties with the authorities' declared intention of enhancing the equity and efficiency of the tax system by broadening the personal tax base, removing a number of loopholes and disincentives and, over the course of the three-year program, significantly shifting revenue composition toward greater reliance on indirect taxation.

The challenges confronting monetary policy--which is crucial to the re-establishment of price stability--concern me the most. The persistent negative real interest rates, despite the substantial financial deregulation that has occurred, might imply that the expected rate of inflation is considerably below the recent inflation rates. However, as suggested by the staff, it seems more likely that the negative real interest rates reflect persistent institutional rigidities in the financial system. I therefore strongly urge the authorities to redouble their efforts to reform that system.

It is difficult to fault the authorities' ambitious aspirations vis-à-vis structural reform, nor the priorities that have been established in the area of continuing exchange and trade liberalization, state enterprise reform, tax reform, and the strengthening of the financial sector. Most important, the authorities clearly recognize how vital it is to allow price signals to function.

Ghana constitutes a good case study of the social effects of Fund-supported adjustment programs. As it is clear that the primary beneficiaries of adjustment have been the rural poor and disadvantaged, Ghana is, in this respect, an example for other countries to emulate.

For the previous reasons, the proposed program is worthy of support, not just by the Fund, but by the international financial community as a whole.

Mr. El Kogali said that the design of the policy framework paper and enhanced structural adjustment arrangement was very encouraging, as it included elements that were important for creating a more favorable environment for continued adjustment. The program had targeted a reasonably rapid rate of growth that should allow for a significant, albeit modest, increase in per capita income. He agreed with the staff that economic recovery had begun to take hold; the country had experienced relatively rapid growth over the past four years, averaging about 6 percent a year. As described in Mr. Ghasimi's opening statement, substantial progress had also been made in adjusting internal and external imbalances.

The authorities' scheme for alleviating the costs of adjustment on the most vulnerable members of society was most appropriate, Mr. El Kogali considered. The social and demographic indicators provided in Appendix VII of EBS/88/207 demonstrated clearly that the quality of life remained relatively low for the majority of the population; and, in fact, data on those and other indicators published in the <u>World Development Report 1988</u> showed that some deterioration in the standard of living had occurred over the past two decades. For example, the per capita calorie intake fell by over 8 percent between 1965 and 1985. As had been demonstrated in the policy framework paper (EBD/88/273), the past two decades had been a period of economic decline. With the inflation rate increasing in 1987, a further deterioration in the living standards of the poor might have occurred, making the implementation of the program even more urgent. Therefore, it was important that the authorities provide for budgetary allocations in subsequent years to protect the poor, because, as Mr. Ghasimi had indicated, much remained to be done in that respect. In view of the latter's fears about unemployment being aggravated by the civil service retrenchment, he asked the staff to provide further information on how the redeployment of displaced civil servants was proceeding.

He strongly supported the conversion from the extended and structural adjustment arrangements to an enhanced structural adjustment arrangement, Mr. El Kogali stated. From a financial point of view, the conversion would enable Ghana to modify significantly the term structure of Fund credit; it could be inferred from Tables 1 and 9 of EBS/88/207 that it would result in a substantial reduction in the outlays made to service Fund credit, so that Ghana's debt service to the Fund would fall from 36 percent of exports of goods and services in 1988 to 9 percent by 1991.

Furthermore, and perhaps more important, the conversion to the enhanced structural adjustment arrangement would provide additional resources from the Fund to underpin growth and to build up reserves, even though repurchases would remain at a relatively high level.

While Ghana's recovery program was proceeding satisfactorily, some worrisome problems remained, Mr. El Kogali remarked. The program was still highly dependent on external assistance and therefore remained fragile. To avoid past experiences with delayed disbursements, it was important to streamline procedures, a task in which donors would have a critical role to play. The staff's sensitivity analysis indicated that external factors, such as a further weakening of cocoa prices, could threaten Ghana's adjustment process. Even though further domestic adjustment would be required in that event, the possibility of safeguarding the program through the use of the contingent and compensatory financing facility should not be ignored. He supported the proposed decisions.

Mr. Di joined in supporting Ghana's request for an enhanced structural adjustment arrangement.

Over the past few years, Ghana had undertaken substantial structural and financial reforms under the Economic Recovery Program adopted in 1983, Mr. Di observed. Economic performance had been most successful in many areas, mainly, the steady growth of real GDP, the substantial improvement in the balance of payments position, and the decline in the inflation rate. In particular, the authorities' great efforts to liberalize the exchange and trade system progressively, and to eliminate most price and distribution controls had apparently stimulated production and exports. The authorities should be highly commended for their determined efforts and encouraging achievements.

Despite those positive results, Ghana still faced a number of major structural and financial problems, as the staff report had indicated, Mr. Di cautioned. Domestic savings and investment were inadequate to support growth, which would not be helped either by the still high inflation rate. The economy was very vulnerable to adverse international developments. Moreover, to develop the economy steadily, the authorities should take further steps to correct the economic problems and to continue the Economic Recovery Program.

In the process of instituting economic reforms, Ghana had been supported by compensatory financing drawings, and by stand-by, extended, and structural adjustment arrangements, Mr. Di recalled. According to the staff, Ghana's performance under those arrangements had been quite satisfactory. To consolidate the progress achieved thus far and to carry out further reforms, Ghana had requested an enhanced structural adjustment arrangement. The objectives and policies under that arrangement seemed to be generally appropriate. In particular, as pointed out in Mr. Ghasimi's opening statement, apart from reducing inflationary pressure and enhancing private sector initiative, one of the authorities' major objectives remained alleviating the social costs of adjustment. Protecting the poorest and most vulnerable groups in Ghana was evidently a matter of paramount importance, and should not be ignored. Considering the economic situation in Ghana, he fully supported the authorities' request for an enhanced structural adjustment arrangement and therefore the proposed decisions.

Mr. Adachi said that, on the occasion of the review under the extended arrangement in April (EBM/88/63), his chair had welcomed the authorities' intention to seek an enhanced structural adjustment arrangement, while emphasizing the need for stronger adjustment. His chair had especially called for an acceleration of parastatal reform, as well as prudent management of macroeconomic policies. In that context, he welcomed the authorities' further accomplishments under the extended arrangement.

However, to pave the way for further development and increased credibility, Ghana had to tackle a number of structural and fiscal problems, Mr. Adachi commented. It was essential for Ghana to have a strong program for it to qualify for an enhanced structural adjustment arrangement. Converting from an extended arrangement to an enhanced structural adjustment arrangement might imply weakened effectiveness in monitoring the program, as the former required the observance of three-month performance criteria and the latter only semiannual ones, although it did have some benchmarks. Therefore, a high degree of perseverance by the authorities with the program would be essential.

The parastatal reform had involved significant start-up difficulties and, although he certainly recognized the recent improvements in that area, further efforts by the authorities were clearly required, Mr. Adachi considered. Moreover, the fragile nature of the external balances raised concerns over the medium-term prospects and the authorities' heavy reliance on external resources.

