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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 87/145

10:00 a.m., October 14, 1987

R. D. Erb, Acting Chairman

Executive Directors	Alternate Executive Directors
A. Abdallah	E. T. El Kogali
	Yang W., Temporary
	D. C. Templeman, Temporary
	A. Rieffel, Temporary
	L. Hubloue, Temporary
A. Donoso	
M. Finaish	A. M. Othman
	A. Bertuch-Samuels, Temporary
	K.-H. Kleine, Temporary
J. E. Ismael	J. Reddy
	J. E. Zeas, Temporary
	M. Foot
	S. King, Temporary
	I. Puro, Temporary
	D. McCormack
	C. V. Santos
	I. A. Al-Assaf
	V. J. Fernández, Temporary
	D. Marcel
	V. Rousset, Temporary
G. A. Posthumus	
C. R. Rye	
G. Salehkhou	O. Kabbaj
	L. E. N. Fernando
	A. Vasudevan, Temporary
K. Yamazaki	N. Adachi, Temporary
	S. Rebecchini, Temporary

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

Also Present

IBRD: Y. Huang, Asia Regional Office; J. O'Connor, Africa Regional Office. African Department: A. D. Ouattara, Counsellor and Director; S. E. Cronquist, R. E. Daumont, A. Doizé, K. Enders, P. H. Mathieru, T. P. McLoughlin, R. C. Williams. Asian Department: P. R. Narvekar, Director; E. Gurgen, S. Ishii, P. B. Pande, S. Shah, G. Szapary. European Department: D. J. Robinson. Exchange and Trade Relations Department: J. T. Boorman, Deputy Director; G. Belanger, M. W. Bell, P. Fontana, H. B. Junz, S. Kanesa-Thasan. Fiscal Affairs Department: B. Dubey. IMF Institute: O. B. Makalou. Legal Department: W. E. Holder, Deputy General Counsel; T. M. C. Asser, A. O. Liuksila, J. K. Oh. Middle Eastern Department: Z. Iqbal, K. Nashashibi. Secretary's Department: G. Djeddaoui. Treasurer's Department: D. V. Pritchett. Advisors to Executive Directors: P. E. Archibong, M. B. Chatah, A. G. A. Faria, G. D. Hodgson, A. Ouanes, P. D. Péroz, I. Sliper, K. Yao. Assistants to Executive Directors: O. S.-M. Bethel, S. K. Fayyad, M. A. Hammoudi, M. Hepp, A. Iljas, V. K. Malhotra, T. Morita, J. A. K. Munthali, C. Noriega, L. M. Piantini, S. Rouai, D. Saha, G. Schurr, D. A. Woodward.

1. NEPAL - STRUCTURAL ADJUSTMENT ARRANGEMENT

The Executive Directors considered a staff paper on Nepal's request for a three-year structural adjustment arrangement in an amount equivalent to SDR 23.6855 million and the first annual arrangement thereunder (EBS/87/196, 9/15/87), together with a policy framework paper (EBD/87/234, 9/14/87). They also had before them a statement of the Managing Director.

The Managing Director's statement read as follows:

There follows for the information of Executive Directors the text of a memorandum that I have received from the President of the World Bank to serve as the basis for my statement on the matter to the Board. This text summarizes the main points covered by the Executive Directors of the Bank and IDA in their October 6, 1987 discussion in Committee of the Whole of a paper entitled "Nepal: Policy Framework Paper, 1987/88-1989/90."

1. The Executive Directors of the Bank and IDA discussed, in a meeting of the Committee of the Whole, the paper entitled "Nepal: Policy Framework Paper, 1987/88-1989/90."

2. Speakers voiced their strong support for the Government of Nepal's stabilization and adjustment programs, expressing the opinion that measures of the type described in the paper were of great importance if Nepal was to improve the utilization of its scarce development resources and to achieve satisfactory levels of economic growth. While complimenting the Government on the paper, some clarification was requested on the specifics of the actions needed to support the Government's expressions of policy intent. Staff therefore elaborated on the considerable quantum of specific actions embodied in the current structural adjustment credit, indicating that progress in fulfillment of conditionalities under the structural adjustment credit had, on balance, been impressive, particularly in relation to macroeconomic performance, trade and industrial liberalization, and the management of the development program. In further discussion of the credit, staff explained that the increased revenue targets would be met primarily by tariff restructuring, accompanied by new excise taxes and by improvements in tax administration; poor disbursement performance, on the other hand, was being addressed by a number of measures aimed at improving project implementation. Nonetheless, it was recognized that limited absorptive capacity and weak development administration were issues that would require sustained reform efforts over an extended time period.

3. A number of speakers alluded to Nepal's severe environmental problems and drew particular attention to rapid deforestation in the densely populated hill areas. Staff explained that the forestry reforms supported by the credit were expected to have a

marked impact on forest management, but acknowledged that much more still needed to be done to arrest environmental degradation. To this end, the U.K. Overseas Development Administration and IDA are collaborating on an important study of national resource management which is expected to yield a set of practical prescriptions aimed at addressing Nepal's environmental basis.

4. Speakers also commented favorably on the Government's Basic Needs initiative and asked how IDA intended to support this effort. In response, staff explained that the Basic Needs program would be studied in the context of the next Country Economic Memorandum on Nepal, in which the allocation of development resources between the Government's key programs would be reviewed. IDA's own future lending program also contains provision for support to social sector programs and can be adjusted as and when suitable opportunities arise for assisting the Government with its program of poverty alleviation.

5. In addition to drawing attention to the above points, the Chairman in his summary highlighted the importance of developing Nepal's vast hydropower resources in order to realize its potential for industrial expansion and exports. In this regard, an appropriate resolution of riparian issues and agreement on long-term sales of power to Nepal's neighbors would be important factors.

Mr. Ismael recalled that at the conclusion of the Board's discussion of the Article IV consultation with Nepal on March 25, 1987, Directors had commended the Nepalese authorities for their role in bringing about significant stabilization gains by adopting a comprehensive economic adjustment program. That program had been supported by a stand-by arrangement with the Fund, followed by a structural adjustment loan from the World Bank, as well as by other policy initiatives proposed by the Asian Development Bank. While noting the progress achieved, Directors had also expressed concern over the underlying weaknesses of the economy, particularly its narrow export base and its vulnerability to exogenous factors, and over the relatively low level of domestic savings. In that context, Directors had welcomed the intention of the authorities to undertake further adjustments that could be supported by an arrangement under the Fund's structural adjustment facility.

The Government of Nepal was requesting a three-year structural adjustment arrangement in support of an economic program covering the period 1987/88-1989/90 and the first annual arrangement thereunder, Mr. Ismael said. That program was designed to increase domestic resource mobilization, improve public enterprise management, place greater reliance on the price mechanism to determine resource allocation, improve project implementation, and accelerate utilization of aid.

The authorities had already undertaken policy initiatives in connection with the first year of the program, Mr. Ismael continued. A major import tariff reform, accompanied by trade liberalization, had been implemented; steps had been taken to strengthen tax administration; and new revenue measures had been introduced. A reorientation of subsidies had been undertaken, and initiatives in the areas of agriculture, forestry, industry, and divestiture were under way. In addition, the authorities planned to launch reforms in the financial sector shortly.

The amount that would be available to Nepal under the structural adjustment facility was SDR 23.6855 million--or 63.5 percent of its quota of SDR 37.3 million, Mr. Ismael noted. Of that amount, SDR 7.46 million--or 20 percent of quota--would be available in a single disbursement to support the first year of the medium-term program. Nepal's outstanding financial obligations to the Fund's General Resources Account resulting from past operations and transactions currently totaled the equivalent of SDR 18.65 million.

Finally, it was worth pointing out that Nepal's per capita income was about SDR 135, Mr. Ismael said. The country was one of the poorest in the world; it was no better off than the sub-Saharan countries, which had received the Fund and World Bank's attention for several years. In view of those considerations, and to help Nepal maintain the momentum of its structural adjustment efforts and development, he would be grateful for the Executive Board's full support for the proposed decision.

Mr. Yamazaki commented that the Nepalese authorities' adjustment efforts, supported by the Fund stand-by arrangement, had had significant results; however, the economy was still suffering from a narrow export base, low per capita income, and weak infrastructure. To raise the standard of living, achieve long-term viability of the balance of payments, and eradicate sources of economic inefficiency, the authorities would have to implement comprehensive structural reforms supported by concessional loans. He therefore welcomed the present discussion on the request for a structural adjustment arrangement.

The authorities' strategy was appropriate, Mr. Yamazaki stated. The Nepalese economy was characterized by stagnant private sector economic activity and a weak public administration that had adversely affected the budgetary process and public investment projects. The authorities seemed to recognize those problems and were trying to tackle them effectively. From that perspective, the program was appropriately designed to make the economy more market oriented by stimulating private sector initiatives; in addition, the program aimed to achieve efficient mobilization of domestic resources through reform of the public sector.

As he welcomed the authorities' strategy and generally supported the program, he would limit his comments to two areas, Mr. Yamazaki observed. First, on fiscal policy, public investment still had an important role to play in view of the weak infrastructure. However, large public investment

should not necessarily lead to an increase in the budget deficit or the crowding out of private investment. It was possible to avoid those adverse results through efficient implementation of public investment and correct measures in the budget area. The adoption of a core program of projects was welcome.

New revenue measures, increasing tax elasticity, should be pursued further, Mr. Yamazaki noted. He welcomed the steps already taken in the area, but he urged the authorities to consider introducing much broader-based tax measures in the following two years of the structural adjustment arrangement. Restraint in regular expenditures and the curtailment of subsidies to public enterprises were most important and should be implemented rigorously. All those measures were essential to achieve the monetary and credit policy benchmarks.

Second, on external policy, an open economy with a small domestic market such as Nepal's was vulnerable to changes in the external economic environment, and therefore much attention should be paid to the external objectives, Mr. Yamazaki remarked. Borrowing on nonconcessional terms should be avoided to the extent possible. Appropriate financial and wage policies were major tools in the short term for achieving the balance of payments objectives. In the medium and long term, however, the objectives would be achieved through diversification of the export base. In that context, it was heartening to note that the Government was currently giving high priority to the development of cottage and small industries because of their potential for foreign exchange earnings, and he hoped for their success. Finally, he could support the proposed decision.

