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0404

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 87/172

3:00 p.m., December 15, 1987

R. D. Erb, Acting Chairman

Executive Directors	Alternate Executive Directors
	A. G. A. Faria, Temporary
	Jiang H.
	M. K. Bush
	A. Rieffel, Temporary
	J. Prader
A. Donoso	
	A. M. Othman
	M. B. Chatah, Temporary
G. Grosche	
	D. V. Nhien, Temporary
A. Kafka	
	C. Enoch
M. Massé	
	C. V. Santos
	P. D. Péroz, Temporary
	C. Noriega, Temporary
	M. A. Kyhlberg, Temporary
H. Ploix	
G. A. Posthumus	
C. R. Rye	
	O. Kabbaj
	L. E. N. Fernando
	S. Yoshikuni
	S. Rebecchini, Temporary

C. Brachet, Acting Secretary
S. Woolls, Assistant

Also Present

IBRD: P. Landell-Mills, Africa Regional Office. African Department: A. D. Ouattara, Counsellor and Director; E. L. Bornemann, Deputy Director; E. A. Calamitsis, Deputy Director; R. O. Carstens, P. Dhonte, M. G. Gilman, A. Jbili, J. W. Kratz, G. B. Taplin. Exchange and Trade Relations Department: L. A. Whittome, Counsellor and Director; S. J. Anjaria, H. B. Junz, V. P. G. Schoofs. Fiscal Affairs Department: A. Tazi, M. Z. Yücelik. Legal Department: A. O. Liuksila, J. M. Ogoola. Research Department: N. M. Kaibni, R. Pownall, B. E. Rourke. Treasurer's Department: D. Berthet, A. Mathuran. Advisors to Executive Directors: M. B. Chatah, J.-C. Obame, N. Toé, J. E. Zeas. Assistants to Executive Directors: J. R. N. Almeida, W. N. Engert, G. K. Hodges, S. King, K. Kpetigo, T. Morita, D. Saha, C. C. A. van den Berg, R. Wenzel.

1. CÔTE D'IVOIRE - 1987 ARTICLE IV CONSULTATION; STAND-BY ARRANGEMENT; AND USE OF FUND RESOURCES - COMPENSATORY FINANCING FACILITY

The Executive Directors considered the staff report for the 1987 Article IV consultation with Côte d'Ivoire and a request by Côte d'Ivoire for a stand-by arrangement (EBS/87/249, 11/30/87; Cor. 1, 12/14/87; and Sup. 1, 12/10/87), together with a request for a purchase under the compensatory financing facility (EBS/87/250, 11/30/87; Sup. 1, 12/11/87; and Sup. 2, 12/14/87). They also had before them a statistical annex on Côte d'Ivoire (SM/87/290, 12/11/87).

The staff representative from the African Department said that the Chairman of the Coordinating Committee of Commercial Banks, following a meeting that had taken place in Paris on December 9-10, 1987, had stated that, except for the requests for a shift in the cutoff date to end-1986 and a contingency facility, the banks were prepared to consider all the other requests submitted by the Ivoirien delegation, including a new money package, provided that all interest payments in arrears were cleared and that the authorities made future interest payments on schedule. It had been agreed that the next meeting with the Ivoirien delegation would take place in Paris on January 12-13, 1988, with the expectation that it would be possible to reach an agreement in principle on the financial package for Côte d'Ivoire with the Coordinating Committee of commercial banks.

Mr. Santos made the following statement:

On behalf of my Ivoirien Authorities, I would like to express my sincere appreciation for the constructive and candid manner in which the negotiations leading to the present request for a stand-by arrangement were conducted. I would also like to thank Executive Directors for agreeing to have these papers placed before them at such short notice.

Since 1981, Côte d'Ivoire has been implementing strong adjustment programs with technical and financial assistance from the Fund, the World Bank, and other multilateral institutions and bilateral creditors in order to correct the internal and external imbalances that have plagued the economy. The authorities' determined efforts at implementing these adjustment programs resulted in a significant improvement in the main economic and financial indicators of Côte d'Ivoire. Indeed, in 1985, real GDP grew by about 5 percent, inflation, as measured by the consumer price index, was kept under 2 percent, the overall public sector balance recorded a surplus of 2 percent of GDP, and the external current position was nearly in balance. This satisfactory performance continued in most of 1986. However, starting in the last quarter of 1986, adverse exogenous developments affected Côte d'Ivoire's economic performance and caused a setback in the implementation of the two-year adjustment program under the stand-by arrangement approved on June 23, 1986.

As my authorities explained in their letter to the Managing Director (Appendix II of EBS/87/249), the reversal of external conditions characterized by a precipitous decline in the export prices of coffee and cocoa and a continuing depreciation of the U.S. dollar vis-à-vis the CFA franc, brought about a drastic change in the underlying assumptions of the program. In light of the magnitude of the impact of these unfavorable external developments, the measures required to keep the program on track became politically and socially unbearable, and therefore the program became inoperative.

The rapid deterioration of Côte d'Ivoire's economic situation in 1987 prompted the authorities to reassess their economic development and external financing strategies and to negotiate a new Fund-supported program that would take the new external conditions into account. They are determined to alleviate the deleterious effects of the unfavorable exogenous developments on the economy and they intend to pursue the adjustment efforts to lay the foundation for a sustainable growth in the medium term. Since the medium-term outlook of the Ivoirien economy is likely to remain difficult due to the persistence of the deteriorating terms of trade, the authorities intend to step up the restructuring of the economy initiated under previous adjustment programs while continuing to maintain a cautious demand-management policy under a new adjustment program for which a 16-month stand-by arrangement is being requested. Also, to compensate for the shortfall in export volume and prices, the authorities are requesting a lower tranche drawing under the compensatory financing facility.

Since the staff paper provides a detailed description of the measures envisaged under the proposed program, I will comment on only some of its important aspects.

In light of developments since late 1986, my authorities consider that the adjustment program that they are now embarking on should be growth oriented, focusing on improving the competitiveness of the economy and maintaining public investment at a level compatible with a sustainable growth target of 3.5 percent a year. Given the high burden of external debt service obligations, the program also stresses an imaginative debt strategy that would allow for the releasing of resources to achieve that growth target.

With respect to the competitiveness of the economy, the authorities are providing appropriate production incentives that could help to promote economic activities in the agricultural and industrial sectors and enhance the role of the private sector. In the agricultural sector, they intend to continue with their policy of crop diversification. While additional steps are being taken to reduce the economy's heavy reliance on

cocoa and coffee and to emphasize other export activities, the authorities are also adopting measures to enhance the quality of coffee and cocoa by rationalizing extension and support services. Efforts to retain the youth in rural communities are being made in the context of a medium-term resettlement strategy with the support of donors. In the industrial sector, the promotion of new areas of activity will be undertaken and the profitability of export products will be enhanced. These latter undertakings will be facilitated by the establishment of prefinancing and credit insurance arrangements to be proveded under a World Bank structural adjustment program. Morover, the level of tax on interest rates charged by the banks will be further reduced in order to provide incentives to the private sector. The reform of the public enterprise sector will also continue, with the government withdrawing from productive and commercial activities.

As to investment policy, an emphasis is being placed on quick-yielding productive activities and on labor-intensive ventures in rural areas. The authorities plan to increase public investment by about 6 percent annually in real terms over the medium term to help sustain economic growth and the creation of job opportunities. The programming and selection of the projects will be done in close collaboration with the World Bank.

As far as my authorities' debt strategy is concerned, the objective is to improve the maturity structure of the debt so as to reduce the debt service burden and to increase the repayment capacity of the country in the medium term. To achieve this objective, they have decided to resort to concessional external resources for the financing of the investment programs. They are also examining the feasibility of adopting the "menu approach" to their debt problem, in particular, to debt-equity swapping.

My authorities recognize that a sound demand-management policy is needed to support the structural reforms if economic growth is to resume on a durable basis. To this end, they intend to pursue prudent fiscal and monetary policies in the period ahead. As to fiscal policy, the authorities plan to reduce the budget deficit by about 3 percentage points of GDP from 7.5 percent of GDP in 1987 to 4.9 percent of GDP in 1988. This reduction is predicated upon the judicious combination of revenue-enhancing and expenditure-reducing measures. On the revenue side, measures will be taken to increase import duties, the rates of the fixed business tax, and the automobile registration fees, to broaden the coverage of the value-added tax to the retail and service sectors, and raise the level of excise taxes on tobacco, beer, and stamp fees. Moreover, tax administration will be strengthened and the authorities will endeavor to limit tax exemptions to those granted under the investment code and/or special agreements. As a result of these measures, total revenue is expected to grow by 9 percent in 1988. Current expenditure,

excluding interest payments, will remain unchanged. In particular, the growth in the wage bill will be contained as no general salary increase will be granted. Furthermore, recruitment will be limited to graduates from professional training schools.

Monetary and credit policies will remain cautious. In order to achieve the credit objectives, the rehabilitation program of the Agriculture Development Bank under way will be completed and that of other banking institutions will be pursued.

