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04

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 86/68

10:00 a.m., April 23, 1986

R. D. Erb, Acting Chairman

Executive Directors	Alternate Executive Directors
A. Alfidja	
C. H. Dallara	M. K. Bush
	M. Lundsager, Temporary
	H. G. Schneider
M. Finaish	T. Alhaimus
	M. Sugita
	K. Murakami, Temporary
	B. Goos
Huang F.	Jiang H.
J. E. Ismael	
	H. A. Arias
	J. Hospedales, Temporary
T. P. Lankester	M. Foot
H. Lundstrom	H. Fugmann
	L. Leonard
E. I. M. Mtei	W. K. Parmena, Temporary
F. L. Nebbia	
	J. E. Suraisry
P. Pérez	G. Ortiz
H. Ploix	V. Rousset, Temporary
J. J. Polak	J. de Beaufort Wijnholds
	A. V. Romuâldez
	B. D. White, Temporary
G. Salehkhou	O. Kabbaj
A. Sengupta	A. S. Jayawardena
S. Zecchini	

L. Van Houtven, Secretary
S. J. Fennell, Assistant

Also Present
His Excellency A. Hyera, Ambassador of Tanzania. African Department: A. D. Ouattara, Director; R. J. Bhatia, Deputy Director; G. E. Gondwe, Deputy Director; A. I. Abdi, J. Artus, D. T. S. Ballali, R. O. Carstens, I. A. H. Diogo, J. M. Jiménez, I. Kapur, J. W. Kratz, S. N'guiamba, D. S. Scheuer. Exchange and Trade Relations Department: E. H. Brau, S. Kanesa-Thasan, M. Nowak, R. Pownall, M. Xafa. Fiscal Affairs Department: F. L. Corfmat, R. D. Kibuka, W. R. Mahler, Jr., J. R. Modi. IMF Institute: T. Ramtoolah. Legal Department: J. G. Evans, Jr., Deputy General Counsel; A. O. Liuksila, J. M. Ogoola. Secretary's Department: J. W. Lang, Jr., Deputy Secretary; A. P. Bhagwat. Treasurer's Department: T. Leddy, Deputy Treasurer; D. Williams, Deputy Treasurer; D. Berthet, J. E. Blalock, D. V. Pritchett, A. Tas, G. Wittich. Personal Assistant to the Managing Director: R. M. G. Brown. Advisors to Executive Directors: M. B. Chatah, L. P. Ebrill, S. M. Hassan, J.-C. Obame, P. Péterfalvy, N. Toé, A. Vasudevan, M. A. Weitz. Assistants to Executive Directors: M. Arif, A. Bertuch-Samuels, W. N. Engert, R. Fox, S. Geadah, O. Isleifsson, Z. b. Ismail, R. Msadek, J. E. Rodríguez, S. Simonsen, A. J. Tregilgas, H. van der Burg, E. L. Walker.

1. TANZANIA - OVERDUE FINANCIAL OBLIGATIONS - REVIEW OF DECISION ON COMPLAINT UNDER RULE K-1 AND NOTICE OF FAILURE TO SETTLE TRUST FUND OBLIGATIONS

The Executive Directors considered a staff paper on the review of Decision No. 8056-(85/126) on complaints under Rule K-1 with respect to Tanzania's overdue obligations to the General Department and the notice of Tanzania's failure to settle Trust Fund obligations (EBS/86/85, 4/21/86).

His Excellency A. Hyera, Ambassador of Tanzania, was present at the meeting.

The Deputy Director from the African Department remarked that following the previous Board discussion on Tanzania's overdue obligations to the Fund (EBM/86/48, 3/20/86), the Tanzanian authorities had invited the staff to visit Dar es Salaam to discuss the main elements of an adjustment program and the authorities' plans to become current with the Fund. The Minister of Finance, Economic Affairs, and Planning had informed the staff at the time of its visit that after prolonged discussions, the Government had reached a consensus on the need to take far-reaching measures in the context of a comprehensive adjustment program that could eventually be supported by the Fund. The staff and the authorities had reached broad understandings on a number of major policy issues, including exchange rate policy, overall budgetary targets for revenues and expenditures, the budget deficit and its financing for fiscal year 1986/87, producer prices, price liberalization, and interest rate policy. The Minister had confirmed those policy understandings in a letter to the Managing Director. The staff would suggest that it visit Tanzania in mid-May to help the authorities prepare a memorandum that would set out the details of the economic and financial policies necessary to achieve the targets, with a view to implementing the policies no later than the 1986/87 budget announcement in mid-June.

In the meantime, the authorities had asked the World Bank to convene a consultative group meeting and had requested Fund support in the mobilization of the necessary financial assistance, the Deputy Director indicated. The staff of the Bank and the Fund were currently making informal contacts with representatives of potential donor countries on the timing and modalities of such a meeting. The Minister of Finance had assured the Managing Director that Tanzania would make every effort to settle its overdue obligations to the Fund within a short period.

In response to questions from Mr. Leonard, the Deputy Director from the African Department stated that the authorities recognized that they could not negotiate a stand-by arrangement with the Fund until the arrears were cleared. He therefore assumed that they would obtain the necessary bridge financing and become current with the Fund, at the latest by mid-June.