Mr. Fernando made the following statement:

> We support Nepal's request for a three-year structural adjustment arrangement and the first annual arrangement thereunder. The strength of the case for our support does not rest merely on the comprehensiveness and soundness of the policy content of the program proposed by the Government of Nepal to address the issues of low income, inadequate savings and investment, and high unemployment. Indeed, the stage has been set by a largely successful stabilization program undertaken within the framework of the recent stand-by arrangement since December 1985. Furthermore, the authorities have demonstrated their commitment and resolve to tackle the structural issues by implementing several measures supported by a World Bank structural adjustment loan and by making the significant progress reflected in the recent budget statement. My remarks are therefore limited to a few specific points.
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> With respect to the role of the exchange rate, in Nepal's economic circumstances, an outward-oriented strategy is considered more beneficial. However, given the extensive borders shared with neighboring countries, both the exchange rate and tariff policy

will have to be guided to some extent by the situation and developments there. Consequently, the objective of maintaining external competitiveness will have to be met to a considerable extent by other policy instruments. In this context, the authorities should recognize the importance of containing the domestically financed component of the budget deficit, of wages policy, and of monetary policy in stabilizing prices.

A somewhat related matter concerns the importance of tariff system reform--the single most important measure to increase revenue mobilization. Additional revenue is critical to financial development expenditure in Nepal's growth-oriented strategy and given the low level of savings. However, in the context of the country's open borders, the fragility of this measure is evident. Hence, once again, there will be pressure on other sources of revenue as well as on efficient tax administration. The unified revenue service is expected to improve revenue policies and their effective implementation. If several ministries were responsible for revenue collection, however, there will be an important political hurdle to overcome.

We commend the authorities for their public sector reform program. The budget policy aims to reduce domestic financing of the deficit to 1.5 percent of GDP by the end of the program period. However, the authorities should recognize the need for a flexible approach to the deficit, estimated on a before-grants basis. Many initiatives have already been taken to improve aid absorption capacity. Moreover, stronger adjustment and sustained growth could dramatically increase Nepal's credit rating, especially as the outstanding debt and debt service burden are very low. Self-financing, export-oriented or efficient import-substituting projects implemented within the framework of sound macroeconomic policies can strongly underpin Nepal's future growth prospects. Hydroelectricity generation merits priority attention; besides its contribution to energy supply, it can also increase the capacity for agricultural irrigation and to this extent lessen the impact of drought.

The public enterprise reform envisaged by the authorities includes privatization, and we have noted the serious measures formulated by the authorities. Although attractive as a policy initiative, the possibilities of success in this area are limited for well-known reasons, such as the stage of development of the capital market. It would be interesting to know whether the authorities have established a clear set of guidelines and an institutional mechanism to focus on and promote privatization. Moreover, we wonder what prospects there are for private foreign direct investment. The stimulus from liberalization in the sphere of trade and industry should provide vital underpinnings for a policy to attract investment capital from abroad.

Finally, we noted the authorities' intentions to increase the capacity of the national airline. The cost of this single item stands out in relation to the value of imports and financing packages, be it the World Bank's structural adjustment loan or the Fund's structural adjustment arrangement. Even though the item is being financed independently, perhaps the staff could give some reassurances about the airline's operations to generate the required cargo load and tourist traffic on both an inward and outward basis in order to make the benefits to the balance of payments more transparent.

Mr. Foot said that his authorities commended Nepal for its adjustment efforts in recent years and endorsed the general thrust of the program supported by the structural adjustment arrangement. They noted, however, that there was a long way to go and stressed that the adjustment program needed to be fully implemented in a timely fashion. As the staff stated, the program was intended to lay a more secure basis for sustainable growth, but he wondered whether the attainment of growth would not actually be more difficult than when the program had been drawn up. Flooding in Nepal, together with severe drought in parts of India, must raise serious questions about both the targeted rate of growth in 1987/88 and the projected rate of inflation. Indeed, the Nepalese Government was currently forecasting a fall in GDP in 1987/88, and he would welcome staff comment on the implications for, in particular, domestic credit and other objectives in the program. Moreover, inflation in India, because of the drought, could be significantly higher than the 6 percent assumed in the staff report, and thus in Nepal as well; staff comment would be appreciated.

He also asked the staff to comment on the realism of the export projections in the program, Mr. Foot continued. Nepal's exports had fallen sharply in volume terms in 1986/87. Under the recent stand-by arrangement, volume growth of 9 percent had been projected, but the outcome had actually been a decline in volume of 13 percent, which must have been one of the larger deviations from Fund-supported programs in recent times. He wondered whether the current forecasts had been underpinned by sectoral analysis conducted by the World Bank and whether any more details were available.

The thrust of policy reforms was in the right direction, Mr. Foot observed. He agreed with Mr. Yamazaki on the need to continue broadening the elements of tax reform. It might be worthwhile to consider whether agriculture could contribute a larger share to revenue than hitherto. He recognized the difficulties of taxing agriculture in developing countries, but he would be interested, given the importance of that sector in the economy, in any comments on that possibility.

Nepal would need to watch developments closely, Mr. Foot remarked. He had noted with some concern the intended use of new aircraft, and he would appreciate further information. He urged the authorities to monitor

the viability of the new venture so that the flexibility associated with leasing the aircraft could be utilized if events so required. He endorsed the proposed decision.

Mr. Rieffel made the following statement:

During the Board's discussion of the 1986 Article IV consultation with Nepal (EBM/87/54, 3/25/87), this chair commended the authorities for their persistence in implementing their stabilization program for 1986/87. At present, Nepal's performance under its recently expired stand-by arrangement continues to impress us and to provide a basis for optimism with regard to Nepal's future and the 1987/88 program. We are especially heartened by the decision of the authorities to undertake a follow-on program that would not require support from the Fund in the form of a new stand-by arrangement. Nepal's payment obligations to the Fund will be substantial beginning in 1989, and additional credit under a stand-by arrangement would tend to expose the country to greater balance of payments pressure in the event that adjustment measures were delayed or that adverse developments beyond Nepal's control occurred.

Before offering some specific comments on Nepal's policy framework paper and structural adjustment arrangement, I must express our continued concern over the application of the balance of payments criterion governing access to the structural adjustment facility. During the discussion in February of tthe staff report for the 1986 Article IV consultation and the second review under the stand-by arrangement for Nepal, this chair had said: "It is not clear to what extent the payments situation reflects problems that are structural and protracted in nature; we would welcome elaboration of those issues in any request for use of the structural adjustment facility." Consequently, we were surprised by the absence of any such elaboration in the papers before us today. Our surprise was even greater, in fact, when we found a number of indications reinforcing the doubts we had expressed more than six months ago. At the same time, we found it more difficult to determine whether Nepal was facing a protracted balance of payments problem because the papers do not contain a single table giving balance of payments projections for the period covered by the policy framework paper, although such tables were provided in the Article IV consultation report considered earlier this year.

Since I expressed our concerns about the application of this criterion only a week ago, I do not want to exhaust the patience of the Board by repeating them today. I must say, however, that whenever there are some doubts about the existence of protracted balance of payments problems, we expect the staff to include in its appraisals of requests for structural adjustment arrangements an explanation of how that criterion has been met.

The policy framework paper provides an excellent summary of the obstacles to growth and balance of payments viability in Nepal. We are satisfied with the objectives even though they appear rather ambitious. In particular, given the World Bank's views on the country's absorptive capacity, the growth objectives will be difficult to meet and harder to sustain beyond 1990. Relative to other policy framework papers reviewed by the Board, the policies outlined to achieve the objectives are uncomfortably vague. In particular, the pace of policy reform is difficult to assess in the areas of public enterprises, trade, forestry, and energy.

Our only other observation on the paper is that 39 of the 55 measures listed in the Summary of Macroeconomic and Structural Adjustment Policies are identified as being covered by the World Bank's recent structural adjustment loan. Five others are in the tourism and energy sectors, which are generally of greater concern to the Bank than to the Fund. This pattern could give the impression that the Bank is supporting the Nepalese program more strongly than the Fund. We suspect this is more a problem of presentation than of substance, and we suggest that the staff should find a more useful way to indicate in these summaries which institution is supporting which reforms. For some reforms, of course, both institutions should be mentioned, and there may be other reforms where another multilateral or bilateral institution should be shown as providing support. Such information would not only help the Executive Directors of the Bank and the Fund get a better sense of how policy frameworks are being supported, but it could also help the country implement its reforms.

We have four brief comments on Nepal's request. First, we agree with the view of the staff that further measures may be necessary to increase tax elasticity. We would like to have the staff's views, however, on what kinds of measures should be under consideration.

Second, we agree with the staff that reforms of the domestic financial market should be undertaken "at an early date." Why then was an early date not set as a benchmark in this area? In fact, the deadlines for all of the structural benchmarks in the first annual program seem to fall at the end of the program year. It would seem more appropriate to set deadlines earlier in the year for at least a couple of benchmarks.

Third, we are puzzled by the inclusion in the first annual program of three structural benchmarks relating to trade liberalization that appear to relate to policy measures supported by the Bank's structural adjustment loan. Why was it necessary to duplicate these benchmarks?

Fourth, given the size of Nepal's pipeline of undisbursed foreign aid, we would have expected a benchmark in this area. We urge the staff to consider this for the second annual program.

In conclusion, Nepal's policy framework paper strikes us as one of the weaker ones we have reviewed, but we have the impression that the country's commitment to reform is actually stronger than reflected in the paper and the first annual program. If this is the case, we urge the authorities not to use the policy framework paper and the structural adjustment arrangement as an excuse to delay needed reforms.

Mr. Bertuch-Samuels welcomed the progress in reducing the domestic and external imbalances that had been made by Nepal under the recent stand-by arrangement. The proposed arrangement under the structural adjustment facility seemed an adequate framework within which to continue the adjustment effort over the medium term and therefore deserved support.