I stress my authorities' determination to address the serious economic and financial difficulties confronting the country. However, it is of the utmost importance that, in evaluating the economic performance of Côte d'Ivoire, major creditors be sensitive to the developments in 1987, these exogenous factors could undermine the smooth implementation of the program. Therefore, flexibility will be essential for the successful implementation of the proposed program.

Extending his remarks, Mr. Santos asked for the Board's cooperation and understanding in examining the authorities' request for a purchase under the compensatory financing facility. The cooperative spirit, dedication, and understanding the Fund management and staff had demonstrated during the negotiations with the authorities, had been instrumental in the successful outcome of the discussions held in the current difficult environment.

The recommendation before the Board for approval in principle of the requested stand-by arrangement seemed to follow the Fund's current practice in cases of uncertainty relating to arrangements with creditors on financial packages to close estimated balance of payments gaps, Mr. Santos noted. However, when the Deputy Managing Director addressed the Board on November 17, 1987 (EBM/87/156) he had not understood that the request for a purchase under the compensatory financing facility would also be subject to approval in principle. When simultaneous requests for a stand-by arrangement and a purchase under the compensatory financing facility had been made in the past, and a recommendation for an approval in principle had been warranted, the Board--although not without serious reservations from a number of Directors--had made approval of the purchase under the compensatory financing facility conditional on the effective date of the stand-by arrangement. However, that approach was based on a controversial interpretation by the majority of the Board of the guidelines regarding the test of cooperation with the Fund, and was tantamount to making the adoption of a stand-by arrangement a prerequisite for a purchase under the compensatory financing facility in the upper credit tranche.

Furthermore, Côte d'Ivoire had requested a purchase in the lower credit tranche, equivalent to only 50 percent of quota. The Ivoirien request met the criteria established under the Decision on Compensatory

Financing of Export Fluctuations (Decision No. 6224-(79/135) as amended) and as confirmed in the staff documents: the shortfall in export earnings was largely attributable to factors beyond the control of the authorities, and was short term in nature; the balance of payments needs of Côte d'Ivoire justified such a purchase; and the staff report for the 1986 Article IV consultation, the proposed adjustment program aimed at reducing the internal and external imbalances, and the measures taken by the authorities in August 1987 in the fiscal sector were conclusive evidence that the proposed request met the test of cooperation. Therefore, Côte d'Ivoire expected the Board to show flexibility and a positive attitude in considering its case, and to give outright approval for the requested purchase under the compensatory financing facility.

Mr. Kafka said that he fully agreed with Mr. Santos about the lack of justification for not giving outright approval to the requested purchase under the compensatory financing facility.

Mr. Grosche said that while he appreciated Mr. Santos's request, he would like the staff to explain what it had had in mind when it drafted the proposed decision.

The staff representative from the Exchange and Trade Relations Department explained that the decision to link the request for a purchase under the compensatory financing facility with the approval in principle of the stand-by arrangement had been guided mainly by concerns about making Fund disbursements while a payments gap existed. There had been no overriding reason to depart from the current practice of not making disbursements when financing assurances were not in place.

All of the previous cases where the use of Fund resources under the compensatory financing facility had been associated with approval in principle for a stand-by arrangement had involved requests for drawings in the upper credit tranche, the staff representative noted. There had been six such cases since 1984. The Fund's guidelines for purchases under the compensatory financing facility, which were established in 1983, did not address the issue that had arisen relating to the safeguarding of Fund resources in cases where the necessary financing from other external sources was not in place. For that reason, the Board had made it clear that it wished to discuss the issue of principle involved, and a staff paper (EBS/87/266) had been circulated for discussion in the near future (EBM/88/16, 2/3/88 and EBM/88/17, 2/15/88).

In considering the need to safeguard the Fund's resources, the exact amount of requested purchases, and whether they fell within the upper or lower credit tranches, was less important, the staff representative added; accordingly, the staff had not asked for a delay in the disbursement.

The Board should take up the request of Côte d'Ivoire again once the outcome of the negotiations with the banking community became known, the staff representative from the Exchange and Trade Relations Department

concluded. At that time, the Board would probably have had the opportunity to consider the issue of financing assurances in some detail, and could take a more considered view in a broader context.

Mr. Kabbaj said that the exact timing of the expected discussion with the banks should be made clear, because the Fund's approval-in-principle procedures usually involved a standard delay of one month. In the case under discussion, the next meeting with the banks was not scheduled to begin for almost one month. There had been previous cases which had involved several months' delay before the approval in principle came into effect. If Côte d'Ivoire had to wait several months before it could make purchases under the compensatory financing facility, it would not be appropriate to use the approval-in-principle procedure, owing to the emergency nature of compensatory financing. He agreed with Mr. Santos and Mr. Kafka that, because the request involved only a lower tranche purchase, the Board should be more understanding.

Given the number of months that negotiations with the banks could require, withholding the use of Fund resources under the compensatory financing facility would serve to weaken, not reinforce, the position of a member country, and would give the banks more leeway to delay proceedings further, Mr. Kabbaj commented. The decisions relating to the stand-by arrangement and the compensatory financing facility should be treated separately.

The staff representative from the African Department said that the Chairman of the Coordinating Committee of the commercial banks had indicated that it should be possible to reach an agreement in principle at the next meeting of the Committee, which was scheduled for mid-January 1988. The authorities also expected an agreement to be reached at that time. The staff had therefore decided to allow a few extra weeks for such an agreement to be reached.

Mr. Kafka reiterated that the 1983 guidelines for purchases under the compensatory financing facility had not specified any requirements with respect to external financing. It was clear that Côte d'Ivoire had fulfilled all the conditions stated in those guidelines; therefore, it was not a matter of the Board's being understanding, but of carrying out a previous Board decision. If the management and the staff did not carry out the Board's decisions in the expectation that those decisions would be changed in the future, the Fund would have no legal basis on which to operate.

Mrs. Ploix agreed with Mr. Kafka that the Fund should follow its established guidelines and not allow the staff to make judgments about matters that were legally determined by the Board. The guidelines for use of the compensatory financing facility were clear. Moreover, the Board had recently reviewed the compensatory financing facility, and had not so far decided to amend it. Therefore, the existing decisions and guidelines should be observed. Côte d'Ivoire's request for use of Fund resources under the compensatory financing facility should be approved outright.

The staff representative from the Exchange and Trade Relations Department said that the staff had not tried to change the established guidelines for drawings under the compensatory financing facility. However, as Mr. Kafka had pointed out, the 1983 guidelines did not mention financing assurances in relation to purchases in the upper credit tranche of the compensatory financing facility. While the guidelines did not specify that a stand-by arrangement had to be in place, they did mention the need for policies acceptable for a program to be supported by a stand-by arrangement. Perhaps the staff had been mistaken in taking the Board's view to be that financing assurances were important, even though in six previous cases the Board had decided to approve in principle both a request for a stand-by arrangement and for a purchase under the compensatory financing facility.

The staff representative from the Legal Department said that the Fund was required by Article I and by Article V, Section 3 to establish adequate safeguards whenever any use of the Fund's general resources was made outside the reserve tranche. The stand-by arrangement was one such mechanism under which the assurance about safeguards was normally decided from the outset, prior to the purchase by the member. Absent an arrangement from the Fund, all requests for straight purchase transactions in the credit tranches under the compensatory financing facility had to be evaluated with a view to whether or not adequate safeguards existed and, therefore, the requirement of adequate safeguards applied to lower tranche compensatory financing facility purchases.

Mr. Kafka said that the distinction made between the upper and lower credit tranches in the Fund's guidelines for the compensatory financing facility was important. In cases involving requests for purchases in the lower credit tranche, the Fund expected the member to give a reasonable assurance that policies to correct the member's balance of payments problems would be adopted. Côte d'Ivoire had done precisely that in negotiating a stand-by arrangement with the Fund.

Mrs. Ploix said if the Board agreed in principle to Côte d'Ivoire's request for a stand-by arrangement, it would also, in effect, agree that the necessary policies were in place to meet the test of cooperation for a purchase under the compensatory financing facility.

Mr. Grosche commented that the mere fact that adjustment policies were being adopted did not mean that the balance of payments gap would be closed. In fact, the policies already in place in Côte d'Ivoire were clearly insufficient to close the existing financing gap; therefore, external financing from the Paris Club was necessary. Once the financing package from Côte d'Ivoire's creditor banks was secure, the Fund would have sufficient financial assurances to finally approve the request for a stand-by arrangement and for a purchase under the compensatory financing facility.

Mr. Kafka pointed out that the decision taken in 1983 to establish guidelines for the use of Fund resources under the compensatory financing

facility had specified that reasonable financial assurances of financing were required, not 100 percent assurance. The guidelines also specified that policies corrective of the member's balance of payments problem would have to be adopted in the future. Côte d'Ivoire had said that it would adopt such policies, and it had asked the Fund for a stand-by arrangement. It was not a condition for purchases in the lower tranche of the compensatory financing facility that the stand-by arrangement would have fully to correct the balance of payments problem. Therefore, the Board should approve the request for a purchase under the compensatory financing facility unconditionally. If the Board wished to change the 1983 decision, it would be more appropriate to do so explicitly at a later date than in a round-about fashion through ad hoc decisions on countries' requests for compensatory financing.