The staff representative from the Treasurer's Department remarked that an additional SDR 800,000 would fall due to the Fund by Tanzania by end-April. In May, SDR 700,000 would fall due, and in June, SDR 64,000. About SDR 3.5 million would fall due in July.

Mr. Mtei commented that the staff team that had recently visited Tanzania had had successful technical discussions with his authorities. Understandings had been reached on policy measures needed to achieve economic and financial adjustment and medium-term recovery. In addition, notwithstanding the pressing demands on the country's meager foreign exchange reserves, his authorities had made a payment of $3 million to the Fund at the beginning of the previous week to indicate the high priority they attached to settling their obligations to the Fund. The Minister of Finance had stated that he was making every effort to discharge the remaining obligations in a short period.

His authorities were working on a timetable that envisaged the possible agreement of a memorandum of understanding in May 1986, which would be used by the Minister of Finance to mobilize funds in the form of a bridge loan to clear the country's arrears to the Fund, Mr. Mtei indicated. Following the clearance of the arrears, the authorities could conclude the formal negotiations, by submitting a letter of intent to the Managing Director and holding a consultative group meeting in early June to determine how the medium-term financing gap could be covered. His authorities had indicated that the bulk of the adjustment measures would be implemented as part of the 1986/87 budget that was due to be presented to Parliament on June 19, 1986.

His authorities had stressed the need for timely external assistance when the comprehensive adjustment program was being put into place, Mr. Mtei emphasized. The infusion of substantial external resources would be critical to soften the impact of the adjustment measures. From a political viewpoint, it was essential that the impact of the adjustment measures be softened. Hence, there was a need to obtain the commitments regarding the necessary finance before the measures were announced and implemented.

Tanzania's debt service burden and external payments arrears had risen to almost unbearable levels, Mr. Mtei went on. His authorities were therefore working under the assumption that after the stand-by arrangement was approved by the Fund, they would approach members of the Paris Club to negotiate a debt rescheduling arrangement. It was their hope that the Governments would view the Tanzanian case with understanding. In conclusion, in view of the circumstances and the proposed timetable for future actions, he recommended that the Board accept the second alternative of paragraph 4 in the draft decision, namely that the Executive Board would consider the question of ineligibility if Tanzania were not current in its obligations to the Fund by July 23.

Mr. Sengupta commented that his chair had always held the view that three basic principles should guide the Fund's consideration of overdue obligations. First, the country concerned should be assumed to be willing and committed to make the overdue payments to the Fund. Second, if countries were unable to pay the Fund, the Fund should assume that they were unable to pay because of the difficulties they were experiencing and because they were unable to cope in spite of their best endeavors. Third, the Fund should help those countries to overcome their difficulties. It was counterproductive to declare a country ineligible to use the Fund's resources, as it did not enable a country to take appropriate measures and to become current with the Fund. A declaration of ineligibility should be used only in the last resort. The Fund should be seen as sensitive to a country's problems. When a country was making genuine attempts to solve its problems and to make the payments to the Fund, the Fund should not take on an adversary role but should help the country to overcome its problems.

Against that background, it was clear that the Tanzanian authorities and the Fund staff had reached an understanding on appropriate adjustment measures, Mr. Sengupta noted. The Fund should provide the authorities with all the necessary help and should allow them sufficient time to adopt the appropriate measures. He therefore supported the second alternative of paragraph 4 in the proposed decision. However, he would prefer to insert some kind of review clause that would allow the Board to discuss the efforts of the authorities before July 23, rather than automatically declaring the country ineligible.

Mr. Alfidja remarked that the Tanzanian authorities were determined to undertake and implement the necessary measures to cope with the serious economic and financial imbalances facing the economy and to mobilize the necessary resources to clear their arrears to the Fund. He favored the second alternative of paragraph 4 in the proposed decision, and he agreed with Mr. Sengupta that the paragraph should be reworded to allow for a further review of Tanzania's situation rather than an automatic declaration of ineligibility.

Mr. Foot stated that he welcomed the positive developments reported by the staff and Mr. Mtei. Tanzania's recent payment to the Fund was a commendable gesture of goodwill, particularly as the country's reserves were virtually exhausted and the Government had been forced on occasion to sell forward crops that had not yet been harvested. The payment of SDR 3 million was therefore substantial. It was also encouraging to note that agreement had been reached in principle on the need for, and range of, adjustment measures to be taken. It had clearly been difficult for the authorities to focus on those issues, and he was glad that progress had been made.

Nevertheless, the arrears to the Fund had been long outstanding, and it was the last chance for Tanzania to get its economy back on track, Mr. Foot considered. Before the authorities announced their adjustment measures in mid-June at the time of the implementation of the 1986/87 budget, they would have to clear their arrears to the Fund, either by aid from donors or by obtaining a commercial bank bridge financing loan. Every avenue for obtaining the necessary resources should be explored. Assistance from donors would be needed to cover the substantial financing gap that was likely to appear. Following implementation of the budget, a Fund program, possibly with resources from the structural adjustment facility, would have to be approved by the Executive Board. He agreed that the authorities should have until July 23 to make the necessary arrangements and implement the difficult adjustment measures. However, that time must be well used. The authorities must ensure that the modalities necessary to make the difficult adjustment measures were in place. It was clear from Zambia's experience that there was no point in covering a financing gap for a year if the authorities' control over cash flow meant that the money was not available for even the first months of the year. Such detailed issues as cash flow forecasting on a week-by-week basis did matter and should be addressed. He was certain that the Fund staff would do all they could to assist the Tanzanian authorities in ensuring that the modalities, as well as the overall framework, were correct.