The efforts to increase domestic resource mobilization by implementing revenue-raising measures and limiting current expenditures were welcome, Mr. Bertuch-Samuels continued. In that context, he shared the staff's view that further measures were needed to improve tax elasticity and to strengthen tax administration. He welcomed the authorities' intention to offset any possible revenue shortfalls that might arise in connection with the changes in the tax and tariff system by slowing down noncore development spending.

The authorities' measures to improve the financial situation of the two largest public enterprises were commendable, and he encouraged them to extend their rehabilitation and reform efforts to the rest of the public enterprise sector and to push ahead with their privatization plans, Mr. Bertuch-Samuels said. As he had stressed during the review under Nepal's stand-by arrangement, progress in improving the design, management, and implementation of projects, together with appropriate financial policies, would go a long way to improve resource allocation and increase Nepal's absorptive capacity for external aid. Thus, while he welcomed the measures undertaken with support from the World Bank to improve project implementation, he agreed with the staff that there seemed to be ample room for further steps in that area, especially with respect to the strengthening of Nepal's administrative capacity.

On a further point relating to the underutilization of foreign aid, it was somewhat surprising that the program allowed for nonconcessional borrowing although, admittedly, of a limited amount, Mr. Bertuch-Samuels observed. He asked the staff to elaborate on the reasons for that provision and on the appropriateness of such nonconcessional borrowing.

Mr. Al-Assaf made the following statement:

The program submitted by the authorities of Nepal in support of their request for Fund assistance under the structural adjustment facility correctly focuses on improving economic efficiency. Structural measures will indeed play a key role in achieving a higher sustainable growth rate of the economy over the medium and longer term. The authorities have set for themselves a growth rate objective of 4-5 percent a year, which seems to be desirable in view of the low overall productivity of the economy, as reflected in one of the lowest per capita incomes in the world. However, this objective may be ambitious, based on the performance of the economy over the last 20 years. One major reason to consider the expected performance of the next 3 years with some caution is the fact that a significant proportion of this future growth will have to be provided by an agricultural sector that is vulnerable to the vagaries of weather. To the extent that this vulnerability reflects the consequences of structural weaknesses that will take time to correct, it would be reasonable to assume that the program targets for agriculture might be subject to some downward corrections.

A satisfactory performance of the nonagricultural sector of the economy, which is assumed to grow at twice the rate of the agricultural sector, may therefore prove essential to the attainment of the objectives set by the authorities. A large part of the nonagricultural sector, however, is under the direct control of the Government. The authorities appear to be aware of the weaknesses and rather low efficiency of a number of public corporations and are attempting to invigorate some of them, through privatization in particular. The first attempts do not appear to have been completely successful, however. The three enterprises offered for sale so far seem to have been shunned by private investors. This development could be interpreted in two ways: either the prices at which the shares were offered were too high, or many investors are taking a sober view of existing or medium-term opportunities for conducting business under truly market-oriented conditions. If this last interpretation is the correct one, the achievement of the basic objectives of the program in relation to the nonagricultural sector might prove less easily attainable than envisaged, and some flexibiliy might be required in this area in due course.

I share Mr. Foot's views on tax policy as related to agriculture. It is surprising that the agricultural sector as a whole seems to be basically tax exempt. Admittedly, agricultural activities are difficult to tax in all countries, and especially in countries such as Nepal where incomes are extremely low. It would seem that activities accounting for almost two thirds of GDP should make a meaningful contribution to government revenues. The tendency of expenditures to run at twice the rate of revenues has

always made it difficult to achieve budget balance in Nepal, an issue that is especially relevant in the context of the present program.

Finally, I support the program, which has been rightfully characterized as courageous and bold.

Mr. Yang recalled that when the Board had discussed the 1986 Article IV consultation with Nepal, his chair had supported the Nepalese authorities' intention to request a structural adjustment arrangement with the Fund. In collaboration with the staffs of the Fund and the World Bank, the authorities had devised a policy framework that clearly defined the concrete measures necessary to tackle the main structural problems present in the Nepalese economy. The achievements attained under the recent stand-by arrangement attested to the authorities' determination to follow through with the program supported by a structural adjustment arrangement. Therefore, his chair fully endorsed the proposed decision.

Mr. Salehkhou made the following statement:

The Managing Director's statement and the staff appraisal both emphasize the typical plight of a low-income country facing financial difficulties. Nepal fully deserves the financial and technical support of the World Bank and of the Fund, given the courageous measures undertaken by the authorities in dealing with present difficulties.

Indeed, Nepal, a landlocked country with scarce natural resources, is to be commended for having achieved a reduction of the fiscal deficit by NRs 5.4 million against NRs 5.7 million as targeted in the program, an improvement in the external current account deficit which contributed to a small surplus in the overall balance of payments of SDR 8 million after many years of deficits, and a reduction in the rate of growth of the monetary aggregates. These gains were made in the face of severe constraints and limitations on domestic expenditures with an unavoidable social impact on the population--whose standard of living remains low--especially as they occurred when export receipts fell as a result of natural calamities.

In view of these developments, the World Bank should lend its support to help the authorities implement a program that includes irrigation projects and hydropower schemes. This would enable Nepal to increase its agricultural exports and possibly sell surplus electricity to its neighbors. The assistance of the World Bank would also be welcome in the tourism sector, where improvement in the means of transportation is needed.

I welcome the stated willingness of the Nepalese Government to continue to implement additional measures in the fiscal, financial, public enterprise, and external sectors. The measures in the fiscal sector are expected to increase domestic resources, especially through reorganization of the tax system aimed at enlargement of the tax base and improvements in the efficiency of tax collection. Increased tax revenues would clearly reduce the budget deficit.

The reforms in the financial sector will include the introduction of incentive measures for government securities and bonds. A second market for such financial instruments is to be organized and developed to encourage domestic savings and to increase the efficiency of monetary management.

The sizable arrears resulting from parastatal activities constitute a financial burden on Nepal and call for the restructuring of this sector. With the assistance of the International Finance Corporation, the authorities are determined to implement effective measures to improve the management of those enterprises staying public, and to sell or liquidate the remaining enterprises with the objective of reducing and eventually eliminating their large arrears to the banking system.

Despite a relatively low debt service burden, amounting to about 5.5 percent of exports of goods and services, Nepal should attempt to strengthen its exports by encouraging exporters with a duty drawback/exemption system that would make Nepalese products more competitive in world markets. The authorities should also implement measures aimed at reducing restrictions on imports needed as inputs for the manufacturing sector.

Finally, although I agree with the staff that the program is rather ambitious, I believe the authorities should be commended for implementing most of the measures envisaged in the program, and I support Nepal's request for arrangements under the structural adjustment facility.

The staff representative from the Asian Department commented that the formulation of the program represented perhaps an ideal case of Fund-Bank collaboration because the Bank had started its involvement more than one year previously while preparing for a structural adjustment loan. Following several identification missions, a fairly comprehensive structural adjustment program in areas such as agriculture, forestry, and hydroelectricity had been set up. When the authorities had requested the arrangement with the Fund under the structural adjustment facility, the Fund staff had relied on the Bank's work. The Bank staff, in turn, had participated in many of the structural adjustment facility discussions so that the program in the macromanagement, fiscal, and monetary areas would be complementary to the structural adjustment loan.

Some of the structural benchmarks had been described as vague, but many structural reforms had been prior conditions, the staff representative pointed out. In fact, the program had been negotiated only after several missions to Nepal. For example, the World Bank and Fund staffs had recognized the importance of tariff reforms, and the need to include them in the first-year program. The authorities had requested technical assistance, and following two Fund missions the authorities had been able to introduce reforms in a timely and efficient manner in the 1987/88 budget. The financial sector reform measures had been identified by the Fund after the World Bank's structural adjustment loan had been negotiated and therefore had not been covered by the Bank loan. No date had been set for implementation, but the measures were expected to be introduced during the first year of the program following a technical assistance mission to Nepal in December. No benchmark existed for undisbursed foreign aid, although the staff had considered such a benchmark worthwhile. One difficulty, however, was that part of the aid in the pipeline related to projects for which a full financing package had not yet been negotiated. Although that difficulty would continue to exist, the staff would explore in future annual programs the possibility of establishing as benchmarks ceilings on the pipeline of unutilized aid.

Balance of payments projections were presented in Annex II of the staff report (EBS/87/196), including exports for the full program period in terms of growth rates of volume and value, as well as various ratios to GDP, the staff representative continued. The underlying detailed balance of payments data were available, but in attempting to present all the macroeconomic projections under the structural adjustment facility in one table, perhaps small details had been crowded out; the staff would attempt to include them in the future. As to the protracted nature of the balance of payments problem, the policy framework paper showed clearly that the export base was weak and that exports were not sufficient to provide the imports needed to tap the country's natural resources. There would therefore be a continued need for foreign assistance. In fact, the aim of the program was to increase utilization of existing foreign aid. Currently, a large resource gap existed, and while reliance on foreign savings would increase during the program period, it should decline over the longer term.

As highlighted in the appraisal, the staff considered the measures that should be taken to increase the elasticity of the tax system very important, the staff representative commented. Implementation would be difficult, however, because Nepal would have to tax agriculture more heavily and heretofore that sector had been virtually tax exempt. Moreover, land tax was typically the responsibility of the local districts, and their representatives exerted strong political opposition in Parliament to tax reforms. Nevertheless, the staff had emphasized that such tax measures should be implemented the following year. To alleviate political problems, the authorities were considering leaving the proceeds of the increased land tax with the local communities but taking away budgetary transfers. The staff did not fully agree with that method

because the areas in most need of development projects were the poorest districts with low revenue. The net revenue gain to the public sector would not be large, while pressure would be exerted on the Government to continue to finance development projects.