Mrs. Ploix said that she agreed with Mr. Kafka; the principles governing requests for stand-by arrangements were not related to those governing use of the compensatory financing facility.

Mr. Posthumus said that he had understood the staff representative from the Legal Department to have cited a more general provision of the Fund's Articles, apart from the guidelines specifically relating to the compensatory financing facility, as requiring the Board to consider the existence of financing assurances in respect of all requests for use of Fund resources, regardless of the facility involved.

The staff representative from the Legal Department confirmed that Mr. Posthumus's understanding was correct. In considering all requests for use of the Fund's general resources, several conditions had to be met; one such condition was the existence of adequate safeguards. It was a question of evaluating risks, rather than of evaluating policies. Although the question of assurances of external financing had not been dealt with expressly in the guidelines for use of the compensatory financing facility, the provision in the Articles of Agreement on adequate safeguards applied to all requests for use of the Fund's resources. The staff was preparing a paper on the topic of safeguards in connection with the discussion of the Board of financing assurances.

Mr. Kafka said that the Articles of Agreement stated that the Fund would make its resources available to its members under adequate safeguards. Under that provision, a series of decisions had been adopted interpreting the Board's definition of adequate safeguards; one such decision had established the guidelines for the use of Fund resources in the lower credit tranche of the compensatory financing facility, where no mention of financing assurances appeared.

Mr. Enoch noted that the staff papers on Côte d'Ivoire's requests had been brought to the Board on short notice; the four-week rule had been waived because Côte d'Ivoire needed approval in principle for the stand-by arrangement before the meeting of the Paris Club on December 16, 1987. When the discussion on the Article IV consultation and request for a stand-by arrangement had been proposed, there had been no mention of the

request for a purchase under the compensatory financing facility. Because the latter request had come without any prior notice, it would be in keeping with the established practices of the Fund either to approve it in principle, or to postpone the discussion on that request for two weeks.

Mr. Grosche said that he supported Mr. Enoch's view. The Board had waived the four-week rule so that it could discuss the request for a stand-by arrangement and determine whether approval in principle could be given for that arrangement, thereby enabling the Paris Club to reach an agreement. Like Mr. Enoch, he had been surprised by the request for a purchase transaction under the compensatory financing facility. However, he could consider that request along with the request for a stand-by arrangement to save the Board time, provided the decision on the compensatory financing facility would not be implemented right away. The Board could either delay the discussion on the request for a purchase under the compensatory financing facility or it could approve the request in principle to be implemented at a later date.

Mr. Posthumus said that he too supported Mr. Enoch's suggestion. The Board should have time to consider both the procedural aspects of the case under discussion and the financing assurances involved.

Mr. Noriega said that he agreed with Mr. Kafka and Mrs. Ploix that as Côte d'Ivoire seemed to have fulfilled the requirements of the guidelines for the use of the resources of the compensatory financing facility, the appropriate decision would be to support that request outright.

Mrs. Ploix said that two other countries had recently requested stand-by arrangements and purchases under the compensatory financing facility at very short notice. The documents for both of the requests currently before the Board had been distributed at the same time; therefore, the Board should accept the waiver as being applicable to both of them.

Mr. Donoso said that he agreed with Mrs. Ploix, since the Board was prepared to discuss the request for a stand-by arrangement, it should take the opportunity to discuss the request for a purchase under the compensatory financing facility. In addition, he was in favor of granting outright approval for the request under the compensatory financing facility.

Mr. Rieffel said that the U.S. chair was prepared to discuss the request for use of Fund resources under the compensatory financing facility, and to support that request in principle. His authorities placed considerable importance on safeguarding the Fund's resources and on ensuring that sufficient financing had been obtained to support the proposed programs.

Mr. Faria said that the problems facing the authorities and their efforts to confront them had been clearly spelled out by the staff; therefore, he would confine his comments to the request for a stand-by arrangement and the request for a purchase under the compensatory financing

facility. His authorities hoped that the London and Paris Club creditors would continue to do their best to ensure the orderly financial restructuring operation that was envisaged in paragraph 3 of the proposed decision in Supplement 1 to EBS/87/249; the most recent information on progress in that respect was encouraging.

In supporting the proposed decision to approve the stand-by arrangement in principle, his authorities' main concern was that the first test date of end-December 1987 would follow too closely the official request, which had been made on November 5, Mr. Faria went on. It was generally accepted that the use of quarterly performance criteria for Fund-supported programs kept economic management sufficiently fine tuned to allow desirable policy effects to become adequately manifested. However, in the case under discussion, the quarterly interval had been shortened, which was significant owing to the considerable uncertainty involved in the absence of a term sheet for nonofficial loans and because of the indirect--in light of the definition given for external arrears in Table 4 of EBS/87/249--repercussions of the rescheduling negotiations on the observance of the two performance criteria related to external arrears. Because of Côte d'Ivoire's institutional monetary arrangements, it was the availability of domestic liquidity that directly determined the extent to which total arrears could be reduced, and, thus, dividing that aggregate into its domestic and external components was an accounting convention of limited policy significance. Perhaps the solution would have been to postpone the first test date until end-January 1988. In the final analysis, performance slippages due to such technical factors could be grounds for a technical waiver.

It was not possible for him to support the proposed decision calling for approval in principle of the purchase under the compensatory financing facility, Mr. Faria explained. During the Board's review of the compensatory financing facility in November 1987, Directors had--apart from differences on other aspects--appeared to agree that approval in principle of a stand-by arrangement was sufficient evidence to meet the test of cooperation required for a purchase in the upper tranche of the compensatory financing facility. Moreover, Directors apparently had accepted implicitly the staff view that for countries with temporary export shortfalls superimposed on longer-term balance of payments difficulties, a more flexible interpretation should be applied in granting lower tranche drawings, thereby ensuring that the compensatory financing facility would continue to fulfill its intended role of providing timely compensation for export shortfalls.

Against that background, Mr. Faria continued, it was difficult to fully comprehend the staff rationale for seeking approval in principle of Côte d'Ivoire's request for compensatory financing, linked to approval in principle of a stand-by arrangement. If the rationale was to avoid making disbursements into a financing gap and to safeguard Fund resources, that would suggest a fundamentally new feature of the Fund's policy on the compensatory financing facility, one on which there was not yet a clear Board consensus. In the case under discussion, the Board's approval

in principle was more than a mere operational device to facilitate the closing of an ex ante balance of payments financing gap for 1988 through rescheduling; it was an unequivocable acceptance of the validity of the policy package agreed to by the Ivoirien authorities and the staff. Côte d'Ivoire clearly met the test of cooperation, and therefore, was eligible for a maximum purchase of SDR 137.37 million or 83 percent of its quota, subject to global access limits.

It would be unfortunate at such a critical time to signal to other official and private creditors and the Ivoirien authorities that considerations relating to Côte d'Ivoire's debt-servicing capacity, the need to protect the revolving character of Fund resources, and the potential scope for overdue obligations had had the staff convince the Ivoirien authorities to accede not only to an application for a drawing of 50 percent of quota, but also to its temporary withholding pending agreement with commercial creditors, Mr. Faria observed. Moreover, an unanticipated delay in closing the financing gap would only further delay the compensatory financing disbursement, contrary to the general intention of that facility.

There had been a similar case in which a purchase under the compensatory financing facility was approved in conjunction with approval in principle of a stand-by arrangement, Mr. Faria recalled. The compensatory financing purchase, which raised the member's total access to the maximum entitlement, had been approved for a specific date. In that case, the compensatory financing disbursement was made on that specific date, even though the stand-by arrangement itself was not finally approved until a short time later. Similar flexibility should be shown in the case of Côte d'Ivoire.

Mr. Enoch said that Côte d'Ivoire's economic condition had clearly worsened since the Board discussion in June 1986, when the previous stand-by arrangement had been approved. Compared with the forecasts included in the staff paper at that time, it was now expected that the current account and budget deficits for 1988 had deteriorated by about 5 percent of GDP. That deterioration largely reflected adverse external developments. Coffee and cocoa prices had fallen dramatically, and that decline had been compounded by the depreciation of the dollar against the CFA franc. The appreciation of the CFA franc affected other exports, which had also fallen in volume. As a result, the external position looked extremely difficult.

The requested stand-by arrangement represented the authorities' response to that difficult situation, Mr. Enoch remarked. Several aspects of the proposed program gave his authorities serious cause for concern. The most important concern was the clear lack of medium-term balance of payments viability. Not only were the financing gaps envisaged under the program large, they were also not expected to decline significantly. His authorities had some doubts about the plausibility of some of the projections involved in producing even the weak outcome presented in the staff report. In particular, the CFA franc had appreciated against the dollar, so it seemed that the annual growth rate of about 3 1/2 percent assumed

in the program would be difficult to secure. He wondered whether the staff could comment on whether the dollar had already depreciated below the level assumed in the program for 1988, and on the implications for the financing gap for 1988.

His authorities were concerned about some of the policy measures that had been put in place as part of the program, Mr. Enoch said. To improve external competitiveness, the authorities were relying upon extensive import tariffs and export subsidies. Such measures were second best, as they created distortions and placed strains upon the administrative system. In addition, he shared the staff's doubts about the strong rise in public investment envisaged in the program.