While the authorities' efforts to mitigate the social costs of adjustment through special programs was welcome, he emphasized that it should not be interpreted by the Board as a gradualistic implementation of the program, Mr. Adachi cautioned. In that connection, the authorities should direct their efforts to such areas as training and employment creation, instead of to compensation measures.

Given the authorities' strong commitment and excellent performance record, he supported Ghana's request for an enhanced structural adjustment arrangement and reaffirmed his chair's strong support for Ghana, Mr. Adachi indicated. At the same time, it was important that the authorities firmly implement the program and accelerate adjustment somewhat in both the structural and macroeconomic areas, as needed.

The staff should further clarify the front-loaded disbursement of enhanced structural adjustment facility resources, since, on previous occasions, such as during the Board discussion on overdue financial obligations to the Fund (EBM/88/110, 7/21/88), his chair had emphasized that a prudent approach should be taken to such front-loaded disbursements, Mr. Adachi pointed out. He supported the proposed decision.

Mr. Fogelholm said that it was most encouraging to observe the positive effects of the Economic Recovery Program, which had been adopted by Ghana in 1983. Under the program, sustained growth had been achieved and the external and internal balances had been significantly improved. In addition to the purely economic achievements, it was also gratifying to note the authorities' measures to protect the poorest and most vulnerable segments of the population from the adverse short-term effects of the adjustment program. The authorities should, indeed, be commended for the immense efforts they had undertaken to date.

At the same time, it was apparent that Ghana had to undergo further macroeconomic adjustment and structural reform in order to sustain the current growth rate and to achieve a viable balance of payments position, Mr. Fogelholm observed. At the current stage of the reform process, the emphasis for further adjustment should be on structural reforms aimed at improving the efficiency of the economy. He therefore supported the staff's recommendation that the major task of structural reform should be to enhance the efficiency of capital allocation and to increase savings, thus stimulating investment. A high level of investment was crucial, not only for future growth and a diversification of the productive base, but also for the ongoing reallocation of the labor force from the public sector to the private sector.

While agreeing with other Directors that due attention should also be paid to demand-management policies, he believed that the authorities should, inter alia, unify the exchange rate, Mr. Fogelholm commented. They would also be well advised to create positive interest rates with the dual positive effect on the inflation rate and the amount of savings.

As was the case with many other African countries, the economy was still highly dependent on revenues from the export of one major commodity--in Ghana's case--cocoa, Mr. Fogelholm noted. In its report, the staff had provided an interesting analysis showing the great sensitivity of Ghana's balance of payments to changes in world cocoa prices. He encouraged the staff to continue that kind of analysis in other similar cases.

It was entirely appropriate that Ghana's reform policy be supported by longer-term financing from the Fund, following the successful implementation of three successive stand-by arrangements, Mr. Fogelholm considered. The nature of Ghana's reform process made the country a good candidate for an enhanced structural adjustment arrangement, as had been noted by his chair during the previous discussion of Ghana's extended arrangement in April. He endorsed the proposed decisions.

Mr. Finaish strongly commended the authorities for their courage and determination in pursuing the far-reaching reform and adjustment program that they had embarked on since 1983. Developments since the Board's most recent discussion on Ghana (EBM/88/63) again pointed to a generally good performance in terms of both growth and of reducing the structural and financial imbalances in the economy. He fully supported the authorities' request for an enhanced structural adjustment arrangement, which would clearly provide a suitable framework for adjustment in Ghana's case.

Moreover, he agreed with Mr. Enoch and other Directors that financial stability was an important prerequisite for the success of the wide-ranging structural reform under the program, Mr. Finaish pointed out. As a consequence, the objective of reducing the inflation rate to 10 percent by the end of 1989 and 5 percent by the end of 1991 was especially important. In that connection, it would be useful to know from the staff whether the program target for inflation of 20 percent at the end of 1988 was achievable, given that it was already November.

The vulnerability of Ghana's balance of payments to external developments, particularly in the cocoa market, was clearly demonstrated by the medium-term scenarios, Mr. Finaish remarked. He therefore wondered whether consideration had been given to including a contingency element in the program. He noted that the balance of payments scenario assumed that oil prices would be $17 a barrel in 1988, and would increase by 3 percent a year thereafter. The recent oil market developments might indeed imply a built-in safety margin for the program. The staff might wish to comment on that issue.

Mr. Rebecchini commended the authorities for their impressive adjustment effort and expressed support for their request for an enhanced structural adjustment arrangement. Several speakers had noted the uncertain external environment that Ghana was facing and the risk that it posed to the authorities' adjustment effort. He therefore wondered whether any consideration had been given to arranging for contingency financing. If such consideration had been given, what were the reasons for not adopting contingency financing clauses?

The Deputy Director of the African Department said that Ghana had made impressive strides toward adjustment with growth since 1983, and was an excellent example of such an effort for Africa. Nevertheless, the authorities recognized that Ghana still faced major structural and financial problems that would require determined efforts if they were to be resolved. The policy discussions with the authorities had always been very frank and wide ranging, and the staff, in close collaboration with its World Bank counterparts, had sought to strike a reasonable balance between the sometimes conflicting objectives and concerns of the authorities.

There were good reasons to believe that private investment would increase as programmed, from about 3 percent of GDP in 1987 to some 6 percent of GDP in 1991, the Deputy Director commented. Available indicators pointed to continued substantial increases in capacity utilization in the manufacturing sector, and a sharp expansion in investment in the mining sector, particularly in gold mining, which was the reason behind the projected rise in gold exports. Moreover, business profits were on the increase as reflected in much improved corporate tax collections, despite the lowering of the corporate tax rate. More important, however, the authorities' policy stance for the period ahead was expected to contribute to fostering private investment. Various elements of the program to be supported by the enhanced structural adjustment arrangement were key to increasing private investment, especially the movement toward a fully realistic and unified exchange rate system, coupled with the continued liberalization of the exchange and trade regime. Virtually all imports were currently eligible for funding through the foreign exchange auction. That process would be reinforced with the abolition of the import licensing system, the further widening of access to the auction to include bona fide transfers of profits and dividends, the liquidation of all remaining external payments arrears, the improvement in economic and social infrastructure, the reform of the financial sector, the maintenance of a balanced credit policy, the retirement of government nonbank debt in the later years of the program, the internal financing by enterprises themselves, and the projected increase in foreign direct investment--assuming a stable political environment. Those considerations underlaid the program's projections, particularly the rise in private investment, but it was possible that other unaccounted for factors could prevent the latter from responding adequately to the authorities' adjustment efforts.