Improvement in tax administration would also be important in increasing the elasticity of the tax system, the staff representative continued. Currently, four offices were in charge of tax collection, and civil servants were transferred frequently between departments, hindering tax enforcement. The authorities had agreed to establish a unified revenue service, and the staff hoped it would be established by the end of the program period. Of course, the staff would look at other areas where tax elasticity could be increased.

The impact of flooding on production was difficult to judge, the staff representative said. On the whole, the staff considered that the effect in Nepal would not be as significant as in India or Bangladesh, as the flooding had not affected large areas of cropland. However, because of the drought in India, inflation in that country would likely be higher. As a result, inflation in Nepal would also likely be higher, and that exogenous shock would have to be accommodated by monetary policy; otherwise production in Nepal would be contracted resulting in slower growth. The staff would monitor that area closely and if it decided further adjustment was necessary, the issue would be raised during forthcoming discussions.

Several Directors had questioned Nepal's acquisition of two aircraft, the staff representative recalled. The national airline's international operations were profitable while domestic operations were subsidized; overall, however, the company had no operating losses. The country's tourist industry was growing rapidly, as shown by the 25 percent rise in receipts and the total of more than 300,000 tourists who had visited Nepal during the past year. To alleviate the resulting bottlenecks, Nepal had fully liberalized charter flights, but it would like to profit from the growing tourist business; the existing fleet was old and had to be replaced. Moreover, air freight was very important for the export of carpets, which was a booming export industry, and foreign airlines had not been willing to take the load. To maintain flexibility, the authorities would purchase one aircraft and lease the other; if market conditions should not meet expectations, they could terminate the lease. A feasibility study had shown that the aircraft would be self-financing, and while the amount might seem worrisome as it added so much to the debt service, the World Bank and other aid donors had considered the project useful.

Progress in the area of privatization would be difficult because of both absorptive capacity and confidence, the staff representative explained. Uncertainty existed as to whether the Government would give up control of the enterprises completely. In fact, the Government had not given the right signals: it had retained 51 percent of the shares in the first four

enterprises privatized, discouraging to some extent the private sector from buying shares. The staff would continue discussions in that important area; meanwhile, the authorities had requested technical assistance from the International Finance Corporation to determine what measures would be needed to prepare enterprises for divestiture.

The staff's export projections were conservative, the staff representative from the Asian Department said. A rebound was expected during the current year because there had been a sharp drop in exports during the previous year, owing to drought and to the sharp drop in garment exports to the United States because of difficulties related to distribution of U.S.-imposed export quotas among local producers. The projected increase in volume was only about 7 percent, compared with 4 percent in the past, and the staff considered the projection realistic.

Mr. Ismael thanked the Executive Board for its support of Nepal's request for a three-year structural adjustment arrangement under the structural adjustment facility. He had noted Directors' comments on the progress achieved thus far and on areas where more needed to be done, and he would communicate those views to his authorities.

The Executive Board took the following decision:

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

2. The Fund approves the arrangements set forth in EBS/87/196, Supplement 1.

Decision No. 8706-(87/145), adopted
October 14, 1987

2. GUINEA-BISSAU - STRUCTURAL ADJUSTMENT ARRANGEMENT

The Executive Directors considered Guinea-Bissau's request for a three-year structural adjustment arrangement in an amount equivalent to SDR 4.8 million (EBS/87/197, 9/14/87).

Mr. Santos, speaking on behalf of Mr. Mawakani, made the following statement:

Four months ago, the Executive Board considered the policy framework paper describing the economic strategy and the measures that the authorities in Guinea-Bissau intend to implement during the three-year period 1987-90. During the Board discussions, the challenges facing the authorities in reducing the present economic and financial disequilibria and in solving the deep-seated structural

problems of their economy were brought to light. Also, the main elements of the adjustment program for which Fund support is sought under the structural adjustment facility were extensively described. As Directors will recall, understandings had been reached on most of the major elements of the first annual program. I will therefore limit my statement to describing a few key policy measures to be implemented in 1987/88.

As indicated in the Memorandum on the Economic and Financial Policies and Measures attached to the report, the Guinea-Bissau authorities are giving high priority to the development of the agricultural sector. In this context, they have adopted appropriate producer pricing policies that are expected not only to stimulate production but also to encourage trade through official channels, thus increasing recorded exports. Measures are being implemented with a view to enhancing the role of the private sector in the economy. The scope of price controls has been reduced substantially and market forces will be allowed to play gradually their role in the determination of the prices of the few goods still under price control.

On the fiscal front, my authorities' objective during the first annual program (July 1987-June 1988) remains the reduction of the budgetary deficit. To this end, a wide range of revenue-raising and expenditure-containing measures have been implemented. These include, on the revenue side, an increase and extension of the coverage of the national reconstruction tax, a shift to ad valorem taxes for alcoholic beverages, and the introduction of an ad valorem tax on gasoline sales. furthermore, negotiations are under way with foreign fishing companies with a view to increasing government revenue derived from the issuance of fishing licenses. On the expenditure side, the measures include a 5 percent reduction in the size of the civil service in 1987 and the containment of the increase in the government wage bill to 25 percent despite the substantial devaluation of the Guinea-Bissau peso. A further reduction of the size of the civil service is envisaged in 1988. Actions are being taken to reform the public enterprise sector in order to enhance its performance through price and tariff adjustments and to strengthen the managerial capacity of the public enterprises.

In line with the overall objectives of the program, the authorities are pursuing prudent monetary and credit policies. Credit expansion is being closely monitored to ensure that adequate resources are made available to the private sector. In this respect, the Government will reduce substantially its recourse to the banking system thereby allowing for a doubling of the credit to the economy. In the context of the institutional reform of the banking system, the authorities are approaching foreign banks for the establishment of subsidiaries in Guinea-Bissau.

As highlighted in Table 2 of the staff report, the authorities have implemented, since January, an impressive list of measures which is an indication of their commitment to restructuring the economy and restoring internal and external balances. Nevertheless, the external position of the country will continue to remain difficult as the debt service ratio, without rescheduling, will amount to 113 percent in 1987 and 96 percent in 1988. Therefore, the provision of exceptional debt relief and the timely disbursement of external financial assistance are critical to the success of the program. My authorities hope that in the context of the forthcoming Paris Club meeting, creditors should be sensitive to their case and reduce the debt service ratios to a level compatible with the medium-term viability of the country's balance of payments.

Mr. Kleine said that he supported the staff appraisal and the proposed decision. His chair had commented on the policy framework paper four months previously (EBM/87/84, 6/8/87), and he would therefore make only a few additional remarks.

The more favorable balance of payments outlook was encouraging, Mr. Kleine commented. Clearly, the authorities' firm commitment to a major reorientation of economic policy, as indicated by the early implementation of key elements such as the adoption of more appropriate exchange rate and producer pricing policies, was already paying off.

He appreciated the fact that his chair's proposal regarding the inclusion of a benchmark for gross official reserves had been taken up, Mr. Kleine continued. He would encourage the authorities to develop, in close cooperation with the World Bank, a medium-term public sector investment plan, which could make an important contribution toward rationalizing the process of development and strengthening the efficiency of the use of scarce resources. At the same time, it would in all likelihood facilitate the mobilization of the necessary external funds.

The authorities should take the required steps, with technical assistance from the Fund and the World Bank, to improve the coverage and timeliness of the statistical data base, Mr. Kleine said. Finally, taking into account the particular operational circumstances of the present case, he would, on an exceptional basis, go along with the practice of having only tentative benchmarks for the first half of 1988, as he understood from the paper that definite benchmarks would be discussed with the authorities around the end of the year.

Mr. Foot recalled that when the policy framework paper had been discussed by the Board in June, he had outlined four areas of concern. With respect to the first area, he was encouraged by the upward shift in interest rates and the fall in the inflation rate, which had greatly eased the concerns he had expressed over the basic stance of monetary policy. Second, he was less encouraged about the very modest pace of

the intended reduction of the fiscal deficit. The overall deficit for 1987 on a commitment basis and expressed as a percentage of total expenditure after allowance for grants was at present considerably higher than had been projected in June.

His third concern, regarding centralized controls, also remained, Mr. Foot continued. The bold action already taken by the authorities in certain areas, notably the exchange rate, would bear fruit only if every effort was made to dismantle the pervasive price and marketing administration. His fourth concern had been about the difficult external position in which Guinea-Bissau would find itself for many years despite the slightly better balance of payments forecast. That concern was exacerbated by the fact that Table 1 in the staff report showed that external arrears at the end of 1986 were about twice as large as expected. In those difficult circumstances, it was imperative not only that creditors provide adequate debt relief but that the authorities use any windfall to strengthen their external position. The current projection for reserves in 1991 was inadequate. In short, he could agree with the staff that the authorities had done enough to justify Fund support, but the program was not wholly convincing.

Finally, he had two points. It was unfortunate but inevitable that the benchmarks for 1988 were indicative, Mr. Foot observed. On a general matter, he suggested that papers such as the present one, issued some months after the policy framework paper, should attempt to highlight the changes that had occurred in the intermediate period, for example, the change in the arrears situation.

Mr. Rieffel made the following statement:

> Having recently discussed the policy framework paper for Guinea-Bissau in some detail, my remarks will not focus on the economic policies already implemented but on important issues for the remainder of the program year. First, however, I must reiterate our support for this program and commend the authorities for the difficult and far-reaching measures they have adopted thus far, demonstrating their commitment to this comprehensive adjustment program which is being supported cooperatively by the Fund, the World Bank, and other multilateral development institutions. Clearly the economy is reacting positively to the measures already adopted, as reflected in the more favorable balance of payments outlook.
>
> The steps that have been taken thus far, however, are only a beginning. It is critical that the reforms be continued throughout the year, particularly in the fiscal and pricing areas, so that the momentum toward reform will not be lost or the desired results compromised. In this regard, it is unfortunate that it was necessary to change the first annual program period from the calendar year

budgetary cycle to a midyear cycle. While we appreciate the difficulties in getting the timing of the cycles for the economic program, the structural adjustment arrangement, and the budget year to coincide, we support this as the general objective and hope that some method might be found to realign the cycles for 1989.