Despite such reservations, his authorities had decided to support the request for a stand-by arrangement, but only with the provision that the program would be strengthened signficantly by the first review, Mr. Enoch remarked. This largely reflected Côte d'Ivoire's good record of economic performance and cooperation with the Fund, and because the problems facing the authorities stemmed from adverse external developments.

If the program were to be strengthened--and his authorities were thus able to continue to support it--the Ivoirien authorities had two options, Mr. Enoch considered. They could seek to further reduce domestic absorption through tighter fiscal policy, which was inevitably going to have adverse consequences for growth prospects. Perhaps it was necessary in any event to recognize that while everyone is in favor of growth-oriented programs, it was doubtful that any country which had suffered an external shock equivalent to 5 percent of GDP in one year and a further significant deterioration in its terms of trade could expect to grow by 3 1/2 percent in the following year. Such an expectation would not be consistent with the experience of most other countries. In any case, it was questionable whether the Fund should support programs which relied solely on domestic austerity in such circumstances, both because it was unlikely that the authorities would be able to sustain the required policies in the face of the inevitable pressures for faster growth--those pressures had led the authorities to declare a moratorium on commercial debt earlier in 1987--and because such programs only encouraged the myth that Fund-supported programs damaged growth prospects. There might be some scope for additional structural adjustment measures which could help reduce the financing gap without involving a reduction in overall domestic absorption, but he had not received that impression from the staff report.

If the authorities in fact perceived serious constraints on the amount of fiscal adjustment that could be introduced, they had the alternative option of reviewing the appropriateness of the current exchange rate, Mr. Enoch commented. His chair was disappointed that the staff report had almost totally ignored exchange rate adjustment. He was aware of the difficulties of exchange rate action arising from the expectational arguments against any change in the CFAF/F parity, the political difficulty of agreement to any such change among the members of the West African Monetary Union, and the advantages Côte d'Ivoire had undoubtedly gained

from belonging to the Monetary Union. However, the Board must recognize that it was being asked to approve a Fund-supported program that did not achieve balance of payments viability, while one instrument which could help in that regard--the exchange rate--had simply been set aside. The staff should have analyzed the question of exchange rate flexibility before bringing the program to the Board. In that connection, he had also been surprised by the absence of any staff analysis of the authorities' ability to repay the Fund.

Although a number of Directors had argued in favor of outright approval for the request for a purchase under the compensatory financing facility, the Board had been asked to make that decision without any prior notice, Mr. Enoch reiterated. As Directors interpreted the legal aspects of approval in principle of a compensatory financing purchase, he wondered whether the Board should discuss the request again early in January 1988, when Directors could take a more informed position on the legal issues.

There was no doubt that the authorities had faced a difficult environment in recent months, Mr. Enoch concluded. They had taken steps to tackle their problems, but their efforts had fallen short of what would be required to achieve a reasonable balance of payments position. It was up to the authorities to decide how to strengthen growth, but no avenue should be ruled out. There seemed to be a real risk that Côte d'Ivoire was heading down a path of adjustment without growth, and he wondered whether that position was sustainable; it was certainly inconsistent with the strategies the Fund had been recommending for many other countries.

Mr. Grosche said that Côte d'Ivoire seemed to have achieved considerable progress toward restoring normal relationships with its creditors, as was evidenced by the agreements on multiyear reschedulings reached with commercial banks and official creditors. Therefore, the slippages in adjustment and the deviation from an overall successful adjustment path were disappointing. The loss in adjustment momentum in 1986 and early 1987 was, to a substantial degree, attributable to the sharp drop in cocoa and coffee prices, which demonstrated the vulnerability of the economy and underlined the need for diversification. Fortunately, that need was recognized by the Government, which intended, in cooperation with the World Bank, to undertake intensified structural reforms aimed at creating better incentives for private sector activity. Nonetheless, without questioning the authorities' commitment to adjustment, it was fair to say that the proposed program raised a number of questions regarding the envisaged adjustment measures.

The pace of adjustment should be accelerated, and more comprehensive adjustment efforts were required to overcome the immediate problems and to put the economy back on the recovery path, Mr. Grosche suggested. That the fiscal situation would remain fragile even in the medium term was noteworthy. The authorities' intention to limit the increase of public expenditure and to reduce the fiscal deficit in 1988 was welcome. However, there would be virtually no further fiscal adjustment in the

years following 1988. In addition, the reduction in 1988 would only be realized if the efforts to strengthen revenues were successful, which was somewhat uncertain given the problems encountered by the implementation of the value-added tax. With respect to the expenditure side, the measures should aim particularly at putting the Agricultural Stabilization Fund back on a sound footing.

Other current expenditures--particularly public sector wages--were also a matter for concern, Mr. Grosche commented. With regard to the public investment program, he fully shared the staff's view that it should be implemented gradually, taking into account existing and prospective financial constraints, as well as the absorptive capacity of the country.

While structural reforms could more easily be implemented in an environment of growth, the authorities should be cautioned against overambitious growth targets. As the staff report showed, under the envisaged policies, the economy remained highly vulnerable to external developments, even in the medium term, and the assumptions regarding the willingness of Côte d'Ivoire's external creditors to finance substantial deficits in the external account through the provision of concessional financing could turn out to be overoptimistic. Eventually, Côte d'Ivoire could face even higher external and internal imbalances, which would almost certainly lead to frustration and disillusionment, and would, again, put the Fund in a somewhat awkward position, if that failure were blamed on the Fund.

Stronger adjustment efforts on the external side were clearly called for, Mr. Grosche remarked. Côte d'Ivoire, as a member of the West African Monetary Union, had almost no scope for exchange rate adjustment. As the staff had noted, the recent effective appreciation would have to be reversed to improve the competitiveness of the export sector. However, the policies suggested by the staff, namely, improvement in productivity and reduction of production costs, would have significant effects only in the longer run and were subject to a high degree of uncertainty. Therefore, he wondered whether within the Monetary Union, consideration could be given to a more fundamental solution in cases like Côte d'Ivoire's where the exchange rate was clearly and substantially out of line.

The program should have aimed at a stronger adjustment effort, Mr. Grosche went on. The authorities' decision to seek Fund support for the economic policies was welcome, but they should respond effectively and quickly to the changing circumstances and take additional measures if needed. He hoped the authorities would make every effort not only to meet, but to outperform the program targets, particularly on the fiscal and the external sides.

He supported the proposed decisions in the supplements to EBS/87/249 and EBS/87/250, but he could go along with Mr. Enoch's proposal to postpone the decision on the request for a purchase under the compensatory financing facility, if the majority of the Board agreed.

Mr. Péroz said that he had no difficulty in supporting the proposed decision on the stand-by arrangement for Côte d'Ivoire. However, the proposal to defer the request for a purchase under the compensatory financing facility until the date on which the stand-by arrangement would become effective was not justified under the Fund's guidelines on the use of the compensatory financing facility. Therefore, he supported Mr. Santos's request for outright approval, based on the arguments put forward by Mr. Kafka.

The continued structural weakness of the tax system was most evident in the degree of government reliance on the Agricultural Stabilization Fund, Mr. Péroz pointed out. The deficit experienced by the Stabilization Fund had clearly compounded the balance of payments difficulties resulting from the export shortfall. The prospects for an improvement in the accounts in the Stabilization Fund in 1988 were, at best, unclear. Under the circumstances, the achievement of the budget target for 1988 would require full and rigorous implementation of the revenue measures announced in the 1988 Finance Act. Until the precise scope of those revenue measures could be better understood, a cautious approach, as far as expenditures were concerned, would seem to be in order, and in that regard, he endorsed the views expressed in the staff appraisal.

In view of the outlook for world cocoa and coffee prices, it was difficult to see how producer prices for those two commodities could remain at their present levels without continued subsidization, Mr. Péroz said. Similarly, nontraditional exports, which presently accounted for roughly 30 percent of total exports, appeared to be increasingly dependent on an export subsidy scheme, a development that might have deserved some further elaboration in the staff report. Because of commodity price developments, the trade balance might not be as strong as it appeared, and he wondered whether changes in the trade balance would affect the realization of the medium-term baseline scenario.

As to the future growth prospects in the context of the present stand-by arrangement, maintaining per capita income at its present level required a minimum growth rate of close to 4 percent, Mr. Péroz concluded. Under the circumstances, creating an environment in which the private sector could increase its contribution to economic activity was essential. Current levels of investment, however, did not seem to reflect any convincing sign of such an evolution. The authorities seemed to be aware of that potential problem, but it was not certain whether the most appropriate response would be to increase the current level of public sector investment. He joined the staff in recommending a cautious approach in that regard.

Mrs. Ploix made the following statement:

> The staff report and Mr. Santos's opening statement make it clear that Côte d'Ivoire is currently facing a difficult financial situation. The sharp drop in the export prices of coffee and cocoa is the major cause of the deterioration that has taken

place since the second half of 1986. The changes in the assumptions underlying the adjustment program have been such that the objectives set forth in the 1986 stand-by arrangement are no longer realistic. Furthermore, the liquidity crisis was such that Côte d'Ivoire's authorities could find no other solution than to postpone payments on their external debts pending the discussion of a new program that would take the new external conditions into account. In light of these unfortunate developments, my authorities are pleased that Côte d'Ivoire's extensive discussions with the Fund have finally resulted in a comprehensive program to be supported by a stand-by arrangement, and that the dramatic export shortfall of 1987 is to be compensated by a purchase under the compensatory financing facility.