The programmed level of international reserves had been increased significantly, the Deputy Director agreed. As the authorities had substantially revised the level of imports used under the extended arrangement, it had been decided, in the process of updating the policy framework paper, to revise Ghana's reserve position upward. Moreover, during the past Board review of the program supported by the extended arrangement at EBM/88/63, Directors had indicated that it would be desirable to strengthen Ghana's reserve position. Given the recent deterioration in the world market outlook for cocoa and the uncertainties in that area, the authorities had argued strongly that reserves relative to imports be further strengthened to deal with unforeseen developments. It was for that reason that Ghana's increased access to Fund resources under the enhanced structural adjustment arrangement--which had been an issue of debate between the staff and the authorities--would be allocated largely to reserves. Part of the increased Fund assistance would be used to accelerate the liquidation of arrears.

On several occasions, the staff had raised the question of the speed of arrears liquidation, to which the authorities had responded that the record spoke for itself, the Deputy Director indicated. The authorities had pointed to the sharp reduction in arrears, from more than $600 million five years previously to the current level of less than $100 million. The arrears reduction target for 1990 under the extended arrangement had been $48 million; under the enhanced structural adjustment arrangement only $25 million would remain to be liquidated in 1990. Directors were correct to maintain that, if the remaining arrears were such a small amount, why not eliminate them more quickly? Nevertheless, the authorities had argued that such a course would not be realistic in view of the projected decline in cocoa prices from an estimated $2,250 a ton in 1988 to $1,700 a ton in 1989 and beyond.

The sustainability of the balance of payments over the medium term was as critical issue, as it was related to Ghana's ability to repay the Fund, the Deputy Director stated. The staff believed that it was important to examine the entire structure of the balance of payments in making an assessment of its sustainability. Even though the current account deficits, excluding official transfers, were expected to be equivalent to about 6-7 percent of GDP during 1988-91, they would be financed without any major increase in indebtedness. Most of the external borrowing would be in the form of loans on highly concessional terms, and, the ratio of debt to GDP, including debt to the Fund, would begin to decline in 1991. Ghana was also expected to have liquidated all of its external payments arrears by end-1990, and to have strengthened substantially its reserve position by end-1991. A further factor to consider was that, despite its very heavy debt service burden, Ghana had made no recourse to debt rescheduling during recent years, and none was envisaged over the entire program period. Of course, Ghana had thereby benefited from considerable capital inflows, suggesting that good performance could be associated with substantial external assistance. Ghana had a fine record of discharging its financial obligations, and its capacity to repay the Fund was not a cause for concern. The enhanced structural adjustment facility would be an important instrument for alleviating the country's debt service burden.

Disbursements under that facility were front-loaded to assure the authorities of the same level of Fund support as envisaged under the extended and structural adjustment facilities, the Deputy Director explained. Given Ghana's balance of payments need, it would not be appropriate to renege on the implicit commitment of Fund resources under the latter two facilities.

The issue of incorporating external contingency mechanisms into the program had arisen near the end of the staff discussions with the authorities, but could not be integrated easily at that late stage, the Deputy Director commented. During the Annual Meetings, the staff had elaborated on the possibilities of using contingency mechanisms, especially in view of the uncertainties in the world cocoa market. The authorities were currently studying the matter. Even though the world market price of cocoa had revived moderately in recent weeks, it could still be influenced by the behavior of other major producers, but that possibility might already have been discounted. The uncertain outlook for cocoa prices could be offset by several factors: the current lower petroleum price than was used in the import price projections; the possibility of some external debt cancellation, which had not been integrated into the program owing to timing considerations and the need for further discussions; and the possibility that some external financial support might be greater than foreseen. The net effect of those factors would have to be examined during the first semiannual review of the program under the proposed enhanced structural adjustment arrangement. Meanwhile the issue would be considered by the mission scheduled to visit Ghana in December to discuss the 1989 budget. Of course, if a financing gap did emerge, a combination of further adjustment and financing would be needed.

He realized that the staff's inflation rate projections were not always optimal, and that revisions to those projections were made from time to time in a number of cases, the Deputy Director observed. Nonetheless, there were some encouraging signs that the authorities would be able to achieve their inflation rate objective of 20 percent by the end of 1988, or, at least, that they were moving toward it. Credit policy had been kept appropriately tight, weather conditions had improved, the authorities were expecting a bumper maize crop, and therefore the most recent consumer price information showed continued significant deceleration in the inflation rate over the same period last year.

The staff had not unfairly singled out the petroleum sector for increased taxation, the Deputy Director noted. As fiscal revenues needed to be mobilized for the government budget and given that retail petroleum prices in Ghana were quite low by African standards, there was scope for raising petroleum taxation. Moreover, petroleum consumption needed to be restrained.

The complex task of redeploying civil servants, with its social implications, was proceeding satisfactorily, the Deputy Director indicated. That matter was also addressed in the statement of Directors of the World Bank transmitted to the Fund.

With respect to whether all controls other than those on public utilities would be eliminated, the staff had stated that most of the remaining controls would be abolished, subject to discussions with the authorities, the Deputy Director of the African Department observed. As Executive Directors had noted, the program included as a structural performance criterion the abolition of the import licensing system. It was a most difficult criterion to set, because the licensing system was used for tax and statistical purposes, and the authorities had stated that several creditors regarded some licensing procedures as useful for their operations.

The Deputy Director of the Exchange and Trade Relations Department said that the staff would make every effort to examine the contribution of the enhanced structural adjustment arrangement to the economic prognosis for Ghana during the first semiannual review, scheduled for early next year. However, he did not want to raise expectations, as the program under the extended Fund and structural adjustment arrangements already involved an ambitious set of policies, and it would be difficult to identify changed prospects that might stem directly from the enhanced structural adjustment arrangement per se.

It was certainly not the staff's intention to adjust the exchange rate beyond some concept of an appropriate level of competitiveness, the Deputy Director continued. Flexibility in exchange rate management, as expressed in the program, clearly meant judging the appropriateness of the exchange rate as events unfolded. Under any Fund arrangement, it was undoubtedly preferable that the real exchange rate be adjusted to the appropriate equilibrium level as soon as possible, and then be held at that rate with appropriate demand-management policies. Even so, as no one knew what the equilibrium exchange rate was--particularly in the context of the significant structural adjustments that were envisaged under a program--one inevitably had to aim for a best estimate of what that rate might be. In addition, the appropriate pace of exchange rate adjustment was often one of the most difficult issues to resolve with the authorities. The reality of not knowing the final appropriate exchange rate and the political reality of the authorities resisting substantial early adjustments to the rate meant that the staff inevitably iterated to an appropriate competitive rate through the kind of process that was unfolding in Ghana's case.

There were quite a number of factors giving the authorities some margin for maneuver in the event of external shocks, the Deputy Director observed. Such margins had been discussed by the Board when considering, inter alia, the questions of deductibility and thresholds in the context of external contingency mechanisms. In all countries with enhanced structural adjustment arrangements, the staff would look for factors providing a margin for maneuver, such as reserve buildups, prompt and additional policy measures, and increased aid flows, since the terms of the compensatory and contingency financing facility were obviously different from those of the enhanced structural adjustment facility. In a case like Ghana, the enhanced structural adjustment facility would provide the most appropriate concessional resources. The staff was alert to concerns about contingencies and would, as well, reconsider access for the second and third arrangements under the enhanced structural adjustment facility in view of any external shocks that might occur.