We should also emphasize our view that the two-stage approach was helpful in this case. It gave the authorities and the staff more time to concentrate on designing a comprehensive policy framework on which the Fund and the World Bank could base their loan programs, and it allowed time for the needed external financing to come together before the stuctural adjustment arrangement was presented to the Board. Furthermore, it is our understanding that the change in program year would have been required by the Fund's current rules regardless of the use of a two-stage approach.

Unfortunately, in this case, we are approving a one-year program without having in place fiscal and other important targets for the entire program year. Without such specifics, the elaboration in late 1987 of a budget proposal for 1988, based on available indications for the 1987 outturn and aimed at a further decline in the overall deficit, will be critical. Also, the timetable for reducing the number of civil servants, to be elaborated in late 1987, should reflect the need for further immediate reduction. We look forward to learning the results of the Government's review of its tariff structure, and we would welcome staff comment on what this review might reveal.

In addition to detailing a budget proposal in late 1987, it will be important at that time to monitor the pricing policies to ensure that prices are in fact adjusted throughout the program period to reflect exchange rate developments and changes in world market prices and costs. Furthermore, we would expect to see steps being taken to finalize a medium-term agricultural strategy. Also, we hope that a review at that time of the performance of the exchange system will provide the basis for eliminating the export retention scheme.

While we appreciate the time involved in studying the public enterprise sector, we wonder whether it might not be possible to begin reforms in certain identified areas before the entire study is completed next June. I would appreciate staff comment on this possibility. We would hope to see more specific reforms within this sector included as benchmarks in the second annual program following the conclusion of this study.

We also had hoped that more specific policy actions aimed at supporting the supply-side reforms could have been included as benchmarks, of which perhaps the reforms in the banking sector could

have been part. In addition, it would have been desirable in light of the changed program year to include some reference in the benchmarks to the need to set a fiscal path for 1988 that is consistent with the program and also to the need for pricing policy to continue to reflect exchange rate and other market developments. While those objectives are spelled out in the memorandum, it would have been reassuring to include them in the benchmarks in light of the difficulties in setting some of the most important targets for the entire first year of the arrangement.

Finally, let me reiterate the importance of maintaining the pace of the reform effort. As was noted in the World Bank's discussion of Guinea-Bissau's policy framework paper, failure to sustain reforms was a major factor in the country's poor growth record over the last decade. So far, this program is heading in the right direction, with the authorities having taken some difficult steps and the economy beginning to respond. We urge the authorities to continue in this direction and to give the economy the chance to achieve its growth targets and balance of payments viability. With such a heavy debt service burden looming ahead, this will be critical.

Mr. Al-Assaf made the following statement:

I support the proposed decision, and I am in general agreement with the staff appraisal. Guinea-Bissau is endowed with relatively abundant natural resources; unfortunately, economic and financial problems in the past have prevented the country from realizing its potential. I therefore welcome the authorities' decision to address these problems within a medium-term context. I believe the program before us will help Guinea-Bissau tap its resources more fully, while laying a solid foundation for more durable growth.

I welcome the authorities' implementation of important measures in the structural adjustment program. These early actions are a clear indication of the authorities' commitment and determination to put their economy on a sound footing. With respect to specific areas in the program, I commend, first, the authorities' measures to reduce the overall fiscal deficit. Owing to the fact that the Government's financial position depends on external support, it is important that the authorities sustain the fiscal adjustment efforts. The reduction in the number of civil service employees will be an important step toward a sustainable fiscal position in the medium term, as will the enhancement of the revenue base.

Second, the recent devaluation of the Guinea-Bissau peso by nearly 60 percent, together with supporting policy measures in the fiscal and external sectors, should improve the external position.

As the authorities realize, the pursuit of a flexible exchange rate policy after this initial adjustment will be essential in preserving the country's competitive position. It will also improve the availability of foreign exchange by helping channel foreign exchange receipts through the official system.

Third, the implementation and maintenance of prudent monetary and credit policies, together with the measures taken on the fiscal front, should contain the rate of inflation and support the external sector objectives. These measures should also encourage domestic savings and more efficient credit allocation. In this context, I am encouraged by the authorities' intention to improve the administrative and technical capacity of the National Bank, including the preparation of the foreign exchange budget, which I hope will help prevent delays in discharging debt service obligations.

In conclusion, I commend the authorities for the early implementation of many courageous measures in this program. These policies will go a long way toward achieving sustainable growth with a viable external position in the medium and longer terms, and I urge the authorities to persevere.

Mr. Rousset made the following statement:

Since our discussion on Guinea-Bissau's policy framework paper took place only four months ago, we have little to add to our earlier comments, and we continue to support the authorities' plan for the next three years.

We are in broad agreement with the staff appraisal of the first-year program, and we support its emphasis on the need for a flexible exchange rate policy and continued tight financial policies. The strict implementation of these policies is all the more important because, despite the improvements in the external current account expected in the course of the three-year program, Guinea-Bissau will continue to rely heavily on external financing, including concessional borrowing and debt relief.

In this respect, we understand that a meeting of the Paris Club is tentatively scheduled for late October to consider the rescheduling of Guinea-Bissau's debt on the basis of this arrangement under the structural adjustment facility. This exceptional procedure had previously been applied only to Mozambique and Uganda, whereas for other countries, stand-by arrangements had been considered necessary. It is true that the limited data on Guinea-Bissau make it very risky--if not impossible--to forecast the precise impact of the recommended measures on production and

fiscal revenues. It would therefore be particularly difficult to design and implement a stand-by arrangement. The staff report is candid in this respect when it states that "the quarterly benchmarks for the first half of 1988 are tentative since firm economic ground for setting definitive benchmarks does not exist." However, even if the possible yield of the measures is uncertain, no doubt should exist about the authorities' commitment to the adjustment process. The next important step will be to adopt a budget for 1988 that includes a reduction in the size of the civil service. The adoption of a budget consistent with the program will be an important sign to the donor community.

During the previous discussion on Guinea-Bissau, we expressed our disagreement with the procedure of separating the presentation of the policy framework paper from the approval of the first-year arrangement. Our reservations were based on the fact that such a procedure presented the risk of increasing not only the time necessary to present the arrangement but also the work load for all parties involved. Even if our experience with this case shows that the length of time necessary has been reduced to a minimum, thanks to the dedication of the staff, our concerns about the increased work load remain justified. Indeed, the data and forecast for 1987 had to be revised. The staff also had to modify the period of the arrangement, initially based on the calendar year and now based on the year beginning in July. These facts indicate that the two-step approach has placed a significantly heavier work load on the staff and the country, and they reinforce our conviction that to the extent possible such an approach should be avoided.

It goes without saying that although we regret the additional work involved, we are pleased that the outcome for 1987 is better than initially expected. We hope that the strong signs of recovery in the agricultural sector will be confirmed and consolidated in the years to come.

Mr. El Kogali stated that his chair supported Guinea-Bissau's request for the use of Fund resources under the structural adjustment facility. As described by Mr. Mawakani, the authorities had implemented far-reaching measures that should go a long way toward reducing the financial imbalances in the economy. He would focus his comments on the viability of the adjustment program in relation to the growth objective and the sustainability of the external sector, but first he wished to comment on the statistical weakness mentioned in the footnote on page 11 of the staff report. National accounts data were not available, and although the objective was to achieve 3-4 percent growth in real terms, it was difficult to assess the feasibility of such an outcome in the absence of data. Technical assistance to Guinea-Bissau in that area could prove useful,

and the authorities were therefore well advised to take full advantage of such assistance as might be available from competent international organizations, including the Fund.

On a more substantive point, while he could see how the financial program was designed to reduce inflation, together with the fiscal and external deficits, there was not much discussion on how the program would promote growth, Mr. El Kogali continued. Instead, the program was framed in such a way that, through exchange rate action, there would be movement in relative prices that would favor export and import-competing industries. Together with the trade and price liberalization measures, the underlying market forces would stimulate production. While that objective was clearly desirable, he would have preferred to see a more in-depth discussion of specific measures that would underpin the sources of growth. Moreover, the program design should have specified, for example, investment initiatives in both the private and public sectors, as it was essentially the expansion of the productive base that would ensure the durability of a meaningful adjustment in Guinea-Bissau.

The external sector was dominated by a heavy debt burden even after rescheduling, with debt service remaining high over the medium term, Mr. El Kogali observed. In turn, that particular problem could undermine the success of the adjustment program. Given that situation, it appeared that Guinea-Bissau could be considered a good candidate for the more innovative rescheduling arrangements that had been promoted recently, including the initiative for debt-distressed African countries proposed by the World Bank. Guinea-Bissau needed more concessional rescheduling arrangements, including lower interest rates on all rescheduled debts, and the extension of grace and maturity periods. He hoped, therefore, that the Paris Club and other creditors would respond positively if the authorities were to seek softer terms. Doing so could go a long way toward reducing the financing gaps that were projected for the medium term and toward building a comfortable reserve position that would ensure normalization of relations with the country's creditors.

The staff representative from the African Department remarked that the staff had attempted to point out in the report any changes in the medium-term framework that had occurred since the discussion of the policy framework paper at EBM/87/84. The positive developments in the balance of payments in 1987 had resulted in a revision of the medium-term outlook since the issuance of the staff report accompanying the policy framework paper. Nevertheless, the staff would certainly in the future take into account Directors' suggestions to highlighting developments. The data for outstanding external arrears had been revised because the staff, as a result of intensive studies of the debt situation, had been able to identify some arrears--particularly of the National Bank--that had not been included in the earlier report.

The staff had discussed the tariff structure thoroughly with the authorities because of the effect of ad valorem taxation of the large increase in local currency values of imports following the substantial

devaluation of the Guinea-Bissau peso in May, the staff representative noted. That discussion would be pursued during the forthcoming consultation mission. With respect to public investments and public enterprises, the staff had discussed with World Bank staff the possibility of setting up a medium-term investment program. The World Bank staff had approved a reduction in the investment program for 1987 because of the expected completion of ongoing projects and a more rational approach to investment planning.