With respect to the authorities' strategy for this new stand-by arrangement, I support the emphasis the authorities placed on combining growth-oriented policies with sound demand management. Public sector investment policy is expected to play a major role in renewing growth, and the careful selection of quick-yielding projects associated with adequate financing will be of crucial importance in this respect. I am encouraged by the authorities' intention to collaborate closely with the World Bank in this regard, and I welcome their determination to reinforce the measures aimed at improving the competitiveness of the economy and diversifying the export base away from the current excessive dependence on coffee and cocoa. The extension of the Export Subsidy Scheme, the generalization of the trade liberalization reform, and the establishment of prefinancing and credit insurance mechanisms should be instrumental to this end. All of these measures were designed in close cooperation with the Fund and the World Bank.

In addition to growth-oriented policies, the effective implementation of demand-management measures provided by this program will be crucial. I welcome the substantial efforts to be made in this area, as evidenced by the forecast increase of the overall tax to GDP ratio from 20 percent in 1984-86 to 23.4 percent in 1988. In the second phase of the program, the authorities will have to devote special attention to eliminating the deficit of the Agricultural Stabilization Fund, since this will be a critical factor in the second review of the program.

The staff's medium-term scenarios clearly show that this program must be implemented in all its aspects, without fail, because the baseline scenario indicates that gaps requiring exceptional financing would still remain. In this respect, my authorities are pleased to contribute to financing through exceptional assistance, and they strongly recommend that action be taken to mobilize other external assistance, as has been done in previous cases with other developing countries, including African countries. Both World Bank and Fund assistance will be vital in setting up this process.

As for the procedure for approving this stand-by arrangement, some uncertainties remain as to the amount of financing that will be provided by commercial banks; and I can agree to the approval in principle. I would like the Fund to facilitate the conclusion of the financing negotiations, to which it can make a meaningful contribution through its representatives.

As to the request for a purchase under the compensatory financing facility, my authorities support outright approval. I fully support Mr. Faria's view that there is no reason to postpone the effectiveness of compensatory financing.

Mr. Fernando made the following statement:

In light of the unforeseen exogenous developments that affected the balance of payments, my authorities agree that a new arrangement consisting of macroeconomic and structural policy reforms should be worked out. The successive stand-by and other arrangements that have been implemented since 1981 and Côte d'Ivoire's good track record of adjustment--which includes the early phase of the 1986-88 stand-by arrangement--indicate the seriousness of the authorities' commitment to adjustment.

Based on a broad assessment of the adjustment program and on the financing package envisaged, my authorities agree to grant approval of the stand-by arrangement in principle, although I do have some remarks to make on the exchange rate, the related aspect of export competitiveness, and export producer margins. The appreciation of the Ivoirien currency both in terms of the dollar and the SDR and in terms of the pegged rate in the West African Monetary Union has clearly impeded the success of the adjustment effort and has reduced the competitiveness of exports. If the exchange rate is not a policy tool available to the authorities, a question arises as to whether competitiveness can be regained and maintained through cost reduction measures. I suspect that the leeway is limited given Côte d'Ivoire's high production cost structure. In that regard, I agree with the concerns voiced by Mr. Grosche. My authorities would appreciate staff comment on achieving enhanced competitiveness and the feasibility of changing the exchange rate peg--although I realize that such a change would have to be incorporated into a regional initiative taken in cooperation with other members of the West African Monetary Union. My authorities appreciate that the exchange rate arrangement does foster a certain discipline in the financial affairs of Côte d'Ivoire, but the emergence of domestic arrears points to some breakdown in that discipline.

The fall in export prices, in terms of both foreign and domestic currency, apart from its effect on government revenue, has also affected producer margins. The price decline will

reduce profits and reinvestment and ultimately will affect productivity. I wonder to what extent this situation prevails, and what actions are being contemplated to ensure adequate producer margins.

For practical reasons, my authorities consider that the purchase under the compensatory financing facility should be approved forthwith and should not be contingent on the effective date of the stand-by arrangement. This chair's position is based on the following considerations: the proposed purchase is much less than the calculated shortfall, it is a lower tranche purchase, the financing of the deficit arising out of this export shortfall would help Côte d'Ivoire continue its efforts to devise adequate measures toward the solution of its financial problems, and it would assist Côte d'Ivoire in avoiding the use of trade and exchange restrictions to manage balance of payments problems. In this context, the consistency with which Côte d'Ivoire has maintained a liberal trade and payments system is noteworthy. Côte d'Ivoire's efforts to remain current in their financial obligations to the Fund is also noteworthy. My authorities are satisfied that Côte d'Ivoire has cooperated with the Fund in an effort to find appropriate solutions to its balance of payments difficulties; since 1981, Côte d'Ivoire has had a good track record of cooperation with the Fund. Another indicator of cooperation would be whether the balance of payments position, if adjusted to exclude the effects of the shortfall, would have been satisfactory. My authorities' judgment is that it would be--if not, I would welcome staff comment. Côte d'Ivoire maintained the program supported by the 1986-88 stand-by arrangement, which has now become inoperative--with the exception of external arrears--until the emergence of exogenous shocks in late 1986. Moreover, a satisfactory level of cooperation is evidenced by the fact that the authorities have received Fund missions and reviewed policies to determine appropriate policies to cope with the balance of payments difficulties.

Mr. Rieffel made the following statement:

Côte d'Ivoire has a tradition of liberal trade and investment policies that commands our support. Furthermore, the authorities continue to work cooperatively with the Fund and the World Bank in their effort to identify appropriate macroeconomic and structural policies, and to implement them effectively. Consequently, the most recent request for Fund support should be viewed with sympathy rather than skepticism.

The change in Côte d'Ivoire's economic prospects in the past 12 months is discouraging. The most disturbing aspect of the current situation is the receding goal of external payments viability. In 1981, Côte d'Ivoire embarked on a three-year

structural adjustment effort supported by an extended Fund arrangement, which was followed by the two stand-by arrangements that led to the one under consideration. Given this history of relations with the Fund, we have assessed the program for 1988 as being contrary to the objectives of achieving balance of payments viability and sustainable growth. Unfortunately, we are not reassured by the requested stand-by arrangement, which we think will lead to recourse to exceptional financial support, rather than to a more appropriate balance of financing and adjustment. Such a balance must be struck by every country that faces balance of payments strains. Our reaction to the 1988 program, however, is that Côte d'Ivoire has opted for more than the optimum amount of external financing. The choice can also be phrased in terms of growth now or growth later. The authorities have adopted a program designed to achieve a comfortable rate of growth in 1988, but that inevitably implies lower rates of growth in the future because of the cost of servicing the external financing required.

While we are prepared to approve the stand-by arrangement in principle, as a necessary first step toward achieving sustained growth and external viability, we believe it is important both for Côte d'Ivoire and for the Fund that the program for 1988 be strengthened before the completion of the first review.

We are also prepared to support in principle Côte d'Ivoire's request for a purchase under the compensatory financing facility--subject to the qualifications about the operation of the compensatory financing facility that this chair has expressed on numerous occasions. Alternatively, my authorities could agree to defer a decision until January 1988, as suggested by Mr. Enoch.

With respect to some specific features of the 1988 program, we are pleased that the authorities have recognized the need for comprehensive structural reforms--especially to promote the diversification of production. The authorities also appear committed to providing a larger role for the private sector in the economy. In both cases, however, the measures proposed for achieving these goals appear tentative. For example, the resources allocated for the public sector--at the margin--would yield higher returns for the economy if they were made available to the private sector instead. We agree with the staff that absorptive capacity is a limiting factor, and the World Bank representative should elaborate on the advantages of private sector investment over public sector investment in Côte d'Ivoire.

In a slightly different direction, the background paper for the 1987 Article IV consultation mentioned the existence of 250 parastatal enterprises in Côte d'Ivoire. However, in the staff report under consideration there is no evidence of a concrete program to rationalize, liquidate, or privatize these

enterprises; we would appreciate some elaboration on this aspect of the program. The staff's concern about the role of the Agricultural Stabilization Fund is well placed, and in the first review, we will be looking for a clear timetable for eliminating the operating deficit of that agency.

The fiscal policy program for 1988 is better than the previous program, but we still have some concerns. While measures recently taken to raise revenues have been sound, we agree with the staff that stronger administration is needed, and reducing the scope of exemptions is particularly important. On the expenditure side, while the increase in the wage bill appears modest, the authorities should do more to limit the growth of the civil service. For example, recruitment should perhaps be limited to the level needed to replace departing employees.

The restrictive credit policies for 1988 are appropriate and credible. Their credibility is one of the benefits of Côte d'Ivoire's membership in the West African Monetary Union. However, membership in that union may also be disadvantageous--most notably in the use of the exchange rate as a policy instrument. While the appreciation of Côte d'Ivoire's currency in the past year has been modest, the appreciation over the last two years has been steady, and substantial. The cost of this exchange rate constraint has been borne by the Ivoirien population in the form of lower growth, and by external creditors. It is important for the authorities and the Monetary Union to keep the issue of exchange rate flexibility under review, and not to assume that the exchange rate is unavailable as a policy tool.