Mr. Adachi said that he assumed that the Fund's previous commitments under the extended and structural adjustment facilities could justify the front-loading of the new arrangement, but he emphasized that Directors should fully consider other aspects in addition to the requirement of balance of payments need, particularly the relevant country's ability to make repurchases.

Mr. Ghasimi said that it was clear from the discussion that the authorities' courageous efforts and initiatives, combined with the continuous support and assistance of the Fund, the World Bank, and other multilateral institutions and donor governments, had produced successful results since the adoption of the Economic Recovery Program. Tangible improvements had been witnessed in every aspect of the economy, and all of the parties concerned should be congratulated.

It had rightly been acknowledged that the continued weakening of world cocoa prices, and the possible further deterioration of those prices below the level assumed in the baseline scenario, would lead to financing gaps in 1989 and beyond, Mr. Ghasimi noted. Such an adverse situation might not be compensated for by unforeseen favorable developments. As Mr. Fernando and other Directors had emphasized, the ability to process more raw material exports like cocoa and timber and the expansion of other nontraditional exports would surely be effective avenues for exploiting Ghana's comparative advantage and for augmenting its foreign exchange earnings. Unfortunately, prospects in those areas were not very favorable, given the existence of tariffs and nontariff barriers in industrial countries, especially on processed goods. In any event, in view of the good track record of adjustment policies in Ghana, one would hope that, in the event of exogenous difficulties in the cocoa market, the staff and the Board would consider the resulting necessary modifications to the adjustment program.

On the question of the quicker elimination of external arrears, as many speakers had emphasized, the authorities had a perfect track record of cooperation with the international financial community, Mr. Ghasimi remarked. The authorities remained committed to eliminating arrears. Nevertheless, Directors should regard the issue in relation to the necessity of ensuring the growth of the economy, which should, after all, be the central objective of all Fund-supported programs, especially those supported by the enhanced structural adjustment arrangement. If the program was to succeed, the agreed timetable for eliminating arrears was indeed reasonable. More generally, it seemed that creditors should demonstrate somewhat more patience with countries in which strong adjustment programs were succeeding, as was the case with Ghana.

After undertaking the most successful adjustment program in sub-Saharan Africa, the authorities were strongly committed to pursuing their medium-term program, while vigorously taking into consideration all of that program's social and political effects, Mr. Ghasimi observed. The arrangements under the enhanced structural adjustment facility would greatly support the program. The authorities appreciated the support of the Fund and donor countries, which had contributed to the success of the program. However, they wanted to explore further with donors means of reducing the long lags between commitments and disbursements, and the problem of tied aid.

The Chairman made the following summing up:

> Directors concurred with the thrust of the views expressed in the staff appraisal of the report on the 1988 Article IV consultation with Ghana. They noted with satisfaction that in recent years the Ghanaian authorities had continued to implement far-reaching structural and financial reforms with considerable success. The progressive liberalization of the exchange and trade system, coupled with the elimination of most price and distribution controls, had led to a substantial strengthening of incentives in favor of production, export, savings, and investment. The gradual rehabilitation of the economic and social infrastructure had helped to ease impediments to economic

growth. Moreover, the restoration of fiscal discipline at an early stage of the reform process had contributed measurably to the reduction of financial imbalances.

In 1987 the reform process had been given even greater impetus and, with the rigorous implementation of a broad range of structural and financial policies, the basic macroeconomic objectives of the program were largely realized. Despite adverse weather conditions, the economy had continued to expand rapidly, inflation had been reduced significantly during the second half of the year, and the balance of payments had registered a sizable overall surplus. Thus, Ghana represented an outstanding example of adjustment with growth in sub-Saharan Africa.

Despite the considerable economic progress made since 1983, however, Directors noted that Ghana still faces major structural and financial problems. Economic growth is constrained by inadequate domestic savings and investment, as well as by infrastructure bottlenecks; the rate of inflation remains high; and the external payments position continues to be vulnerable to adverse developments in the international environment, such as the recent sharp drop in world market prices for cocoa. The pace of adjustment with growth in the economy is also constrained by weaknesses in the financial system and in the operations of state-owned enterprises.

Against this background, Directors expressed broad support for the authorities' updated medium-term program, covering the period 1988-91, which aims at sustaining the growth momentum of the economy and achieving a viable external payments position. However, some concern was expressed about the prospective widening of the external current account deficit and the further accumulation of external debt. Directors noted with satisfaction that the program seeks to address in a systematic manner the needs of the poorest and most vulnerable groups in Ghana.

Directors welcomed the emphasis being placed by the program on an acceleration of structural reforms. They encouraged the authorities to continue to take decisive steps aimed at further improving the framework of incentives in the economy through a more flexible exchange rate policy, exchange and trade liberalization, and higher agricultural producer prices. In this regard, the measures already implemented in 1988 augured well for the future, but they needed to be sustained and broadened through further actions, including the planned abolition of the import licensing system and a further widening of access to the auction market for foreign exchange. Directors encouraged the authorities to unify the exchange markets as soon as possible, and to give higher priority to the reduction of external payments arrears. Directors also encouraged the authorities to persevere in their efforts to strengthen the efficiency and equity of the tax system; pursue the civil service reform; rationalize the allocation of government resources with a view to increasing appropriations for high-priority investments; accelerate state enterprise reform and the divestiture program; and implement the planned financial sector reform.

While commending the authorities for their strong commitment to reform, Directors remarked that determined efforts will be required to achieve the program targets. To mobilize the necessary domestic resources to sustain the recovery of the economy, it would be important to strengthen the domestic savings effort through a combination of measures, including actions aimed at achieving positive real interest rates. Directors were of the view that there was a need to foster more vigorously private sector activity, and to encourage productive investment from abroad. In view of the uncertainties in the world cocoa market, the situation would have to be monitored closely.

Finally, Directors emphasized that Ghana's reform program was deserving of the continued support of the international community. Accordingly, they approved Ghana's request for a three-year arrangement under the enhanced structural adjustment facility. They also expressed the hope that official external assistance to Ghana will be provided as appropriate, in a timely fashion, and on highly concessional terms.

It is expected that the next Article IV consultation with Ghana will be held on the standard 12-month cycle.

The Executive Board then took the following decisions:

<u>1988 Consultation</u>

1. The Fund takes this decision relating to Ghana's exchange measures subject to Article VIII, Sections 2(a) and 3, and in concluding the 1988 Article XIV consultation with Ghana, in the light of the 1988 Article IV consultation with Ghana conducted under Decision No. 5392-(77/63), adopted April 29, 1977, as amended (Surveillance over Exchange Rate Policies).