He could therefore support the second alternative of paragraph 4 in the proposed decision, Mr. Foot indicated. However, he could not go along with the suggestion of Mr. Sengupta and Mr. Alfidja that the paragraph should be reworded to allow for a further review. Any Executive Director could request that the Executive Board consider Tanzania's situation at any time before July 23.

The three-month extension was in recognition of the payment made by the authorities to the Fund and of the adjustment measures that they were prepared to undertake. Much remained to be done in a very short time, and some of the financing needs were substantial. He hoped that the authorities would be reporting to the Board on favorable developments in the near future.

Mr. Suraisry remarked that he was encouraged by the authorities' decision to implement a comprehensive adjustment program that could deal effectively with the country's difficult economic and financial problems. He also welcomed the staff's statement regarding the broad understanding reached between the staff and the authorities on a number of important policy measures. Therefore, he could support the second alternative of paragraph 4. He urged the authorities to take advantage of the breathing space provided to make every effort to become current with the Fund promptly. It was essential for them to eliminate their arrears to the Fund before the adjustment program could be approved. In that context, he welcomed the ongoing efforts to convene a consultative group meeting.

Ms. Lundsager stated that she welcomed the recent payment by Tanzania to the Fund, which had indicated the seriousness with which the authorities viewed the matter of their overdue obligations. However, it was discouraging to note that Tanzania's arrears had continued to increase since the previous Board discussion on the issue. She would normally be somewhat hesitant to postpone acting on a previously adopted expectation. The Executive Board had shown understanding in addressing Tanzania's situation and was reviewing the country's overdue obligations to the Fund for the third time. Nevertheless, the authorities' acceptance of the need to implement a comprehensive adjustment program was an important first step, and she hoped that the reform actions would be implemented as soon as possible. In that respect, the comments of Mr. Mtei and the staff at the beginning of the meeting were encouraging. However, she wondered whether the authorities might be able to secure financing within a shorter time period, perhaps two months, as the budget would be announced in mid-June. Finally, she supported the second version of paragraph 4.

Mr. Leonard commented that he agreed with the staff that on the basis of Tanzania's payments performance, a decision putting into effect immediately the expectation of ineligibility expressed at the Board's previous discussion on Tanzania might well be appropriate. However, precedent and equal treatment of members allowed the Board some room for maneuver. Tanzania had recently made a payment, although small, to the Fund, and the authorities had accepted the need to implement a comprehensive adjustment program and had indicated their intention to adopt and carry out the major elements of such a program. Moreover, they were consulting with the Fund on ways to become and remain current with the Fund. They aimed to clear their arrears to the Fund very shortly.

For those reasons, the Board should not declare Tanzania ineligible to use the Fund's resources but should give the authorities more time to meet their obligations and to bring their plans for adjustment to maturity, Mr. Leonard considered. However, he did not agree with the idea implicit in the second version of paragraph 4 of the proposed decision that unless Tanzania were current in its financial obligations by July 23 it would be declared ineligible. That kind of prior commitment by the Board to a decision could be embarrassing. It would be preferable if the Board had a further opportunity to examine Tanzania's situation before a declaration of ineligibility. He therefore suggested that the Executive Board should consider the decision on July 23. The Board could perhaps be informed of progress made by Tanzania on some intermediate date, perhaps in early June.

Mr. Hospedales noted that Tanzania was in the process of formulating a comprehensive adjustment program, which the staff considered to be a substantial step toward bringing about the needed improvements in the country's economic situation. The authorities were apparently committed to the program and had expressed their intention to discharge the remaining arrears to the Fund. They had recently made a payment of SDR 2.6 million to the Fund, despite the country's critical reserve position. For those reasons, he supported Mr. Mtei's request to provide Tanzania with additional time to implement a policy package. He agreed with the second version of paragraph 4 in the proposed decision. He urged the donor community to provide the necessary financial support and encouraged the Fund to facilitate financing arrangements. He supported Mr. Sengupta's view that the Board should have an opportunity to review Tanzania's position before the country was declared ineligible to use the Fund's resources.

Mr. Lundstrom stated that the Nordic countries had followed the deterioration of the Tanzanian economy with great concern, particularly as Tanzania had long been a principal recipient of Nordic development assistance. He was therefore particularly heartened and encouraged by the indications in the staff paper that the authorities had accepted the need for comprehensive adjustment. However, more important, was their declared intention to implement the policy package discussed with the staff. It would have been more reassuring if some of the necessary policy measures had been implemented already. However, he appreciated the difficulties involved in prior actions in Tanzania's case.