It is unfortunate that Côte d'Ivoire was not able to conclude a debt relief agreement with its commercial bank creditors in time to permit outright approval of its request for a stand-by arrangement. We are concerned by the indications that the current negotiating positions of the authorities with respect to both commercial bank and official creditors appear to differ from the positions these creditors normally find acceptable. We hope that the authorities are not underestimating the long-term benefits of concluding agreements that are well within the parameters of rescheduling agreements with other countries.

The prospect that external payments viability will not be achieved by 1992 under the staff's medium-term baseline scenario is troubling. If this is the case, Côte d'Ivoire's ability to repay the drawings made under the proposed stand-by arrangement--and the compensatory financing facility--could depend heavily on the link between the West African Monetary Union and the French Treasury. We have the impression that there are measures that could be adopted that would lead to external viability at an earlier date. I wonder why a third scenario representing a stronger adjustment was not included in the staff report.

My authorities are prepared to support the request for a purchase transaction under the compensatory financing facility as it meets the current criteria for access to that facility. At the same time, however, this request raises a number of troublesome issues that strongly point out the need to restructure the facility in the context of the comprehensive review now under way. For example, under the proposed decisions, Côte d'Ivoire would draw 50 percent of quota under the compensatory financing facility and less than 1/2 percent of quota under the stand-by arrangement, when the Board's approval becomes effective. As this chair said during the review of the compensatory financing facility, this pattern of financing has the potential to undermine incentives to carry out needed policy reforms and to increase Fund exposure without strong assurances of repayment. Furthermore, the projected trend of exports used in calculating the compensable shortfall suggests that there will be little recovery from the level attained in the shortfall year, which raises the question of whether the shortfall is temporary.

During the Board's discussion on the compensatory financing facility in March 1987, this chair suggested a rule of thumb for evaluating the nature of a shortfall. If the recovery in the postshortfall year is projected to be 50 percent or more of the decline from the preshortfall year, then it can be reasonably assumed that the shortfall is temporary. In contrast, the recovery calculated for Côte d'Ivoire is only 10 percent of the decline from the preshortfall year.

Fund members in circumstances similar to those of Côte d'Ivoire should note the advantages of a facility such as the external contingency facility proposed by U.S. Treasury Secretary James Baker at the Annual Meetings. It was unfortunate that such a facility was not in place when Côte d'Ivoire's request for a stand-by arrangement was made.

Mr. Rye made the following statement:

The proposed decisions are difficult; the staff report and the program to which it refers are seriously flawed. However--not without hesitation--I support the proposed decisions, noting that they are in principle, subject to the closing of the financing gap expected in 1988.

I base my support on the following conclusions: the economic problems of Côte d'Ivoire are very largely--though not entirely--outside of its control; Côte d'Ivoire's record of cooperation with the Fund is good; in present circumstances, the Fund can play an essential catalytic, as well as direct, role in helping to overcome those problems; and the program contains a number of

important initiatives, including wage restraint, a restrictive monetary stance, and a withdrawal of the public sector from a number of commercial and industrial activities.

My concerns relate mainly to the pace of adjustment of both the domestic and external imbalances. The staff's medium-term projections show that the overall public sector deficit--on a cash basis--is projected to decline by only one half of 1 percent of GDP between 1987 and 1992. The projected improvement on a payments order basis is only marginally faster. Over this period, tax revenues as a proportion of GDP would actually fall marginally.

On the external side, there is a similarly small decline in the current account deficit as a proportion of GDP, which is projected to remain at about 5 percent until 1992. As a result, Côte d'Ivoire will face substantial financing gaps, estimated at $1.45 billion in 1988 and $1.1 billion in 1992. Côte d'Ivoire's total debt outstanding is projected to increase by 41 percent, or 1.5 percent of GDP, over the next five years.

These projections raise fundamental questions about the adequacy and sustainability of Côte d'Ivoire's adjustment effort. The projected medium-term economic improvement would fall far short of that required to ensure balance of payments viability. As it is, significant further adjustment, including structural adjustment, would need to be pursued well beyond 1992. There have been too many examples in recent years of the Fund helping countries to obtain significant external financing only to find that the pace of adjustment is inadequate to ensure sustained progress into the medium term, saddling these countries with an increasing--and increasingly intractable--debt burden. Unless further adjustment measures are adopted in 1988 and beyond, an increasing debt burden could be a real prospect for Côte d'Ivoire. The already large use of Fund resources and the prospects of further Fund exposure reinforce these concerns, including the attendant risks for the Fund's financial position.

The staff has an obligation, of course, to provide an assessment of the debt-servicing capacity of members making use of Fund resources. In that regard, it is stated in the latest six-monthly report on overdue obligations that, under the guidelines for preparation of country assessments that involve a drawing on the Fund, analysis of a member's medium-term prospects is to focus clearly and explicitly on the member's capacity to meet its obligations to the Fund. There is no such focus or assessment in the staff report, and although such an analysis would not have been easy to carry out, given the uncertainties involved in this case, surely something could have been said in that regard.

There is a further significant omission from the staff report. There is clear evidence that Côte d'Ivoire's exchange rate is substantially overvalued--particularly given the sharp decline in the terms of trade--and that this overvaluation lies behind an increasing number of distortions in the economy, including higher and more widespread use of import duties and export subsidies and a reluctance to adjust producer prices. On page 7 of EBS/87/249, the staff states that the deteriorating external performance has been primarily responsible for the large fiscal and balance of payments deficits and for the rapid slowdown in growth. Despite these developments, the paper virtually ignores exchange rate policy. While much of the external deterioration resulted from export price falls beyond the authorities' control, the role of the exchange rate cannot be ignored--particularly since an export price recovery does not seem likely. Moreover, in the absence of exchange rate adjustment, the proposed macroeconomic measures are clearly inadequate. I realize the problems of change in this area, but the report should have at least included a more detailed discussion of the currency arrangements, including their effect on the economic performance--particularly the balance of payments--of the other members of the West African Monetary Union. This is one case where regional relationships are of the essence. The Ivoirien authorities cannot seriously address their country's balance of payments weakness--including diversifying the export base--without early action on the exchange rate. I strongly suggest that exchange rate policy be fully examined at the first program review.

On fiscal policy, the authorities are expecting to gain further tax revenues from increased tax efficiency and reduced fraud. While these objectives are admirable, the experience of many countries has shown that such gains are usually slow in coming. More comprehensive fiscal measures may be necessary, particularly on the expenditure side. I note from pages 11 and 13 of the staff report that the authorities are reluctant to strengthen the fiscal adjustment process under the existing program on the grounds that they had already imposed too harsh a burden on the population in recent years, and that additional stringent fiscal measures would have a contractionary impact on economic activity, thus potentially stirring social unrest. I accept, of course, that only the authorities themselves can make this kind of judgment, but it raises a question about the degree of their commitment to fully implementing the necessary adjustment effort over a number of years. Such an indication of adjustment fatigue at the start of this program is hardly encouraging.

I have no particular comment on the details of the request for a purchase under the compensatory financing facility. However, on the nature of the decision, I agree with Mr. Enoch's point about timing, and my first preference would be to defer a

decision until we have the benefit of more considered staff advice. Some of the discussion today has been, understandably, extemporaneous. However, if a majority of the Board favored an in-principle decision, as suggested by the staff, I would agree to it.

Mr. Posthumus said that it had taken from May until November 1987 for the Fund to conclude its negotiations with Côte d'Ivoire, and the Board had been given only two weeks to consider the results of those negotiations. The time allotted for Board consideration was too short, and the staff report was too complicated and not helpful enough to overcome the time factor. It was, therefore, difficult to assess the current situation in Côte d'Ivoire. No agreement had been reached with the Coordinating Committees of the banks, and none was expected at least until the middle of January 1988. Although he had not been aware of the Paris Club meeting scheduled for December 16, 1987 to decide on the rescheduling of official debts, he still remained uncertain as to why it was necessary to reach a Fund decision so quickly.

It was clear from the staff report that Côte d'Ivoire had suffered from an extremely adverse external environment, and for such an extremely vulnerable economy with a huge debt burden, that situation presented a big problem, Mr. Posthumus remarked. The Fund clearly should help, even if the authorities could do more themselves; however, questions remained concerning the Fund's role and the role of other creditors.

He wondered whether the staff thought the overall balance of payments position, as illustrated in Table 9 of EBS/87/249 was sustainable, Mr. Posthumus went on. He could not foresee external viability, and he doubted further adjustment would solve the problem. In addition, the gross financing requirement was larger than the amortization due on foreign loans, and the banks were going to insist that future interest be paid. That meant Côte d'Ivoire had to borrow to pay its interest, which would, perhaps, make the medium-term balance of payments situation still more unsustainable. He wondered whether the staff had considered how--and the extent to which--the rescheduling would affect future sustainability, and whether it had any ideas for solving the problems in the external sector. From Table 9 of the staff report and the proposed decisions, it seemed as though the external debt problem could not be solved. He wondered whether it was realistic to expect the financing requirement to be met, given its magnitude.