2. Ghana maintains the exchange restrictions described in EBS/87/68, Supplement 1, in accordance with Article XIV, Section 2, except that the multiple currency practices arising from the operation of the foreign exchange auction market and from the difference between the exchange rates in the auction market and the foreign exchange bureaus, the restrictions evidenced by external payments arrears, and the restrictions

on transfers of balances under the bilateral payments agreements with Fund members are subject to Fund approval under Article VIII, Sections 2(a) and 3. The Fund welcomes the intention of the authorities to eliminate these multiple currency practices and restrictions, and encourages the authorities to remove them as soon as possible. In the meantime, and with the exception of the restrictions on the transfers of balances under the bilateral payments agreements with other Fund members, the Fund grants approval of the retention by Ghana of the multiple currency practices and exchange restrictions subject to approval under Article VIII, Sections 2(a) and 3, until November 30, 1989 or the completion of the next Article IV consultation with Ghana, whichever is earlier. The Fund urges Ghana to terminate the remaining bilateral payments agreements with Fund members as soon as possible.

Decision No. 9017-(88/165), adopted
November 9, 1988

Enhanced Structural Adjustment Arrangement

1. The Government of Ghana has requested a three-year structural adjustment arrangement under the enhanced structural adjustment facility, and the first annual arrangement thereunder.

2. The Fund notes the updated policy framework paper for Ghana set forth in EBD/88/273.

3. The Fund approves the arrangements set forth in EBS/88/207, Supplement 2.

Decision No. 9018-(88/165), adopted
November 9, 1988

3. HONDURAS - OVERDUE FINANCIAL OBLIGATIONS - SETTLEMENT

The Chairman noted that he had just been informed by the paying agent for Honduras that payments were being made, effective that day, which would fully settle the country's overdue financial obligations to the Fund. The further review of the decision on the complaint under Rule K-1 could therefore be withdrawn (see EBS/88/223, Sup. 2, 11/11/88).

4. ETHIOPIA - 1988 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1988 Article IV consultation with Ethiopia (SM/88/223, 10/12/88). They also had before them a background paper on recent economic developments in Ethiopia (SM/88/239, 10/28/88), and an information notice on the real effective exchange rate (EBS/88/229, 11/8/88).

Mr. El Kogali made the following statement:

Recent economic developments in Ethiopia have been inextricably linked to bad weather and other exogenous factors, including adverse movements in the terms of trade, limited access to the markets of industrial countries, and difficulties relating to the level and timing of external finance. The authorities, therefore, find it disturbing that the staff has minimized the impact of these factors, and, instead, has concluded that the economic difficulties are mainly the result of "inadequate and inappropriate policy adaptations." In their view, such a characterization can only serve to mislead Directors into having a distorted picture of developments in the Ethiopian economy, while not showing sufficient recognition of the fact that the Government has managed the economy reasonably well under very trying circumstances. To buttress their argument, the authorities have drawn attention to the fact that, despite severe strains on the balance of payments, Ethiopia has: remained up to date in servicing its external debt; undertaken appropriate reform of the pricing and marketing of agricultural production; kept inflation in check; ensured fiscal discipline and maintained a strong tax effort despite the low level of income; and limited the system of price control to only a few commodities necessary to protect low-income groups.

As a centrally planned economy, with deep-seated structural rigidities and much poverty, the process of adjustment in Ethiopia clearly does not lend itself easily to market-oriented prescriptions. While it is true that the price mechanism is being used in a number of centrally planned economies to further the process of reform, the Fund needs to exercise some caution in recommending uniform uses of policy instruments, particularly as its experience with adjustment in centrally planned economies is somewhat limited. Although planning remains a major feature of economic management in Ethiopia, the authorities do not regard the plan itself as inflexible. Indeed, the Government is in the process of reviewing the current five-year plan precisely in order to identify constraints and devise appropriate policies in light of past experience. It is expected that the country's commitment to adjustment will be supported by the international community through increased concessional aid flows.

Agricultural development remains the key to the overall development strategy, in keeping with the dominant role of that sector. The aim is to strengthen the resilience of the agricultural sector to cope with the problem of recurrent drought and to move progressively toward food self-sufficiency. In this respect, the authorities are improving irrigation and extension services and have simplified the distribution system. They have also raised producer prices, as was done in 1983. The monopolistic role of the Agricultural Marketing Corporation (AMC) has been reduced, while the role of private merchants has been enhanced by permitting the latter to buy grain directly from farmers at prices lower than those set for the AMC.

Expanding production in the manufacturing sector is also a priority, with particular emphasis being placed on improving the performance of state enterprises. Increased productivity in these enterprises is already becoming evident, as losses in a number of them have declined. Meanwhile, ways are being examined to enhance productivity by improving incentives to employees. In addition, steps are being taken to expand mineral production in order to diversify the country's productive base. The target for the production of gold in 1989 is expected to be met, and there are good prospects for iron ore and soda ash production, and for the quarrying of marble and granite.

It is clear from Table 2 (SM/88/223) that revenue performance has been good, with the ratio of revenues to GDP rising from 23 percent in 1983/84 to about 30 percent by 1987/88. The projected fall in revenue in 1988/89 to about 24 percent of GDP is due largely to the decline in economic activity. For instance, taxes and business profits are expected to fall by about 24 percent, and those on agricultural income by about 19 percent. Import duties are expected to be only slightly more than half of the amount collected in the previous year. It is to the authorities' credit that they have made a major effort to counter these revenue shortfalls--an example of their pragmatism in setting economic policies--by instituting measures that should yield revenues equivalent to some 3 percent of GDP.

Interest rate policy is designed to foster the developments of priority sectors and to keep investment costs at reasonable levels. The savings deposit rate is 6 percent, while the average lending rate is 7 percent. These rates have remained positive in real terms in that the inflation rate this past year is estimated to have been only slightly over 2 percent. Thus, the authorities do not share the staff's view that the current interest rate structure, implemented in July 1986, has compounded inefficiency in the mobilization and allocation of resources.

There has been a marked deterioration in the balance of payments during the past two years, with the overall balance going from a surplus of about SDR 153 million in 1985/86 to an estimated deficit of about SDR 107 million in 1987/88. The situation reflects weak export earnings owing to the adverse terms of trade, the impact of bad weather on the production of export commodities, the large debt service payments, and the drop in net public transfers. All of this has strained Ethiopia's reserves, which declined from about SDR 212 million in 1986/87 at the end of June 1987 to about SDR 89 million at the end of June 1988. Some improvement in the balance of payments is expected in 1988/89, but the situation will remain difficult, mainly because the country's reserves are already at a very low level.