Based on Mr. Mtei's statement regarding the firm determination of his Government to negotiate a Fund-supported program on the basis already agreed in principle, the Board was justified in granting Tanzania the additional time required to settle its overdue obligations to the Fund, negotiate a program, mobilize additional support, and announce the adjustment package on June 19 in connection with the budget, Mr. Lundstrom remarked. He was opposed to declaring Tanzania ineligible to use the Fund's resources at the present meeting, and therefore supported the second version of paragraph 4 of the proposed decision. However, the decision should not be reworded to allow for a further review. He had no difficulty with the date of July 23 as indicated in the second alternative of paragraph 4. It could perhaps be argued that Tanzania would have to become current in its financial obligations to the Fund well before any negotiations between the authorities and the staff could take place and that therefore an earlier date for a declaration of ineligibility might be considered. However, an earlier date could complicate the authorities' efforts to obtain bridge financing. By July 23, Tanzania should not only be current in its financial obligations to the Fund but also have embarked on an economic program designed to put the country on the road to economic adjustment and sustainable growth. He hoped that the authorities would not allow the last opportunity to pass them by.

Mr. Wijnholds stated that he welcomed the authorities' willingness to reach an agreement with the Fund. He wondered whether that agreement would take the form of a stand-by arrangement or whether it would be a loan under the structural adjustment facility. He supported the second version of paragraph 4 of the proposed decision, namely that Tanzania would automatically be declared ineligible to use the Fund's resources if it were not current with the Fund by July 23, 1986. He was not in favor of rewording that paragraph to allow for a further review of Tanzania's situation. However, if the view of the majority were to hold such a review, he could support a delay only of two months.

Mr. Huang remarked that he welcomed the payment made by Tanzania in full settlement of its overdue obligations in the SDR Department and partial settlement of its obligations in the General Department. That payment represented the authorities' willingness to cooperate with the Fund. Their intention to implement major adjustment policies was commendable, and he encouraged them to fully settle their overdue obligations to the Fund as soon as possible. The Fund should not only lend financial resources but should also help developing countries in times of difficulties. The authorities should have more time to overcome their problems. He therefore supported the suggestion of Mr. Sengupta and Mr. Alfidja.

Mr. Goos commented that he supported the second version of paragraph 4. His support for that version reflected a number of considerations, which did not alter his deep concern about Tanzania's continued nonobservance of its financial obligations to the Fund. The considerations he had in mind were the authorities' apparent commitment to a policy package supported by the Fund constituting a most important step in bringing about needed improvements in Tanzania's economic and financial situation; Tanzania's payment of SDR 2.6 million in full settlement of its obligations in the SDR Department; and the authorities' declared intention to make every effort to clear their arrears within a short period. Moreover, a decision to further delay ineligibility at the time of the third review would be broadly in line with the Board's decisions in similar cases. He supported the decision in the form presented, and he joined Mr. Foot in opposing an amendment that would provide explicitly for additional feasibility or a review clause as suggested by other Directors. Any member of the Executive Board could request at any time that Tanzania's situation be discussed in the Eeecutive Board. He hoped that the authorities would use the extension of the review period to make full and prompt settlement of their obligations to the Fund.

Mr. Rousset stated that he supported the second version of paragraph 4 as drafted.

Mr. Zecchini noted that the latest positive developments reported by the staff and Mr. Mtei were welcome as they had taken place in the face of a very difficult reserve position and demonstrated a constructive attitude on the part of the Tanzanian authorities toward solving the economic and financial problems of the country, particularly with respect to the arrears to the Fund. In the light of those developments, he was willing to consider Tanzania's situation with a degree of flexibility. However, flexibility should be applied within the rules of the Fund and without establishing a precedent. Therefore, he was willing to allow Tanzania three more months to finalize an agreement with the Fund on an adjustment program and to obtain the necessary financial support to become current with the Fund. He therefore supported the second version of paragraph 4.

Mr. Pérez observed that there had been some positive developments in Tanzania's case. The country had made a payment to the Fund of SDR 2.6 million, which although falling short of expectations, clearly indicated the country's willingness to become current with the Fund. Furthermore, the authorities had indicated their willingness to adopt far-reaching adjustment measures in order to address the deteriorating economic situation. Agreement had been reached between the staff and the authorities on appropriate economic measures to be adopted in key areas. That agreement could lead to the use of Fund resources, following the elimination of the country's arrears. Finally, he supported Mr. Leonard's proposal.

Mr. Salehkhou commented that his chair had always attached considerable importance to the cooperative nature of the Fund, particularly in relation to its borrowing members. Regrettably, cooperation had not always been given careful consideration, and at times there had been confrontations between the Fund and members and a deterioration of the Fund's image. His chair had consistently adopted a pragmatic attitude toward members' overdue obligations to the Fund. A declaration of ineligibility should be considered only as a last resort and after thoughtful consideration of the overdue member's attitude, willingness, and ability to clear its arrears to the Fund.

Tanzania had been encouraged to enter into an adjustment program with Fund support, given the increased emphasis on the growth orientation of Fund programs, Mr. Salehkhou observed. The Fund should welcome the authorities' intentions and discuss with them a comprehensive program that would lead to the elimination of existing internal and external imbalances and to the establishment of a viable balance of payments position. Such a program, together with concessional aid and other financial assistance, was necessary to enable the country to clear its arrears, particularly those to the Fund. He therefore supported the second version of paragraph 4, which should be reworded to allow for a further review by the Executive Board before Tanzania was declared ineligible to use the Fund's resources.

Mr. Finaish stated that he supported alternative two of paragraph 4, but was in favor of rewording the paragraph to provide for a further assessment of Tanzania's situation before the country was automatically declared ineligible on July 23.