His authorities supported the proposed approval in principle for Côte d'Ivoire's request for a stand-by arrangement, Mr. Posthumus continued. However, he would prefer to postpone the decision on the request for use of Fund resources under the compensatory financing facility for a few weeks, as Mr. Enoch had suggested. That scheduling would give the Directors some time to reflect on Côte d'Ivoire's particularly complicated and difficult situation, although, even at that later date, approval in principle would remain a possibility.

The disadvantages of the approval-in-principle procedure had been made clear in the case of Côte d'Ivoire, Mr. Posthumus commented. The creditors had the freedom to agree on whatever rescheduling they chose, and the Fund had to go along with the proposals, despite the outcome of the rescheduling meeting--and the outcome could be that Côte d'Ivoire's situation was unsustainable.

Mr. Massé said that his authorities recognized the substantial role played by external factors in the deterioration of the economy, and that those factors were largely beyond the control of the Ivoirien authorities. However, the recent developments underscored Côte d'Ivoire's vulnerability, which stemmed from dependence on a limited number of primary commodities and from a heavy debt burden. Therefore, the authorities' recognition of those difficulties and the achievement of a sustainable economic growth path, which required the implementation of far-reaching policies to diversify the economy and the export base, was welcome. His authorities believed that, together with prudent fiscal and monetary policies, this strategy provided the only feasible option for the economy to achieve viability and reduce its vulnerability to exogenous shocks. In view of the difficult medium-term outlook, the undertaking of new adjustment measures was commendable.

However, his authorities were concerned about the pace of reduction in the large fiscal and external imbalances and the rapid growth of external debt, Mr. Massé commented. In 1988, the public sector deficit on a payments order basis was programmed to decline by a notable 2.6 percent of GDP. However, the staff's projections showed that the fiscal deficit on either a payments-order basis or on a cash basis remained relatively large through the medium term at about 4 percent of GDP. Correspondingly, large fiscal financing gaps remained throughout the medium term. The current account deficit was programmed to decline modestly to 5.7 percent of GDP in 1988, although the projections suggested that it would remain at about 5 percent of GDP throughout the medium term. In addition, large financing gaps that required additional financing each year were projected for 1988-92.

Against that background, the authorities' intention to diversify and expand their export base was appropriate, Mr. Massé continued. A focal point of the case under discussion was the extension of the export subsidy scheme. However, in view of the associated financing requirement, the large imbalances and debt burden, and the fact that the authorities seemed to have some misgivings about the subsidy scheme, the effectiveness of that approach was questionable--even in connection with the other policies envisaged by the authorities. In addition, there seemed to be a lack of specificity regarding reforms in various economic sectors, namely, reforms in the agriculture, energy, water, and transportation sectors, and the restructuring of parastatals in those sectors. There also seemed to be no clear strategy on how to eliminate the deficit of the Agricultural Stabilization Fund. While progress in those areas was important to the adjustment effort, policy formulation appeared to be at a relatively early stage. He wondered whether the staff or Mr. Santos would comment on the sort of timetable envisaged in those areas.

At a minimum, there was no room for slippage in the implementation of reforms aimed at achieving greater economic efficiency and improved competitiveness, Mr. Massé remarked. As the staff had correctly suggested, given Côte d'Ivoire's exchange arrangements, stringent domestic demand-management policies, and increased efforts to improve productivity and reduce production costs were all the more essential. It was in that connection that the medium-term prospects were particularly disturbing. Unless there was a substantial recovery in Côte d'Ivoire's terms of trade, which the staff had not expected, large external and domestic imbalances would continue to prevail, even if the envisaged policies were implemented--and the authorities seemed to be at an early stage in that regard.

Against the backdrop of substantial exogenous shocks and unfavorable prospects over the medium term, apparently there was some scope to strengthen the adjustment effort, Mr. Massé noted. While it seemed clear that Côte d'Ivoire's participation in a currency union had yielded important benefits--mainly a degree of discipline that would not otherwise have been present--it also seemed that under the current and prospective circumstances, Côte d'Ivoire's exchange rate regime might be unduly restrictive. While the fixed exchange rate could, in principle, provide an important nominal anchor for the economy, the authorities at the present time seemed to be targeting on the wrong value. Indeed, it was not easy to envisage a sustainable adjustment path with growth that did not include an element of exchange rate depreciation. He wondered whether the staff or Mr. Santos would comment on those considerations. It would have been helpful to have a discussion on the exchange rate in the staff report.

His authorities agreed with an approval in principle for the requested stand-by arrangement, in view of Côte d'Ivoire's forthcoming meetings with the Paris Club and London Club banks, Mr. Massé observed. With respect to the request for a purchase under the compensatory financing facility, the preoccupation with safeguarding the Fund's resources expressed by some Directors was legitimate. However, previous Fund decisions had not been drafted with that view in mind; therefore, he agreed with Mr. Kafka that if the Board was not happy with the current guidelines on the use of Fund resources under the compensatory financing facility, it should change them. In the meantime, it should follow the present guidelines for purchases in the lower credit tranche. Those criteria implied that the member must be willing to receive Fund missions; to discuss in good faith the appropriateness of its policies; and if necessary, to deal with its balance of payments difficulties. Côte d'Ivoire had met those requirements. In the case under discussion, some changes in economic policy were necessary, but, if the stand-by arrangement were approved in principle, that would constitute a change in policy sufficient to put the economy back on track. In addition, there was a difference between the previous decisions regarding purchases in the upper tranche and Côte d'Ivoire's request for a purchase in the lower tranche, namely, that the conditionality for lower tranche purchases was less stringent. The Board should approve the request for immediate

disbursement under the compensatory financing facility, rather than just approving the disbursement in principle. Finally, his authorities expected to see a strengthening of the adjustment effort before the Board's first review of the stand-by arrangement.

Ms. Kyhlberg said that the proposal to approve, in principle, a stand-by arrangement had left her authorities uncertain about many important elements in the proposed economic program and the necessary financing. The lack of specificity in the staff report had been underlined by the fact that the performance criteria would be adjusted during the first review of the stand-by arrangement in accordance with the external financing available at that time. Based on the information obtained thus far, it appeared highly unlikely that the proposed program would lead to balance of payments viability in the medium term, which was unfortunate and gave rise to concerns regarding the strength of Fund-supported programs in general.

The special circumstances of Côte d'Ivoire and the authorities' determination to cooperate with the Fund had enabled her to support the proposed stand-by arrangement, Ms. Kyhlberg continued. However, her support was based on the understanding that the authorities would implement additional measures to strengthen the program when necessary. While progressing on an ambitious adjustment program, Côte d'Ivoire had been seriously affected by deteriorating terms of trade, and that situation had been exacerbated by its strong dependence on world market commodity prices. In light of the heavy external debt burden, the negative effects of exogenous developments were so large that the economy could not adjust in the short term. There was no question that the resulting substantial shortfall in export revenues justified in principle the proposed decision to approve the lower tranche drawing from the compensatory financing facility. However, crucial elements of the program with regard to public enterprises and investment and price and wage policies had to be further specified. In addition, fundamental problems had to be addressed, particularly if the required improvement in the terms of trade did not materialize--which seemed likely.

Côte d'Ivoire's vulnerability to external factors was intensified by its membership in the West African Monetary Union, Ms. Kyhlberg commented. Consequently, the burden that adjustment efforts placed on demand-management policies had been--and would continue to be--very heavy. Like other Directors, she noted the lack of discussion about exchange rates in the staff report, and was interested to hear comments on exchange rate changes as an alternative to additional austerity measures.

Her authorities supported the proposed decisions, Ms. Kyhlberg added. However, she could also agree to Mr. Enoch's proposal to postpone the decision on the compensatory financing facility.

The staff representative from the African Department said that the process of negotiating the program with Côte d'Ivoire had been relatively slow and difficult. It had taken a number of missions over a period of

several months and a lot of determination to finally reach agreement with the authorities. The most recent Fund mission had not returned from Abidjan until November 4, 1987; therefore, the staff had had little time to prepare its report. The 1987 Article IV consultation and request for a stand-by arrangement had been brought to the Board at short notice in order to facilitate the meetings between Côte d'Ivoire and the London and Paris Clubs, which were scheduled to take place in the coming weeks.

In answer to the question regarding the staff's projections on exchange rate developments, the staff representative continued, the CFA franc, which was pegged to the French franc, had appreciated by a further 8 percent since the staff had projected a rate of CFAF 300 to the dollar. However, it did not automatically follow that the viability of the external position would be affected. For instance, it was not clear that with the further decline of the dollar commodity prices would stay at current levels. In fact, there were some signs, at least in dollar terms, that some of the dollar's depreciation would be offset by higher dollar prices for commodities. In addition, the continued decline of the dollar would help to alleviate the external debt burden, because a substantial part of Côte d'Ivoire's debt was expressed in dollar terms. Based on the current situation, the additional change in the CFA franc-dollar relationship had not significantly changed the assumptions used in designing the proposed program.