Since 1985, Ethiopia's competitiveness has been improving, largely as a result of the depreciation of the U.S. dollar, to which the birr is pegged. The birr depreciated further in real terms in 1987/88 by 10 percent, following a nearly 24 percent real depreciation in 1986/87. The authorities have noted the reference in the staff report to the existence of a parallel market, in which the birr is said to trade at some Br 4-5 per U.S. dollar, compared with the official rate of Br 2.07 per U.S. dollar. They have pointed out that, because the size of the market has been shrinking during the past year and is insignificant, the prevailing exchange rate is an unreliable indicator of the opportunity cost of foreign exchange. It is the authorities' view that an exchange rate adjustment at this time, when the supply of export commodities is still severely constrained by drought, would not of itself lend to an improvement in the balance of payments. Besides, they have indicated that import demand is mostly tied to capital investment and tends to be inelastic. However, matters relating to the exchange rate and pegging are being kept under review.

Ethiopia's debt service ratio has been rising and currently stands at about 39 percent. However, the authorities are more optimistic about the country's capacity to service its debts in the future than the staff, which characterized the Ethiopian economy as being "at a crossroads more than at any other time in the recent past." As a matter of fact, the authorities found no basis for expressing such a dismal view of Ethiopia's capacity to service future external debt obligations on a timely basis. They regarded it as unfair that the staff report would do so in respect of their economic prospects solely on the basis of developments in a single year. Moreover, they drew attention to the fact that the level of output in 1987/88, although lower than that of 1986/87, was not as bad as that of 1984/85, or even that of 1985/86, while the rate of inflation has remained modest. Even though the rising trend in the debt service ratio will continue in the current fiscal year, the authorities believe that it will thereafter be reversed, and fall to 24 percent by 1992/93, in part because of prudent borrowing policies. Moreover, with good weather conditions and favorable fuel prices, they are hopeful that Ethiopia will successfully service its external debt.

With respect to the medium-term outlook, the authorities believe that the scenarios prepared by the staff should be viewed with caution. They consider the export targets for coffee under Scenario A to be on the low side, and the import targets, especially for consumer goods, to be somewhat unrealistic, given the expected level of foreign exchange and the inflow of external resources.

The authorities request the Board's approval of the existing restrictions on payments and transfers for current international transactions, at least until the intensity of the drought is minimized and conditions return to normalcy. They had hoped that such a recommendation would have been proposed by the staff, as had been done under less severe circumstances in 1986. In making this request, they draw Directors' attention to the fact that, in addition to the drought situation, the country has been affected by adverse movements in the terms of trade, the low level of external aid, and the instability in the price of its major export crop.

Extending his remarks, Mr. El Kogali said that he had just received a telephone call from the authorities informing him that the Chairman of the Central Committee of the Ruling Party had proposed a number of new policy initiatives to the Committee that were currently being discussed. The suggested measures included: policies to further enhance the development of the private sector; permission for joint ventures between the latter and foreign investors, ventures that had previously been permitted only with public enterprises, liberalization of policy with respect to land ownership; and permission for private individuals to invest in small-scale enterprises and to participate in joint ventures with the Government. Those suggestions demonstrated the point made in his opening statement that the authorities were indeed becoming more flexible in managing the economy and were making a serious effort to develop and implement a meaningful adjustment program. The authorities had recently sent updated data to himself and to the staff.

Owing to the intensification of the drought and to other adverse exogenous factors, abolition of the existing exchange restrictions would not at present serve the larger interests of the Ethiopian economy, Mr. El Kogali added. Moreover, approval by the Board of those restrictions would be consistent with Article IV, Section 3(b), enjoining the Fund to pay due regard to the circumstances of members in the application of the Fund's surveillance role. Approval would send the right message to the authorities at the current juncture.

Mr. Zecchini made the following statement:

The recent measures described by Mr. El Kogali are welcome, and I hope that they will be implemented forcefully without delay and be part of a broader strategy aimed at restructuring and better exploiting the potential of Ethiopia's economy. Notwithstanding the new measures, the current and prospective situation of the Ethiopian economy does not appear encouraging. The authorities' continued failure to undertake essential structural reforms together with an unwarranted relaxation of macroeconomic policies in 1987 and unfavorable exogenous developments, such as the drought, are contributing to very worrisome balance of payments prospects. A comprehensive adjustment effort, aimed at correcting the financial imbalances and at removing long-lasting market distortions is urgently needed. Only such an effort will establish the conditions for better allocating domestic resources and for mobilizing external financing to exploit the country's vast untapped potential in sectors such as mining, agriculture, and tourism. As clearly highlighted by the staff's simulations, a comprehensive policy package will yield a stronger balance of payments outcome, more rapid growth, and higher real per capita income. I fully support the staff's assessment and its recommendations.

The increasing size of the fiscal deficit is a cause for concern, particularly because its financing will rely substantially on foreign borrowing, owing to the limited availability of domestic financial resources. According to the staff report, foreign financing will be equivalent to about 6 percent of GDP in 1987/88. The additional external financing will increase the already growing external debt-servicing burden. Of equal cause for concern is the fact that no indication is provided of an intention by the authorities to tackle the problem of the budget deficit. For the coming fiscal year 1988/89, the only measure in place to partially correct the deteriorating fiscal trend is the special decree or levy that was introduced in May. This new measure is expected to raise revenues by some 3 percent of GDP. It would be useful to have additional information on the levy, particularly with respect to its effectiveness, its distortionary effects, and whether it is envisaged as temporary or permanent.

It is regrettable that current expenditures continue to grow, as a result not only of military needs, but also of a substantial expansion of outlays for grain and fuel subsidies. The latter reflects the effects of the increase in producer prices, which has not been passed on to consumers. When higher prices are passed through, they will eventually improve the transparency of the costs associated with the unrealistic price system. It is essential that the authorities consider the pass-through of higher prices as a first step in the transition to a price system that would make the decisions of both producers and consumers more responsive to relative scarcities.

Capital expenditures are budgeted to increase by some 56 percent in the coming fiscal year. In principle, an expansion of public investment is a welcome development, but given the weak performance of that spending in the previous year, it is essential that the authorities test beforehand the viability of all additional investments and the capacity of the public administration to manage such expenditures.

In the monetary domain, there seem to be two major problems. First, the authorities continue to rely heavily on monetary policy for the purpose of influencing the allocation of credit. The structure of interest rates is set in a manner that channels credit toward specific sectors and penalizes others, particularly those relating to private initiatives. Second, the level of nominal interest rates has not been adjusted to the mounting rate of inflation; hence, real interest rates on lending and deposits have turned negative during the past year. Both of these factors will make it difficult to sustain the process of diversifying the productive base and to achieve the needed mobilization of domestic and external savings.

On exchange rate policy, I share the staff's recommendation for devaluation. Sufficient evidence is provided in the staff report on the overvaluation of the currency at the current exchange rate, including the fact that the authorities continue to rely on payment and transfer restrictions. It is, however, of the utmost importance that the exchange rate realignment be supplemented by a broader rationalization of the price system at large, lest the effectiveness of the devaluation in improving the supply response of the economy be seriously undermined. To avoid future exchange rate misalignment, a review of the current procedure of pegging the Ethiopian currency exclusively to the dollar seems to be warranted.