Mr. Murakami said that he supported the second version of paragraph 4 as it was originally drafted.

Mr. Schneider remarked that the information provided by Mr. Mtei and the staff was welcome, as it indicated the authorities' full acceptance of the need for far-reaching adjustment measures and their intention to clear their arrears to the Fund. He supported the second version of paragraph 4 but did not favor the rewording of the paragraph to allow for a further review of Tanzania's situation, especially as the Executive Board had previously taken a decision with the intention of declaring Tanzania ineligible.

Mr. Nebbia observed that the authorities had indicated their willingness to become current with the Fund by making a substantive payment to the Fund and by announcing their intention to implement an adjustment program that could be supported by the Fund. Nevertheless, the timetable for the necessary actions was tight. The Fund should be flexible in dealing with members with overdue obligations. He supported Mr. Leonard's proposal.

Mr. Ismael stated that in light of the additional information provided by the staff and Mr. Mtei, he could support the second version of paragraph 4.

Mr. Romuâldez remarked that he favored the second version of paragraph 4 for the reasons that had been outlined by Mr. Foot.

The Deputy Director of the African Department remarked that in proposing a delay of three months, the staff had taken into account the sentiment expressed by the Executive Board at the discussion on the 1986 Article IV consultation with Tanzania that donor support was likely to be more forthcoming after prior actions had been taken by the authorities. However, the authorities hoped to receive some indication of the extent of donor support before they announced the budget. The staff felt that if a donors' meeting were held prior to the budget announcement, concrete donor response might not be forthcoming and a second round of discussions with donors would be required following the announcement of the budget. Two months would not provide sufficient time to allow the authorities to take all the steps that were necessary to become current with the Fund, and the staff had therefore proposed a three month delay in declaring the country ineligible. The staff was expecting the authorities to adopt a stand-by arrangement, although it would also explore the possibility of negotiating a loan under the structural adjustment facility.

The Acting Chairman remarked that the staff had been concerned that the authorities should have sufficient time to obtain commitments from donors in support of the program. Furthermore, donors would have to be in a position to provide assistance immediately because the cash flow situation in Tanzania was extremely difficult. The staff would work with the authorities on the modalities of the short-term cash flow requirements. However, they would need some indication of the magnitude, timing, and form of donor support. As it might take time for donors to be able to pin down more precisely the timing and the form of their assistance, it was important that the Fund begin discussions with donors on an informal basis in the near future.

Mr. Mtei reconfirmed that his authorities were committed to clearing their arrears to the Fund as soon as possible. They hoped to mobilize a bridge loan to repay the Fund before the formal negotiations on a Fund program were completed. He hoped that the donor community would respond positively to Tanzania's efforts, so that a viable program could be worked out and the Tanzanian economy put back on track.

The Executive Board then took the following decision:

1. The Fund has reviewed Decision No. 8056-(85/126) G/S/TR, adopted August 26, 1985, in light of the facts described in EBS/86/85 (4/21/86), pertaining to Tanzania's overdue financial obligations to the Fund.

2. The Fund welcomes the payment by Tanzania. However, the Fund regrets the continuing nonobservance by Tanzania of its financial obligations to the Fund in the General Resources Account and to the Fund as Trustee of the Trust Fund, and notes that further obligations will become due in the near future. The Fund again urges the Tanzanian authorities to make full and prompt settlement of these overdue financial obligations.

3. The Fund welcomes the intention of the authorities of Tanzania to carry out major adjustment policies. The Fund urges Tanzania to implement these policies within the context of a comprehensive adjustment program, as a matter of urgency.

4. Unless by July 23, 1986 Tanzania is current in its financial obligations to the Fund in the General Resources Account, with effect on that date Tanzania will be ineligible pursuant to Article XXVI, Section 2(a) to use the general resources of the Fund.

Decision No. 8259-(86/68) G/TR, adopted
April 23, 1986

2. BENIN - 1985 ARTICLE IV CONSULTATION

The Executive Directors considered the staff report for the 1985 Article IV consultation with Benin (SM/86/28, 2/13/86; and Sup. 1, 4/21/86). They also had before them a staff report on recent economic developments in Benin (SM/86/41, 2/26/86).

Mr. Alfidja made the following statement:

Following two years of sluggish economic expansion, real GDP in Benin is estimated to have grown by about 4 percent in 1985 owing to a significant rise in agricultural output and related activities, as well as to some recovery in the commerce sector. The production of food crops recovered significantly. The harvest of the main cash crops was also generally more abundant. The marketed output of cotton, the second largest source of foreign exchange after crude oil, nearly doubled relative to the level registered in the preceding year. Likewise, larger quantities of groundnuts and palm kernels were offered for sale. The interplay of better climatic conditions, adequate supply of seeds and enhanced prices contributed to the increase in agricultural output. In the particular case of cotton, the implementation of integrated rural development projects was also instrumental in the gain recorded. Commerce, another important component of GDP, recovered in 1985, in part as a result of the expansion in output of agricultural products. To build on the progress achieved so far, and in the framework of the 1983-87 Development Plan, the Government has initiated steps which, over time, should lead to further improvement in total output. In the agricultural sector, the Beninese authorities are implementing development projects in the context of which extension and nursery services are provided to farmers, agricultural methods are improved, and marketing facilities are enhanced. The experience gained from alternating cash crops such as cotton with food crops such as maize will be extended. Concerning the livestock subsector, a study is being undertaken with a view to assessing the various needs in this field and formulating appropriate policies to meet them. Attention will also continue to be devoted to expanding fishing activities, on a small scale, with the assistance of institutions such as the United Nations Development Program and the European Communities. Substantial investments are also being made in the energy and transportation sectors.