Technical assistance was needed to improve Guinea-Bissau's data base, particularly with respect to the national accounts, the staff representative from the African Department concluded. Moreover, tax administration would be reinforced through additional technical assistance provided by the Fund.

The staff representative from the Exchange and Trade Relations Department noted that with regard to the timing problems arising from bringing the program and arrangement periods into close proximity, the staff could not ascertain the amount of time required to formulate the policy framework paper and to arrange and agree on an appropriate program. In the present case, the two-stage process had been necessary because of the financing gap existing in May, which had had to be closed before the Board could consider the structural adjustment arrangement. During the discussion of experience with the structural adjustment facility scheduled for early December, the question of appropriate discrepancies between program periods and arrangement periods and the effect on benchmarks would be addressed. Obviously, benchmarks indicated the milestones that the member should reach in the medium-term process at particular stages. For that reason, no problem could arise from straddling fiscal years while the authorities formulated budgetary and other policies according to those benchmarks. Meanwhile, through the Article IV surveillance process, discussions would ascertain whether the member's policies were adequate to remain on the medium-term path.

Mr. Santos said that he appreciated Executive Directors' support for Guinea-Bissau's request to use the resources of the structural adjustment facility. He would convey to his authorities the Directors' praise for their courageous steps already taken under the program, as well as their concerns and recommendations. The question of the program period merited early consideration because of the problems in implementation that could arise for the staff and the authorities concerned.

The Executive Board then took the following decision:

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

2. The Fund approves the arrangements set forth in EBS/87/197, Supplement 1.

Decision No. 8707-(87/145), adopted
October 14, 1987

3. ARTICLE IV CONSULTATIONS - SEMIANNUAL REPORT

The Executive Directors considered the staff's semiannual report on the frequency of Article IV consultations (SM/87/230, 8/25/87).

Mr. Templeman made the following statement:

Since we have recently had the opportunity to discuss at some length the frequency of Article IV consultations in connection with our consideration of the bicyclic procedure for use with some member countries, I can be brief. First, I would urge management to make every effort to avoid the bunching of Article IV consultation discussions. For example, the staff paper indicates that about 50 discussions were conducted in the first half of 1987, leaving 70 or more to be considered in the second half of the year. I realize that the scheduling problem is a difficult one, but hope some attention will be given to this aspect of a broader problem.

Second, we remain very concerned about the problem of prolonged delays in conducting consultations with a few countries. Some progress has been made since the staff paper was prepared. Consultations with the Libyan Arab Jamahiriya were concluded on October 9, and I understand that we expect to have the Article IV consultation with Peru on the Board agenda late in November. This leaves Democratic Kampuchea, which appears to be a unique and unresolvable problem under existing circumstances. But I do not believe that the Islamic Republic of Iran and Iraq fall into that category.

An examination of the October issue of International Financial Statistics indicates that, for the Islamic Republic of Iran, almost no data are shown for 1986 and 1987 other than exchange rates and the position in the Fund. Some data for earlier periods are also not available. In the case of Iraq, even fewer numbers are shown, with almost all data for 1985 through 1987 to date missing. We can understand how some kinds of economic data could be especially sensitive at a time of military conflict, but we do not understand why submission of economic data to the Fund is almost totally lacking, or why a way cannot be found to conduct some useful form of consultations. For example, in the case of Lebanon, notwithstanding the very complicated security problem there, it was possible to conduct an Article IV consultation with talks held outside the country.

The commitment of member countries to provide information to the Fund is a fundamental obligation of membership, particularly under Article VIII, Section 5. Failure to abide by this obligation over a prolonged period is a grave matter. We propose that management request the authorities of the Islamic Republic of Iran and of Iraq to submit the maximum amount of information possible on a confidential basis, as necessary, and that Article IV discussions be initiated within the next three months, so that the surveillance role of the Fund can be made effective. The documentation for the consultations could, of course, be issued in a numbered series in the manner that has been used in some other sensitive cases in recent years.

As to the staff's suggestions for a new system of notifications to the Board in the case of prolonged delays in concluding consultations, I have some preference for the second alternative, whereby initial notification to the Board could be based on the cycle specified for the member rather than the outside limit of 24 months, since it is quite possible that a significant delay in a major country that is on a regular cycle could pose a serious problem.

Finally, I would be interested in hearing the thoughts of the staff and other Directors about the type of procedure and the coverage of the discussion that might be triggered by a new notification system.

Mr. Abdallah made the following statement:

Basically, the experience with Article IV consultations during the first half of 1987 does not differ widely from that during the comparable period of 1986. Projections of conclusions of Article IV consultations for the entire year are similar to those of the preceding year. As shown in Table 1 of the report, 50 consultations were concluded in the first half of 1987, representing 33 percent of membership, compared with 56 in the same period in 1986, which represented 36 percent of membership. However, when compared with the figures for the corresponding period of 1985, the outcome reflects a significant decline in the number of consultations concluded in 1987.

As regards delays in concluding consultations, it is not encouraging to note that many member countries have exceeded the 3-month grace period during the first 6 months of the year. For the year as a whole, as in 1986, delays in concluding consultations with some member countries on a 12-month cycle would be prolonged far beyond the originally scheduled period. Even though Directors had earlier reaffirmed that the interval between consultations should not exceed 24 months, by the end of the first half

of 1987 the number of countries for which more than 24 months have elapsed since conclusion of the last consultation was 5 compared with 3 in the corresponding period of 1986.

The causes of delays in concluding consultations, highlighted on pages 7 and 8 of the staff report, represent a mixed bag, ranging from protracted discussions, staffing difficulties, and mission scheduling problems owing to political events, to timing of the budget and authorities' requests. However, it would appear that some delays are not entirely occasioned by individual countries' circumstances. Therefore, in seeking to minimize delays--a course worth pursuing--attention must be focused on what both the Fund and the authorities can do to that end. We know from experience that protracted discussions and subsequent delays are sometimes caused by both the authorities and the staff. Notwithstanding Article IV, Section 3(b), the Fund would need to take into account the totality of a member's circumstances before reaching any conclusion.

I have taken careful note of the new procedure proposed by the staff, which involves notification of delays to the Executive Board. This might be useful if it is intended only for information purposes; the procedure could give the Executive Director representing the member concerned an opportunity to clarify his authorities' intentions concerning the timing of the consultation or the causes of the delay. Beyond that, its usefulness is doubtful. I do not believe that, given the diverse nature of the causes of delays in concluding consultations, the matter commands such priority as to warrant placing it on the agenda for review, in each case, by the Board. Such reviews would further overburden the Board and would not prove particularly beneficial at a time when the Board is effectively seeking ways to reduce its very heavy work load.

Finally, under the simplified interim procedure a total of six staff reports would be issued by the end of this year. More such reports aimed at covering, initially, the 23 cases approved under the interim consultation procedure would assist in reducing the frequency of Article IV consultations. It must be stressed that even though reporting under this procedure is simplified in many cases, there is a need to make it a sufficiently comprehensive evaluation of developments and policies. The recent exchanges between the Fund staff and the Seychelles authorities over issues of accuracy, objectivity, and balance in reporting for that country's interim consultation deserve special mention. If such a situation recurs, would it not be necessary to involve the Executive Board by putting such an apparently controversial report on the Board's agenda for approval on a lapse of time basis?

Mr. Finaish noted that with regard to the question of security, the staff, in the semiannual report of October 15, 1984 had stated in a footnote that "security problems refer to cases where the member, in a situation of armed conflict, has declined to receive a consultation mission, or where the security of the mission cannot be assured. These grounds for delay in consultations have been considered acceptable by the Executive Board." Moreover, in the summing up of April 7, 1983, the Managing Director had stated that "in considering the circumstances that might justify delays in consultations, Directors noted that military hostilities, for example, would warrant a delay. However, it was to be understood that once the special circumstances had passed, the consultation should be held quickly." He wondered whether the experience of a few countries was not covered by those understandings.

The procedures under the first option suggested by the staff needed further elaboration, Mr. Finaish considered. He would appreciate clarification regarding subsequent reviews by the Board. He wondered about the frequency of those reviews and whether they would have a purpose similar to the Board's review of members' overdue financial obligations.

Mr. Templeman observed that delays in concluding consultations had been a problem for some time, and it was appropriate at present to consider whether there was some way that the Board could solve that problem.

He agreed with Mr. Finaish that it was necessary to spell out the procedures more clearly, Mr. Templeman continued. However, perhaps the staff wished to hear the Board's comments before specifying the procedures.

Mr. Posthumus asked the staff to explain whether the 15 notifications that would have been given to the Board under the second option concerned countries where consultations had been delayed more than 15 months but less than 24 months. He understood that if the delay had been longer than 24 months, the Board would have already been notified under the first option, which the staff supported.

The staff representative from the Exchange and Trade Relations Department commented that the staff had wanted to have the views of the Board on possible approaches to cases of prolonged delays in concluding consultations. The staff had not intended to propose a rigid timetable of Board consideration of notifications of probable delays. Indeed, the staff had referred to the judgment of management regarding causes of delays and to the "possibility" of such issues being placed on the Board's agenda. Past experience with the consultation scheduling process suggested that Board discussion would be required only in a very limited number of cases as delays had been mainly due to reasons judged acceptable by management.

The ongoing semiannual review process would not be affected, the staff representative added. Consequently, even if Board discussion of a case of prolonged delay should take place following adoption of one of

the proposed procedures, further consideration could occur on the occasion of the semiannual review when the Board could be informed of recent developments vis-à-vis the country with regard to either staff discussions or plans for consultations in the interim period.

Another staff representative from the Exchange and Trade Relations Department said that the footnote in the semiannual report of October 15, 1984 essentially reflected the conclusion of the Executive Board's discussion in 1983, when it had considered explicitly the cases that might justify delays. The term "security problems" was used as a shorthand in that footnote and in some earlier papers to refer to the sentence in the summing up cited by Mr. Finaish where it was recognized that military hostilities would justify delays in consultations.

Of the 15 notifications that would have been issued in 1986 under the first option, most would have concerned countries where consultations had been delayed more than 15 months but less than 24 months, the staff representative explained.