In addition to calling for fundamental reforms of the price and interest rate structure, I wish to underscore that continued progress is also required in reforming the public enterprise sector and the state farms. Even though it has to be acknowledged that some improvements have taken place in key areas, such as in the grain marketing arrangements, much more needs to be done to improve efficiency in the management of the public productive system.

Mr. Rieffel said that the deterioration in the Ethiopian economy since the 1987 Article IV consultation was disappointing. He agreed with the staff's assessment of the situation and noted that his chair's concerns were largely the same as those expressed a year ago.

The authorities should implement the reforms recommended by the Food and Agriculture Organization-funded study of state farms, Mr. Rieffel continued. While welcoming the measures taken recently to liberalize grain marketing, he continued to believe that restrictions on grain distribution were a major obstacle to increasing agricultural production. He had been encouraged to learn of the study under way on the price control system and hoped that it would lead to a relaxation of those controls in a manner that would increase the efficiency of the economy. Moreover, it was important to implement the new measures just mentioned by Mr. El Kogali.

A more active exchange rate policy would help to strengthen the balance of payments and his chair would lend its support to an informal exploratory depegging study as a first step in that direction, Mr. Rieffel added.

As stated by the staff, the Ethiopian economy was at a crossroads, Mr. Rieffel remarked. The authorities should therefore adopt a comprehensive reform program along the lines outlined in Scenario B, which appeared to offer much brighter prospects for growth and rising living standards than Scenario A. If the authorities had some doubts in that respect, they might be interested in the quite successful experience of Ghana in reorienting its economy toward growth, without overlooking the need for social equity.

The Chairman commented that he agreed with the latter observation.

Mr. Serre expressed his concern at the current structural and financial imbalances. Like the staff, he noted that the Ethiopian economy appeared to be at a crossroads more than at any other time in the recent past. A package of adequate measures was needed to address the current economic and financial rigidities, for which he considered the World Bank Peasant Agricultural Development Program (PADP) as a first step.

Substantial structural benefits would arise from a major reorientation of the domestic pricing system, Mr. Serre emphasized. The degradation of the agricultural resource base--which affected 85 percent of the global population--was undoubtedly due to inadequate producer prices, the network of price controls, the existing state farm system, and the restrictions on food marketing. Taking into account the measures adopted under the PADP, the authorities should extend the liberalization of agricultural structures to address the current misallocation of resources and to increase both food self-sufficiency and food exports. Relaxing the restraints on the manufacturing sector would also allow for increased overall productivity, which was of the utmost importance for sustaining growth.

The projected overall fiscal deficit for 1988/89, equivalent to about 23 percent of GDP excluding grants, was clearly unsustainable, Mr. Serre pointed out. The authorities should, at least, pass on to consumers the most recent increases in producer prices and eliminate the exemption from import duties. As recommended by the staff, current outlays would have to be tightened substantially to reduce the high contribution of the fiscal budget to monetary expansion.

In the latter connection, and taking into account previous developments, one could only urge the authorities to improve the level and structure of interest rates in order to re-establish positive rates for savings, and to abandon discrimination against the productive private sector, Mr. Serre commented. The authorities' recourse to nonbank sources of financing to cover the fiscal deficit, particularly from the pension and social security systems, would alter Ethiopia's future prospects and demonstrated the necessity of the authorities to be more stringent in using those sources of finance.

The large balance of payments deficit in 1987/88 had induced a serious drawdown of gross official reserves, Mr. Serre noted. Considering the uncertainty of the export gains expected in 1988/89, the authorities should adopt a realistic exchange rate adequately reflecting estimates of domestic resource costs and the exchange rate in the parallel market. A realistic exchange rate policy would contribute to reversing the declining competitiveness of the export sector.

He agreed with the staff's analyses of the necessity of adopting the relevant measures under the adjustment-oriented scenario, Mr. Serre indicated. A comprehensive policy package, including flexible pricing, interest rate, and exchange rate policies, combined with fiscal restraint and trade liberalization would allow for sustainable growth under sound financial conditions. Ethiopia had to overcome its dependence on external assistance arising from natural disasters; the authorities should adopt a structural adjustment program supported by the international financial community.

Mr. Comotto made the following statement:

I agree with Mr. El Kogali that what might broadly be called "exogenous" problems have had a serious impact on Ethiopia's economic performance, and that the Board must recognize the authorities' very trying circumstances. In this context, the authorities' timely debt service payments--not the least, their borrowing from the Fund--are indeed highly commendable as are some of the reforms that have been undertaken. I look forward to the elaboration of the measures announced by Mr. El Kogali, while, like Mr. Zecchini, I hope that they will be implemented resolutely.

Nevertheless, the situation in Ethiopia has deteriorated again, and notwithstanding the news about possible new measures, it is difficult to argue that policies are in any sense adequate. Indeed, I agree with the staff that the current policies are likely to aggravate difficulties. The authorities appear distinctly unenthusiastic about the process of reform;

the measures supported by the World Bank were agreed to after only protracted negotiation, and their acceptance by the authorities seems to have been motivated more by the need to secure the associated financing than by any faith in the efficacy of the measures. The limited liberalization of grain distribution, for example, seems a temporary expedient and not a permanent change in policy priorities, given that the ultimate objective of the Agricultural Marketing Board remains the socialization of grain distribution. Moreover, other measures recommended by the Food and Agriculture Organization remain only partially implemented.

At the heart of the authorities' skepticism vis-à-vis the process of reform seems to be a fairly basic difference of philosophy with the Fund and the World Bank. The authorities are clearly committed to central planning. They would presumably argue that this commitment reflects the higher priority attached to their social and political objectives than to the objective of economic efficiency. However, I think it is increasingly accepted that the allocative efficiency of the market mechanism is the best means of supporting social and political objectives. The authorities in increasing numbers of centrally planned economies have been "voting with their feet" on this issue in recent years and introducing market-oriented reforms. Ethiopia, on the other hand, still opts for a trade-off between economic efficiency and its particular social and political priorities. The problem is that there is a point in such a trade-off beyond which the productive economy cannot sustain itself, let alone the additional burden of the other objectives. In Ethiopia, this point in the policy trade-off was reached some time ago.

Philosophical differences also seem to be underpinned by very real practical obstacles. The noneconomic demands on the debilitated Ethiopian economy are critically exaggerated not only by the impact of recurrent droughts, but also by the cost of the insurgency. The authorities suggested recently that military expenditure accounted for about half of the fiscal budget. The diversion of already scarce resources is therefore on such a scale that the economy is inevitably being rationed severely. The authorities have chosen to apply such rationing through quantitative restrictions. The staff is recommending a shift to price rationing to try to capture the efficiency gains that will result from a market-based system of resource allocation. The policies recommended by the staff are correct and are, indeed, the only means by which the authorities can halt the further intensification of Ethiopia's economic difficulties. However, the practical problem is that a shift to a price mechanism under current circumstances would probably involve a drastic realignment of the general price level in Ethiopia. The authorities are understandably reluctant about having to confront such a consequence. Unfortunately, the underlying economic reality cannot be suppressed indefinitely and, as the Board has seen in other overregulated economies, the same consequences will emerge as economic activity is forced out of official channels.