Pricing policy in Benin is guided by income and cost considerations. The prices of a number of basic imported commodities are set, taking into account the low level of income of the majority of the population. The prices of locally produced food crops reflect supply and demand conditions. The effects of the relatively moderate inflation prevailing in Benin's trading partners, together with those associated with the good harvest of food crops, exerted a downward pressure on domestic prices in 1985.

Despite some decrease in the overall deficit of central government financial operations, the fiscal situation remained difficult in 1985. It was a reflection of a moderate increase in revenue, essentially import and export duties and a marginal rise in total spending on account of higher outlays by the Treasury and a small increase in investment expenditure. The Beninese authorities are cognizant of the difficult situation of the public finances and have taken some measures designed to enhance government receipts and restrain spending growth. The revenue actions include the imposition of a special tax on petroleum products, the extension of corporate profit taxes to cover some lucrative but previously untaxed commercial activities and the levy of a toll on the utilization of certain infrastructural facilities. In view of the limited possibility of a rapid, sustained and substantial growth of revenue in the near future, they have been focusing on the expenditure side of the Treasury account. In this vein, a number of measures have been taken in an attempt to restrain expenditure growth. In addition to the general freeze of civil servants' salaries, the Government decided, in a shift of policy, to put an end to the policy of automatic recruitment into the civil service of university graduates and former employees of liquidated public enterprises. As stated by the staff, in a country with a long history of automatic government hiring, restrictive measures on employment have major social and political implications. The consequences of this change in policy should, therefore, not be understated. Restraint has been placed also on the use of government vehicles and telecommunication services,and also on rental and utility-related expenses. The strict enforcement of retirement provisions is to result in the departure from government service of some 600 persons in 1986. Official travels have also been reduced in terms of frequency and size of delegations.

In the monetary sector, the available information suggests that the deceleration in net domestic credit, which began in 1983, continued in 1985. The principal contributory factor to this outcome was the shift in 1985 of the position of the government sector from a net debtor to a creditor, through a reduction of the Treasury's liabilities vis-à-vis the Central Bank. As regards credit to the private sector, it contracted further in 1985, though less sharply than in 1984, partly as a result of the persistence of the liquidity difficulties being experienced by commercial banks. The Government has initiated steps aimed at improving the operations of the deposit money banks. As reported by the staff, these measures, which involved changes in senior management and the tightening of accounting and reporting procedures, have led to perceptible improvements. Efforts to recover past loans are being stepped up. The Government intends to take further actions if warranted, upon completion of the comprehensive review under way of problems pertaining to the entire banking sector.

In the external sector, the sizable increase in cotton export earnings was more than offset by the higher flows of imports associated with the implementation of some major developmental projects. The ensuing deterioration in the trade balance, and the higher interest payment obligations, have led to a widening of the current account deficit. My authorities are aware of the difficult external situation, as well as the unfavorable medium-term prospects of the economy described in the staff report and believe that measures that are being taken to stimulate the production of export crops and to restrain the growth of aggregate demand will contribute to the reduction of the imbalances in the external sector.

During a recent visit to Washington, the Beninese authorities had thorough discussions with the staff on ways and means for addressing the serious economic and financial problems facing Benin in the framework of a comprehensive adjustment program. A Fund mission is due in Cotonou in the coming weeks to negotiate with the authorities the elements of such an adjustment program.

Ms. Lundsager noted that in the past year, the Beninese authorities had made some progress in basic reforms of the productive sector. Some steps had been taken toward price liberalization and reform of the public enterprises, and efforts had been made to contain some government expenditures. However, adverse external developments, notably border closings and changes in the world market prices of exports, had overwhelmed those efforts, and it was clear that without an accelerated pace of reform, the imbalances could expand and thus impede growth and development.

In particular, fiscal developments were increasingly worrying, with the Government's stock of arrears currently almost equivalent to one year's expenditure, Ms. Lundsager pointed out. As no further increases in credit from the Central Bank of West African States (BCEAO) were possible, it could be concluded that arrears would grow again in 1986. With sizable arrears to local suppliers, it was becoming increasingly unlikely that government revenues would be maintained. Efforts should be made to settle the cross-arrears, although a more lasting improvement in the fiscal position probably required a stronger effort to control expenditures. Particular action was called for with respect to public hiring practices, as wages were already low and wage freezes could not be expected to continue indefinitely. Savings in the wage bill were much more likely to be realized if a concerted effort were made to reduce the size of the civil service. Some reforms had been implemented, including the elimination of some automatic hiring practices. However, the wage bill might increase by 14 percent in 1986 owing to practices that remained in place.