Mr. King said that he continued to be a strong supporter of the bicyclic procedure. He welcomed its implementation and hoped that other countries would adopt that procedure. For example, not all countries with structural adjustment arrangements would automatically need to be on 12-month cycles, although it would obviously be most appropriate in many cases.

In a few cases, Article IV discussions had been delayed significantly beyond the scheduled timetable, Mr. King noted. He encouraged all countries to carry out the obligations of membership as fully as circumstances permitted. He could go along with the staff's suggestion that the Board be routinely informed when a consultation was likely to be delayed significantly. The notification to the Board should be based on the cycle specified for the member; however, it would not be appropriate for the Board to discuss each case automatically. Instead, he would prefer that the notification be simply for the Board's information, although the opportunity would be provided for either the Executive Director concerned or any other Board member to call for a discussion.

Mr. Salehkhou made the following statement:

> In addition to providing the six-monthly report on the experience with Article IV consultations and a listing of forthcoming consultations, the paper before us deals with cases in which there have been prolonged delays in conducting Article IV consultations. While I agree that the consultation process is at the heart of surveillance, I continue to believe that flexibility should prevail and that particular attention will have to be paid to the special circumstances of members in considering the conduct and frequency of Article IV consultations.

As far back as 1983 I expressed doubts about the usefulness of issuing periodic reports to the Executive Board on the status of consultations with individual members, fearing that the wrong impression might be given that members on the list were not fulfilling part of their obligations to the Fund. I mentioned at the time that such impressions would be all the more undesirable considering that consultation delays generally stem from special problems facing individual members and that such problems were in most cases beyond the control of the authorities concerned. In other cases, the delays may be attributable to the staff as a result of departmental constraints and/or scheduling complications owing to program implementation.

The issue of prolonged delays in the conduct of Article IV consultations directly involves my own country. I wish to reiterate that well-known regional circumstances have prevented my authorities from conducting a full-fledged consultation with the Fund. In this regard, I recall that these same special circumstances were recognized as such by the Executive Board as early as in 1983. The Chairman's summing up at EBM/83/55 (3/28/83) states that "in considering the circumstances that might justify delays in consultations, Directors noted that military hostilities, for example, would warrant a delay; however, it was to be understood that, once the special circumstances had passed, the consultation should be held quickly."

Accordingly, it should be recognized that with regional circumstances remaining difficult, it would not be advisable for the Fund to change its traditional and consistent position and to press the authorities to hold Article IV consultations at this or any time before the hostilities end. This is especially true in light of the deteriorating regional situation, and the Fund's insistence on holding consultations under these circumstances could be construed as a political position. This argument could be reinforced if one considers that of the five countries listed by the staff as those with which consultations have not been held for more than 24 months, each reflected different circumstances for the delay. The Board has just concluded the consultation with the Libyan Arab Jamahiriya that had been delayed because of a change in the composition of the Government, while the consultation with Peru is scheduled to be held shortly. Furthermore, Democratic Kampuchea's right to use the Fund's general resources was limited for lack of contact with the authorities for an extended period. The staff has reported that the situation of armed conflict has inhibited holding formal Article IV consultations with the remaining two countries.

In the case of the Islamic Republic of Iran, however, I would remind the Executive Board that since 1982 there have been five staff visits to the country and informal discussions with the

authorities. One of the more recent visits led to the preparation and subsequent discussion, in an Executive Board seminar, of the study on Islamic banking which included, inter alia, the latest comprehensive information and statistics on the banking system. Another staff mission is scheduled to take place shortly to hold similar informal discussions. Moreover, bilateral discussions are held with management and staff on the occasion of the Annual Meetings and Interim and Development Committee meetings in Washington and elsewhere. One may therefore conclude that the Iranian authorities have lived up to their obligations under the Articles and have fulfilled the spirit, if not indeed the letter, of their legal obligation, given the prevailing special circumstances.

Finally, I strongly support the staff's pertinent observation that in cases of prolonged delays in concluding consultations, the Fund would need to take into account the totality of the member's circumstances.

Mr. Posthumus said that he had a slight preference for the second option, or what the staff had called the alternative system, where notification would take place on the basis of the cycle specified for the member concerned. Following such notification, the Board would not have to discuss the item, but a short explanation by the staff, and if necessary some information from the Executive Director concerned, would usefully apprise the Board of the situation.

The arguments for the lack of consultations with the Islamic Republic of Iran and Iraq were well known, Mr. Posthumus commented. Nevertheless, the delays remained a cause for concern, and the authorities should consider whether some other form of consultation could be acceptable in the future.

Mr. Puro remarked that he recognized the problems associated with the delays in concluding Article IV consultations and noted that the problematic cases were few. The staff had supported the first of two proposed alternatives to cope with the problem; however, the staff's grounds for its choice remained somewhat unclear. He was broadly satisfied with the present practice of bringing prolonged delays to the attention of the Board, and he would prefer that that procedure be continued. But he could go along with whatever procedure was adopted, so long as it did not consume too much of the Board's time.

Mr. Zeas said that he supported the first alternative, which required a notification to the Board when the interval between consultations appeared likely to exceed a 24-month period.

Mr. Fernández expressed support for the first option. He agreed with the staff that for the time being, that procedure should serve to

deal with those few cases of protracted delays. He asked the staff to comment on how the procedure would apply to countries with 24-month consultation periods.

The staff representative from the Exchange and Trade Relations Department explained that the first alternative, based on earlier discussions in the Board when it had been clearly stated that the period between consultations should not exceed 24 months, would use the specified consultation cycle as a trigger to notify the Board of delays exceeding 24 months in concluding the consultation. Under the second alternative, the Board would be notified in each case whenever a member exceeded the expected consultation cycle. For example, if a country on a 12-month cycle went beyond the 3-month grace period, the Board would be notified of the slippage; if a country were on a 24-month cycle, notification to the Board would occur in the event that the period between consultations went beyond 24 months.

Under the current 90-day notification procedure, the Board was notified when a mission and consultation discussions had occurred but the Board discussion concluding the consultations would not take place within a 90-day period, the staff representative added.

Mr. Adachi stated that as Article IV entrusted the Fund with the critical responsibility of surveillance, he supported the staff's proposal to enable the Executive Board to review cases of protracted delays in concluding the consultations on a timely basis, provided that the implementation of the proposal would not greatly add to the work load Executive Board and the staff. He therefore supported the staff's first proposal whereby formal notification of delay would be issued only in cases where the 24-month limit was likely to be exceeded.

Mr. Rye said that, in view of the work load, he also favored the first option presented by the staff. As to the cases of protracted delays, he had some sympathy with the views expressed by Mr. Templeman. He would be content to leave the matter in the hands of the Managing Director to see whether he considered it appropriate to mount some low-key effort to sound out the authorities concerned and to see whether some progress could not be made toward restoring a normal relationship with the Fund.

Mr. McCormack said that he had a marginal preference for basing notification on the specified cycle, but with the expectation that there would not be a Board discussion in most cases. The Board could deal with the majority of cases in the context of the regular six-monthly report on the frequency of Article IV consultations.

Mr. Templeman commented that although the seminar on Islamic banking had been interesting, he did not consider it part of the surveillance exercise. He wondered whether the current informal talks with Fund management mentioned by Mr. Salehkhou were similar to the broad economic

monitoring involved in surveillance or whether they were simply a follow-up to earlier discussions on banking or other such topics. As to bilateral talks during the Annual Meetings, although they could be useful, they were not reported to the Board and did not form a part of the surveillance process in any formal sense.

He remained puzzled by the complete lack of data for the Islamic Republic of Iran and for Iraq in International Financial Statistics (IFS), Mr. Templeman observed. Although other countries had some statistical shortcomings, it was difficult to understand why, in the present case, no data whatsoever were available; even some figures could be useful to the international community. He recognized, however, that the issue was somewhat separate from the question of the frequency of Article IV consultations.

As to a notification system, a procedure currently existed whereby the Board was aware through notification or semiannual reports of the status of Article IV consultations, Mr. Templeman continued. Except in unusual cases, a new notification system would not be of any further use. He hoped that the system would not add to the work load and that it would provide information on a largely pro forma basis. Of concern, however, were those few cases where serious substantive problems existed, such as the Islamic Republic of Iran and Iraq. During the past few years, there had been distressing evidence of relations between the Fund and member countries becoming so sensitive as to impede surveillance, one of the principal functions of the Fund. The Board would need to focus on such cases in light of the Fund's responsibility to correct the situation.

Mr. Vasudevan commented that it would be helpful to avoid bunching Article IV consultations as well as Article IV consultation reports. As to cases of protracted delays in concluding consultations, he did not see much merit in institutionalizing any approach. He wondered whether the existing procedures did not take care of the problem of delays, if not protracted delays. Even if the existing procedures in that regard were inadequate, it remained unclear whether rigid review procedures were necessary. Moreover, establishing any new system should not burden the Board with additional review work, even if notifications were issued merely for the Board's information. From that point of view, the first approach had perhaps much to commend it, but in the absence of full details about the purposes that such notifications were expected to serve and about the procedures that would follow issuance of such notifications, he was not in a position to give any definitive views on the matter.

He would be prepared to review the situation to determine whether more countries could be placed on a 24-month cycle without including them in the bicyclic procedure, Mr. Vasudevan concluded.

Mr. Donoso said that he had no difficulty in going along with the first proposed procedure. He understood that following notification, the Director representing the country would be allowed to present the views

of his authorities. Subsequently, unless firm timing were proposed by the member, Board discussion could take place. Possibly, the procedure could provide an opportunity for the authorities to clarify their relationship with the Fund but not necessarily lead to further Board discussion. He suggested that after notification, and the opportunity for the Executive Director concerned to present his authorities' view, the option might be left to that Director to suggest Board discussion.