A decision to embrace fundamental reform in Ethiopia would offer the prospect to the authorities of receiving conditional and catalytic finance to cushion adjustment and to offset the price shock that is otherwise likely to occur. Unconditional external financing, particularly if it is borrowing, is only a temporary expedient if such resources are not allocated efficiently and not used to support economic rehabilitation. The Fund can point to numerous precedents; some countries, such as Mozambique, started out in very similar circumstances to Ethiopia's.

It seems unlikely that the authorities are going to consider comprehensive economic reforms in the near future. Under the circumstances--which make use of Fund resources improbable--and in view of Ethiopia's impeccable debt service record, I wonder whether the Board should not consider placing Ethiopia on the bicyclic consultation cycle. Given Ethiopia's economic difficulties, bicyclic consultation is not ideal, but the authorities would obviously continue to obtain technical assistance through consultations with the staff. Furthermore, the staff can always bring Ethiopia to the Board if circumstances warrant urgent reconsideration. Of course, this suggestion is subject to the authorities' wishes.

It is gratifying that the authorities attach such importance to the Board's approval of their exchange restrictions. However, subject to comment from the Legal Department, I am not convinced that approval is warranted at this time. The expectation underlying the temporary approval of these restrictions in 1986--that they would be removed in a short period of time--was not fulfilled. Moreover, the authorities do not appear to be pursuing policies that offer a realistic hope for the removal of the restrictions in the near term. As approval of exchange restrictions should only be granted when those restrictions are expected to be temporary, I therefore support the staff's recommendation for nonapproval.

Mr. Fernando said that he recognized the authorities' plight, arising from the relentless pressures of recurrent bad weather and the country's generally poor endowment of natural resources. He therefore welcomed the new initiatives currently under consideration.

He had noted Mr. El Kogali's concern that the adjustment program recommended by the staff contained elements that had not been adapted adequately to the authorities' system of central planning, Mr. Fernando continued. That concern merited greater attention. For instance, greater priority might have to be placed on improving the efficiency of public enterprises, while retaining state ownership of those enterprises. To consider privatization at the current stage might be premature. However, he was confident that in shaping domestic policies, the authorities would recognize the need for modifications and adaptations, given both the imperative need for balance of payments adjustment--requiring Ethiopia to be competitive in the world market--and the need for continued substantial donor support to raise the amount and efficiency of investment.

The real effective appreciation of the currency in the decade prior to 1985 had not been neutralized entirely, even though several indicators in the external sector had become unfavorable, Mr. Fernando observed. To the extent that adjustments to the exchange rate would improve export performance, it seemed desirable for the authorities to have a greater say in the direction of exchange rate developments. In that respect, the current exchange rate system constrained the authorities' flexibility, a point on which he agreed with Mr. Zecchini. Furthermore, it was gratifying to note Mr. El Kogali's reaffirmation that the subject was under review.

With respect to agricultural pricing, he was interested to hear more about the role of the private sector, which, according to Mr. El Kogali, "has been enhanced by permitting the latter to buy grain directly from farmers at prices lower than those set for the AMC," Mr. Fernando commented. It was not clear whether that action could induce more production. While the Agricultural Marketing Corporation might be required to reach a minimum target for procurement, he wondered whether the policy permitted private sector transactions at mutually negotiated prices once the AMC requirements were met. At the same time, greater efficiency in the operations of the AMC could permit the evolution of a price level that could better blend state sector and private sector procurement.

An adjustment program to support the elimination of Ethiopia's restrictions on payments and transfers was not in evidence, Mr. Fernando stated. However, he wanted to hear staff comment on Mr. El Kogali's request that the drought-induced effects on the balance of payments warranted a reconsideration of the recommended nonapproval of the exchange restrictions.

Mr. Posthumus said that, despite the fact the Ethiopian economic system was centrally planned and although the authorities did not intend to change that system, structural changes could still be effected through the fiscal budget. He wondered whether too quick a liberalization of the price system would support or inhibit structural change.

The Chairman noted that the pace of price liberalization was a crucial question in centrally planned economies, especially if the central bank was a weak institution.

Mr. Zecchini commented that implementing a price system that was more responsive to relative scarcities did not necessarily have to involve price liberalization, because even in a system of administered prices, the authorities had, in some cases, found methods of gaining a clear idea of prices that would be appropriate. He had been careful not to refer to liberalization and privatization in his statement to the Board, as centrally planned economies did have ample scope for instituting an appropriate pricing system, exchange rate, set of benchmarks, and incentives to induce proper consumption and investment decisions.

Mr. Di said that he agreed with Mr. Posthumus and Mr. Zecchini on the issue of the pricing system in a centrally planned economy. It was a special and complex question that would probably take a long time to discuss.

As a result of the disastrous drought and internal unrest, critical conditions of poverty and large-scale famine had emerged, Mr. Di continued. It went without saying that the worrisome and miserable developments in Ethiopia had become a cause of major concern to the rest of the world. The Ethiopian economy was extremely vulnerable to changes in the weather and in the international economic environment. A twofold approach was necessary to tackle the country's difficulties; first, human survival should be the priority of policy, which required international humanitarian relief; and second, to sustain growth, the root causes of economic development should be examined closely. The most important task for Ethiopia was to strengthen its capacity to protect itself against natural disasters; thus, the authorities should give the greatest possible attention to creating the necessary infrastructure for shielding the economy from unfavorable weather conditions. Helping to protect the country from adverse external developments was also important to Ethiopia's recovery and growth.

During the most recent Annual Meetings, the problems of poverty reduction and food security had been re-emphasized by the Development Committee, Mr. Di recalled. Given the serious difficulties in the Ethiopian economy, it would be most welcome if the Fund and the World Bank--while international humanitarian relief efforts were being made--could work together closely and intensify their efforts to help the authorities attack poverty by strengthening the country's infrastructural base and by designing adjustment programs. Ethiopia was one of the poorest member countries and required the Fund's special consideration and attention.

The Executive Directors agreed to resume their discussion in the afternoon.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/88/164 (11/4/88) and EBM/88/165 (11/9/88).

5. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 88/31 and 88/32 are approved. (EBD/88/306, 11/1/88)

Adopted November 7, 1988

6. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/88/269 (11/3/88) and EBAP/88/272 (11/7/88), and by Advisors to Executive Directors as set forth in EBAP/88/269 (11/3/88) is approved.

APPROVED: May 16, 1989

LEO VAN HOUTVEN
Secretary