In addition, the rapid expansion of the public enterprise sector in the past had led to a large number of inefficient and unprofitable enterprises that were reliant upon government transfers to cover their operating costs, Ms. Lundsager noted. A more rapid pace of public enterprise reform could go far toward addressing the various problems. Further divestment could ease the budgetary burden of transfers while stimulating increased efficiency by making those entities self-reliant. Those enterprises producing public goods and services, while remaining under public control, could improve their operating performance by streamlining operations, reforming personnel policies, and increasing tariffs as needed. World Bank assistance in those areas had been useful, but she wondered if there was scope for a faster pace of reform.

The efforts to reduce the size of the civil service and to divest some of the public enterprises should be supported by continued efforts to strengthen the private sector, Ms. Lundsager continued. A more vibrant and expanding agricultural sector could then provide the foundation for sustained economic growth and, in particular, could generate the employment opportunities that would facilitate a reduction in public sector employment. A more soundly based commercial bank sector could support those broad efforts by supplying the intermediation services needed by a growing and diversified economy. While the authorities were still studying the report prepared by the BCEAO, she hoped that they would identify and begin implementing the necessary actions in the near future. Without supporting measures, the benefits of other reform measures, including those aimed at strengthening producer incentives in the agricultural sector, would be less effective.

The urgency of implementing a broad set of reforms, building on those already initiated, was evident from the tables on the balance of payments position and medium-term outlook in the staff paper, Ms. Lundsager noted. External debt was already high, and investment financed by foreign equity participation, as opposed to loans, would be highly desirable. Given world oil and cotton prices, efforts should be made to strengthen production of other exports and viable import substitutes. Mr. Alfidja had provided welcome details of efforts being made to expand agricultural production. However, as the authorities could not utilize exchange rate adjustment to spur domestic production of tradable goods, they must look to domestic pricing and marketing relationships. A strong and broadly based reform effort, building on the initial steps already taken by the authorities, could form the basis of a Fund arrangement, including perhaps the use of resources under the structural adjustment facility. That type of financing would be appropriate for the needs of Benin, as would the real and financial sector reforms that would accompany such a program. Finally, she supported the proposed decision.

Mr. Goos remarked that while Mr. Alfidja had commented in his opening statement on positive developments in Benin, the deterioration in the economic situation and the policies currently being pursued gave cause for concern. The medium-term outlook for the balance of payments could, at best, be described as gloomy. While the unfavorable situation reflected in part unfavorable external circumstances, the information in the staff paper pointed to serious shortcomings in the conduct of economic policy as a key factor behind Benin's economic and financial malaise.

He was in broad agreement with the staff analysis and recommendations, Mr. Goos remarked. While the authorities expected a slight decrease in the consolidated central government deficit in 1986, the staff indicated that based on more realistic assumptions, the deficit would increase further to an unsustainably high level. It was particularly worrying that the authorities were unable to control current expenditure, especially on wages and salaries, which were expected to rise by 14 percent in 1986. As approximately two thirds of total current expenditure, excluding interest payments, would then be accounted for by the government wage bill, it was clear that immediate and drastic cuts were needed in that area in order to ensure an orderly financing of the deficit and to avoid the accumulation of further arrears. But the problem was not only financial in nature. The rapid expenditure increase was accounted for not only by the need to increase wages from their extremely low level but also by the rising number of people employed in the public sector. Expenditure could therefore be brought under control only if the system of automatic hiring were abolished and additional steps taken to reduce the absolute number of civil servants. Such a streamlining of the civil service would certainly help to enhance the efficiency of the public sector. The more rapid the progress in reducing the number of civil servants, the sooner the Government would be able to provide individuals in active service with greater incentives, resulting eventually in a more motivated, competent, and efficient staff.

Transfers to loss-making public sector enterprises represented another important financial burden on the budget, Mr. Goos observed. The completion of the studies on the reform of public enterprises was welcome, but he agreed with the staff that the speed of implementation of the necessary reform measures should be accelerated and their scope broadened considerably. The need for determined action and speedier progress in that area was clear given that public enterprises accounted for more than three fourths of national output and about two thirds of gross, fixed investment, while 40 of the 60 enterprises had registered losses in 1985. Moreover, their poor performance, which had resulted in the accumulation of large arrears to the banks, was clearly a major cause of the liquidity crisis in the banking system.

As the authorities recognized, the rehabilitation of public enterprises must be accompanied by the reform of the banking system in order to facilitate the operations of the restructured enterprises and, more generally, to provide the economy with a more efficient financial system, Mr. Goos remarked. Against that background, it was disheartening to note that efforts to tackle the problems in that area had not yet gone beyond the stage of studies. He therefore urged the authorities to attach higher priority to the reform of the banking system along the lines suggested by the staff. Perhaps the World Bank could play an important role in that area, as it had done in the rehabilitation of the public enterprises.

Benin was an obvious candidate for assistance under the structural adjustment facility and, as the country had not yet made use of Fund resources, it could also receive financial support through other facilities, Mr. Goos pointed out. However, Fund support in whatever form or through whatever facility should be contingent on a basic reorientation of the authorities' present policy stance, which would hold the promise for a significant and sustainable improvement in the country's economic situation. Such an adjustment program should include as critical ingredients substantial progress in fiscal consolidation, including a convincing approach to the resolution of the public sector employment problem, as well as resolute reforms in the state enterprise and banking sectors. However, even if those requirements were met, he cautioned against an extensive use of the Fund's regular resources, which were relatively expensive and of short maturity. In view of Benin's protracted balance of payments problem and the largely structural nature of its imbalances, the authorities would be well advised to rely to the largest extent possible on concessional external financing. Accordingly, the

Fund should concentrate on providing catalytic assistance. The authorities should reach agreement with the Fund on a comprehensive adjustment strategy. Once a convincing policy framework was put into place and the Fund and Bank had indicated their support for the program, he was confident that the necessary concessional external financing would be forthcoming from bilateral and multilateral sources.