The institutional arrangements involved in membership of the West African Monetary Union had been discussed on previous occasions, the staff representative noted. It was clear that Côte d'Ivoire was not free to unilaterally decide its own exchange rate. Instead, exchange rate changes had to be implemented by a unanimous decision of the Monetary Union, and clearly this was not easy to bring about. Another reason the staff had not elaborated in detail on the need for exchange rate flexibility was that the CFA franc was a fully convertible currency with no exchange restrictions on transfers. Therefore, the confidence factor was significant; even hints of possible exchange rate movements could give rise to large speculative capital flows. The staff considered that under the circumstances, the subject of the exchange rate should be treated with caution.

The staff agreed with Directors that import tariffs and export subsidies were a second-best solution to the current exchange rate problem, the staff representative went on. However, given the institutional arrangements of the Monetary Union, trade measures were the only available instrument. As the staff had pointed out in its report, through a determined effort to reduce and restrain the expansion of wages and prices, it was possible to influence the real exchange rate. The rate of inflation in Côte d'Ivoire had remained relatively low thus far, and that helped to explain why the real effective exchange rate had not appreciated as far as might otherwise have been expected.

A number of Directors had questioned Côte d'Ivoire's balance of payments viability over the medium term, including the medium-term projections in EBS/87/249, the staff representative observed. The staff had attempted to give a frank and straightforward assessment of the difficulties of achieving medium-term viability in Côte d'Ivoire. However, given Côte d'Ivoire's liberal position regarding private sector initiatives and a record of generally successful management in the past, its potential for mobilizing additional financial resources from various sources, including multilateral institutions, the African Development Bank, the World Bank, and bilateral donors--a specific route that should be explored further--was substantial.

As for staff projections of medium-term external viability, much would depend on the assumptions made with respect to rescheduling, including the interest rate to be used, the staff representative explained. The assumptions used in the staff report were based entirely on standard market terms, and did not include any concessional rescheduling terms. Therefore, if creditors found it possible to give better than standard terms for rescheduling debt, it would, of course, improve the medium-term viability.

The authorities were making a determined effort, in cooperation with the World Bank, to strengthen the parastatal sector, the staff representative noted. The program currently under way involved making an inventory of all the public enterprises and determining the extent to which they could be privatized. One of the options the Ivoirien authorities had included in their discussions with the banks was a proposal for a debt-equity conversion scheme, and the authorities had stated that they were prepared to consider foreign partners in that context. The staff representative from the World Bank might wish to comment on how the public and private sectors could be strengthened through the various sectoral adjustment loans currently being prepared.

Indeed, the situation regarding Côte d'Ivoire's medium-term viability was difficult, the staff representative from the African Department commented. Additional financing could be provided, and it was possible--although unlikely--that commodity prices would improve. Therefore, the staff had preferred to be conservative in its assumptions.

The staff representative from the World Bank said that the Bank was conscious of the need to develop adjustment projects in the agricultural and energy sectors. In fact, two major operations were planned over the next 12 months: one agricultural sector adjustment loan and an energy sector adjustment loan. The World Bank staff had not yet reached agreement with the Government on the content of those operations, but the programs would include detailed policy statements and conditionality, that would reinforce the adjustment process. The World Bank had begun its preparations to develop those operations, in close cooperation with the Government, and there was no reason why an agreement could not eventually be reached and the operations put into effect.

In answer to the question that had been raised regarding public and private investment, everyone involved with Côte d'Ivoire, and particularly the authorities, agreed on the importance of creating an environment that would be conducive to investment, the staff representative from the World Bank said. A major component of the entire adjustment program being worked out with the World Bank was to create conditions favorable to private investment. Nevertheless, the World Bank considered that some modest expansion in the public investment program was justified to support private investment, because of concern about the possible downward spiral in the economy. According to the World Bank's projections, if greater austerity measures were introduced and no effort were made in the short to medium term to generate more economic activity, the medium- to long-term prospects would not be good. On the other hand, if economic activity were stimulated and good development projects were established--the World Bank was working with the authorities to develop high return projects, which were fully financed externally--then there would be no reason not to encourage the authorities to carry out those projects.

Mr. Santos said that he had noted the very specific concerns raised by some Directors on the exchange rate, the pace of adjustment, and the need for a further strengthening of the program. He would convey those messages of concern to his authorities.

The question of the exchange rate, as the staff representative had stated, had been raised many times in previous Board discussions, and the Directors were well aware of the institutional arrangements incorporated in the framework of the West African Monetary Union, Mr. Santos concluded. Of course, the authorities felt that the many advantages gained from membership in the Monetary Union more than compensated for the fact that their exchange rate could not be used as a specific and independent instrument of policy.

The Acting Chairman made the following summing up:

> Executive Directors generally concurred with the thrust of the appraisal in the staff report for the 1987 Article IV consultation with Côte d'Ivoire. Directors noted that, following an improvement in 1985 and 1986, Côte d'Ivoire's economic and financial situation had suffered a setback in 1987, primarily as a result of the sharp decline in world market prices for coffee and cocoa. Directors commended the authorities for their decision to strengthen economic policies and implement structural reforms designed to achieve higher economic growth and increased economic diversification. The view was widely held, however, that the speed and strength of adjustment should be stepped up, and questions were raised about the mix of policies that were being used.
>
> Directors welcomed the introduction of demand-management measures aimed at reducing the large fiscal and balance of payments deficits. They urged the authorities to implement

fully the revenue measures that had been introduced in 1987, together with the measures that would be included in the 1988 financial law. It was thought that significant complementary actions should be taken on the expenditure side, including the pursuit of prudent wage and recruitment policies and control over the operations of the Agricultural Stabilization Fund. Progress toward improving the situation of the public enterprises was also needed. The view was shared by Directors that a stronger fiscal effort should be evident by the first review under the stand-by arrangement.

There was widespread concern nonetheless that the authorities' program placed too much emphasis on demand management alone, with likely adverse effects on economic growth over the medium term. Questions were raised about the potential for giving greater scope for the growth of the tradable goods sector and for the diversification of the productive base. Although it was clear that difficult issues were raised by Côte d'Ivoire's membership in a currency union, several Directors thought that, given Côte d'Ivoire's prospective external environment, consideration of adjustments in currency relationships should not be precluded.

Directors, in the context of encouraging the authorities toward greater economic diversification and increased export-oriented activities, stress the need for Côte d'Ivoire to continue to implement the policy reforms supported by the World Bank structural adjustment loans, which sought to improve incentives in the agricultural, energy, and industrial sectors and to strengthen public sector investment programming.

Directors welcomed the authorities' determination to raise the level of productive investment in the economy through an increase in public sector investment and through further encouragement of private sector initiative. They cautioned, however, against possible adverse consequences on the fiscal and the balance of payments situation arising from a substantial increase in public investment, and recommended that careful selection of public sector investments be undertaken in close cooperation with the World Bank. The view was held that perhaps greater reliance could be placed on private sector initiative and investment.

Directors noted that Côte d'Ivoire has resumed discussions with its external creditors in order to secure additional exceptional resources to close the financing gaps during the program period. They encouraged the authorities and the creditors rapidly to reach understandings on the required package of exceptional financing and to regularize Côte d'Ivoire's situation vis-à-vis its external creditors. Directors expressed the hope that official creditors and the commercial banks would consider favorably Côte d'Ivoire's request for debt rescheduling.

Directors noted that unfavorable terms of trade and rising debt service obligations will continue to weigh heavily on Côte d'Ivoire's development prospects and its ability to achieve external viability in the next few years. Accordingly, they stressed the need for the authorities to make determined and sustained efforts to improve further domestic resource mobilization, while pursuing a cautious external borrowing strategy.

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

The Executive Directors then turned to the proposed decisions. After a further brief discussion, it was ascertained that there was a majority in favor of approving Côte d'Ivoire's stand-by arrangement and for a purchase under the compensatory financing facility, in principle.

The decisions were:

Stand-By Arrangement

1. The Government of Côte d'Ivoire has requested a stand-by arrangement for a period of 16 months, in an amount equivalent to SDR 94 million.

2. The Fund approves the stand-by arrangement set forth in EBS/87/249, Supplement 2, subject to paragraph 3 below, and waives the limitation in Article V, Section 3(b)(iii).

3. The stand-by arrangement set forth in EBS/87/249, Supplement 2, shall become effective on the date on which the Fund finds that satisfactory arrangements have been made with respect to the financing of the estimated balance of payments deficit in 1988, but provided that such finding shall not be made later than January 31, 1988.

Decision No. 8752-(87/172), adopted
December 15, 1987

Use of Fund Resources - Compensatory Financing Facility

1. The Fund has received a request by the Government of Côte d'Ivoire for a purchase equivalent to SDR 82.75 million under the Decision on Compensatory Financing of Export Fluctuations (Executive Board Decision No. 6224-(79/135), adopted August 2, 1979, as amended).

2. The Fund notes the representation of Côte d'Ivoire, waives the limitation in Article V, Section 3(b)(iii), and approves the purchase in accordance with the request, as of the date on which the stand-by arrangement set forth in EBS/87/249 becomes effective in accordance with Decision No. 8752-(87/172), adopted December 15, 1987.

Decision No. 8753-(87/172), adopted
December 15, 1987

APPROVED: July 28, 1988

JOSEPH W. LANG, JR.
Acting Secretary