Mr. Bertuch-Samuels commented that he viewed protracted delays in concluding Article IV consultations as a matter of serious concern because of the implications for the effective exercise of Fund surveillance. Obviously, without members living up to their obligations under Article IV, Section 3, the surveillance exercise could easily become meaningless. He could see, therefore, some merits in adopting a procedure along the lines suggested by the staff. The Board's already heavy work load should be kept in mind, however; he therefore preferred the first option whereby notification would be limited to those cases where the 24-month limit was likely to be exceeded. Nevertheless, he had an open mind to basing notification on the country's specific cycle.

Mr. Finaish said that he agreed with the staff that should a consultation not be held for an extended period, the Fund would need to take into account the totality of the member's circumstances. However, it should be recognized that in those cases where prolonged delay had been caused by security problems, it would at best be difficult to specify a firm timing for the next consultation. Consequently, so long as those problems persisted, there would presumably be no need for subsequent reviews of the matter by the Board, as specified in the procedure outlined by the staff. It was understood, of course, that once the security problems ended, consultations should be held. That position was in line with the views expressed by Executive Directors on the occasion of the 1983 annual review of the implementation of surveillance, as indicated by the Chairman's summing up which he had referred to earlier.

Insofar as consultations with Iraq were concerned, the Iraqi authorities considered that, in light of the continuing armed conflict, it would not be possible to make available sufficiently comprehensive data to permit concluding Article IV consultations, Mr. Finaish stated. Since the last consultation with Iraq, however, the authorities had maintained contact with the staff in the context of the Annual Meetings and on other occasions as well.

With regard to Mr. Templeman's comments about the consultations being held with Lebanon despite the conflict in that country, the Lebanese authorities had been eager to have consultations on an annual cycle while the Board had been reluctant to have such frequent consultations, Mr. Finaish recalled. In the case of Iraq, the authorities' reluctance was a result not of the staff's inability to travel to the capital because of security but because of the lack of sufficient information to provide to the mission.

The staff representative from the Exchange and Trade Relations Department explained that the staff had envisaged a somewhat simpler and more straightforward procedure than Directors had mentioned. Three types of cases could arise. First, delay could arise within the context of either proposal--beyond the 12-month cycle or 24-month limit--for generally acceptable reasons, and that situation would be put to the Board in the form of a notification presumably without further action.

Second, a situation could occur where differences of view regarding the delay could arise on the part of the staff and the authorities, in which case a notification to the Board with an explanation from the staff of the reasons for the delay might elicit a response from the Executive Director concerned, providing an explanation from the authorities' point of view, the staff representative continued. Executive Directors could then agree with the information provided in the staff documents and by the Executive Director, and no further action would be necessary. In a third case, the statement by the Executive Director might prompt other Executive Directors to request Board discussion, but the staff expected that those cases would be very few.

On various occasions, the staff had held discussions with the authorities of some countries regarding statistics in IFS, the staff representative remarked. He recalled that in particular cases the authorities had been strongly urged to provide additional line items on an up-to-date basis, whereupon they had argued that such information was sensitive and could not be provided. Ultimately, information for IFS was provided by the authorities at their discretion, following discussions with the staff, based on what could safely be published in their particular circumstances.

The discussions that took place between management, the staff, and the authorities of the various countries during the Annual Meetings and on other occasions were very useful to the staff and management in bringing them up to date on developments in those countries, the staff representative reported. Nevertheless, Mr. Templeman was accurate in commenting that those discussions were not in the context of special consultations and did not provide information to the Executive Board; the discussions were therefore outside the context of Fund surveillance, which was of course conducted by the Executive Board.

In response to a question, the staff representative from the Exchange and Trade Relations Department explained that whenever there was a scheduling delay, the authorities through their Executive Directors were in contact with the staff and/or management and in most cases there was agreement on how to proceed. He envisaged the same result in future so that notification to the Board would reflect discussions that had taken place between staff and management on the one hand and the Executive Director concerned on the other. That Executive Director could provide the Board with information that was not in the notification, but Board discussion would not take place automatically. However, an Executive

Director or management could propose Board consideration if the issues were sufficiently substantive. At present, specific cases could be discussed in the context of the semiannual reports on the frequency of Article IV consultations.

Mr. Posthumus agreed that it would not be necessary to have a discussion, but he believed that notification would also not entail automatic Board agreement. The notification would simply entail acknowledgment of the reasons for delay put forth by the staff or the Executive Director.

Mr. Salehkhou remarked that while he could not disclose the content of the informal discussions that had taken place with regard to the subject of Islamic banking, his authorities had provided comprehensive information on the financial sector to the best of their abilities under the circumstances.

The lack of data was not due to a statistical problem, Mr. Salehkhou commented. Rather, it was due to the nature of the statistics, which had strategic value and could not be divulged publicly for the sake of national security.

The Acting Chairman said that in attempting to assess the Board's views on the proposals with respect to cases of prolonged delays in conducting consultations, it was apparent that some Directors did not want to change the existing procedure and other Directors who had indicated a desire to consider alternatives were divided between the two options suggested by the staff. Perhaps, in light of the fact that the semiannual reviews provided an opportunity to consider the matter of prolonged delays, Directors might prefer to address the cases in that framework.

Mr. Templeman observed that the subject warranted more focused attention than it had been accorded in the past. He had understood that a majority of the Board was in favor of a notification system but was not clear as to what form it should take. He would prefer the adoption of a new, separate, mutually acceptable system that would not increase the Board's work load and under which the management and Executive Directors would be free; in those few cases where serious, substantive problems existed, to bring them to the Board for discussion.

Mr. Posthumus agreed with Mr. Templeman that it would be useful to initiate a new procedure.

Mr. McCormack noted that he had a marginal preference for the new procedure, precisely because it acted as a warning signal. It would be useful in alerting Directors to the circumstances outlined in the notification and therefore helpful in making a judgment. A detailed discussion could take place during the six-monthly review, or, if the circumstances were sufficiently serious, a special Board meeting could be convened by management or an Executive Director.

Mr. King suggested that it might be worthwhile to adopt the procedure for a short period, after which it could be decided whether the system had been useful in adding to Directors' awareness of the situation.

Mr. Bertuch-Samuels said that he supported Mr. McCormack's comments and Mr. King's suggestion.

Mr. Archibong commented that the information notice should be used for the information of Executive Directors, who might find it necessary to convey their concern to the members' authorities and request explanations for the delay. He did not consider it necessary for the Executive Board's work load to be increased by the procedure.

Mr. Finaish remarked that all members should respect their obligations under the Articles with respect to consultations. The question of security had been raised because a member in his constituency considered that providing information during a period of conflict would not be helpful to the country. As the specific problem of security had been recognized by the Board some time previously, he hoped to avoid a recurrence of Board consideration of the matter when it could not serve any useful purpose.

Mr. Salehkhou remarked that the legitimacy of the prolonged delays in the special cases he had mentioned had long been recognized by the Board and treated accordingly in the semiannual reports on the frequency of Article IV consultations. As Directors were aware, the situation had not improved in any sense. He did not see the wisdom of issuing notices to the Board that seemed to indicate that a country was not abiding by its obligations to hold discussions with the Fund; the impression given was wrong. For that reason, he preferred the present procedure, which included the issuance of semiannual reports.

Mr. McCormack asked the staff whether it would continue to issue notices when the 24-month period had been exceeded, or whether it would treat the situation in the context of regular reviews. If the latter, the procedure would be a forward-looking exercise where a judgment would be made about the likely emergence of a significant delay; that method would be more useful than repetitive notices after the event.

The staff representative said that the proposed procedure gave the Board the opportunity to discuss an individual case that it deemed sufficiently substantive to be considered outside the context of the general reviews. The present semiannual review was being considered by the Board primarily because the issue of prolonged delays in the scheduling of consultations had been raised; typically, the semiannual reports were not discussed by the Board but were merely provided for information. Consequently, the notification system might diminish further the need to discuss the semiannual reports, as substantive cases could be scheduled for discussion either by management or the Executive Directors.

The Acting Chairman stated that there had been support for the second alternative outlined in the staff paper whereby initial notification to the Board could be based on the consultation cycle specified for the member rather than the outside limit of 24 months. As suggested, the procedure could be implemented on an experimental basis and reviewed in the context of the semiannual report on Article IV consultations. The notifications to the Board would be in the form of information notices, leaving it to the discretion of Board members or management as to whether the matter should be brought to the Board for discussion.

The Executive Directors continued to attach importance to countries fulfilling their obligations under the Articles, with respect to both the timely provision of information and the conduct of Article IV consultations on a regular basis, the Acting Chairman remarked. Directors generally agreed that the Board had recognized in the past, and continued to recognize, that security considerations might justify delays in Article IV consultations; at the same time, those prolonged delays remained of concern to the Board.

In the case of prolonged delays, management held the view that it was within its responsibilities to take the opportunity to discuss the matter with the national authorities to ensure that circumstances had not changed and to assess whether the authorities would reconsider their desire not to have an Article IV consultation, the Acting Chairman noted. Management would continue to exercise that responsibility in the future.

A number of Directors had expressed support for the bicyclic approach to consultations, the Acting Chairman recalled. Indeed, some Directors had asked the staff to consider whether other countries could not become candidates for the bicyclic procedure. At the same time, it had been suggested that, within that procedure, reports should remain sufficiently comprehensive to provide the necessary information to the Executive Board.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/87/144 (10/9/87) and EBM/87/145 (10/14/87).

4. RELATIONS WITH GATT - CONSULTATIONS WITH CONTRACTING PARTIES - FUND GUIDANCE

The Executive Board approves the recommendation by the Committee on Liaison with the CONTRACTING PARTIES to the GATT with regard to the guidance statements for the Fund representative

attending the GATT consultations with Ghana, India, Israel, Pakistan, and Sri Lanka on October 19-30, 1987, as set forth in EBD/87/249, Supplement 1 (10/7/87).

Decision No. 8708-(87/145), adopted
October 9, 1987

5. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/87/217 (10/8/87) and EBAP/87/218 (10/9/87) and by an Advisor to Executive Director as set forth in EBAP/87/217 (10/8/87) is approved.

APPROVED: May 16, 1988

LEO VAN HOUTVEN
Secretary