Mrs. Ploix stated that she was in broad agreement with the conclusions of the staff report. The increasingly rapid deterioration in Benin's economic situation, as reflected in the significant accumulation of external and internal arrears, gave cause for concern. She agreed with the staff that the imbalances in the Beninese economy were rooted in the continued implementation of inappropriate policies: the pursuit of inadequate fiscal policies, the channeling of investments toward non-priority and unprofitable sectors, and the automatic recruitment of young graduates into the civil service. In the absence of a prompt implementation of an adjustment program, the economic outlook for the short and medium term was grim. The most recent figures for the 1986 budget presented in the supplement to the staff report confirmed that bleak outlook.

A set of structural adjustment measures needed to be elaborated and implemented as quickly as possible in order to reverse the economic deterioration, Mrs. Ploix noted. From the structural viewpoint, the report clearly outlined three main target areas: the restructuring of the banking system; an increase in export earnings by redirecting the investment program, giving high priority to the development of the agricultural sector; and the rehabilitation of the public enterprise sector. The preliminary diagnostic study of the banking system carried out by the BCEAO should enable the authorities to make prompt decisions. Studies and discussions between the authorities and the staff on the public enterprises and the Government's investment program had already been carried out with the help of the World Bank staff. That dialogue should be expanded with the objective of reaching concrete decisions. In view of the larger role that the private sector might have to assume, the effectiveness of that dialogue could be enhanced if representatives from the IFC were included.

There was an urgent need for Benin to define and implement immediately, in close consultation with the Fund, wide-ranging adjustment measures, Mrs. Ploix considered. As the formulation of a comprehensive program of economic measures will probably require some time and several Fund missions, it was essential that the authorities take concrete action promptly to contain any further deterioration of the balance of payments position. Moreover, prior actions would indicate to the international financial community that the authorities were willing to embark on an adjustment program. Without such a signal, it was doubtful that they would be able to elicit the support of the donor community.

Mr. Salehkhou noted that the Beninese economy had improved in 1985 after two years of sharp deterioration owing to a severe drought and a decline in transit trade. The improvement in economic activity had been spearheaded by sizable growth in the agricultural sector as a result of favorable weather. That improvement, in turn, had reinforced economic growth in other sectors, such as food processing and trade. The availability of foodstuffs had helped to keep prices down.

A slight improvement had been recorded on the fiscal front, as government revenues had been reinforced by transfers from petroleum exports, Mr. Salehkhou remarked. However, investment expenditures remained high and had exceeded the budgeted amount by more than 20 percent, leading to further domestic borrowing, as external transfers had been insufficient to meet the investment requirements. Total government arrears had reached 25 percent of GDP, of which 70 percent were foreign obligations.

The authorities' heavy recourse to domestic bank borrowing had resulted in an inadequate extension of credit to the productive sector, Mr. Salehkhou observed. The study conducted by the Central Banking Department in late 1985 had indicated the magnitude of the banking problem in Benin and had called for a structural overhauling of the banking system and a reorientation of credit and investment policy. The emphasis on the reform of fiscal policy was at the core of the discussions between the authorities and the Fund. In addition to the action with respect to the banking system, the reform required the adoption of measures to improve government finances and rehabilitate public enterprises. It also called for a rationalization of the investment process, whereby scarce resources were placed in labor-intensive, short maturity projects with a higher level of priority. In that respect, the emphasis of the 1983-87 Development Plan had been shifted toward rural development in order to increase food production and export commodities such as cotton. The chances for a further improvement of government revenues in the coming years were enhanced by the development of the second phase of the Seme oil project, which should increase output from 2.6 million barrels in 1985 to 4 million barrels in 1986. However, given the prevailing situation in the international oil market and the expected rapid depletion of Benin's oil reserves, there was an urgent need to diversify the country's economic base.

Another important task facing the authorities was the rehabilitation of the public enterprises undertaken with assistance from the International Development Association, Mr. Salehkhou commented. The difficulties associated with the credit relationship between the authorities, the public enterprises, and the banking system should be solved so that each institution could function without jeopardizing the performance of others. The recent moves to restructure certain public enterprises and the liquidation of others was welcome and would facilitate the reform of the banking system, as the arrears of those enterprises to the banks were settled.

A prudent fiscal policy should continue to be pursued in 1986 and 1987, Mr. Salehkhou considered. It was crucial that expenditures be restrained and not be underestimated in the transitional period of the structural reform. The authorities were practicing considerable expenditure restraint, despite the possible social and political repercussions of the measures taken. He was encouraged by the details of the specific expenditure-cutting measures outlined by the staff and Mr. Alfidja. The authorities must maintain their efforts to create employment opportunities. But unfortunately, major projects could not be financed locally and foreign financing was unavailable owing to the lack of counterpart funds. Benin was clearly eligible for concessional aid and should benefit from resources in the structural adjustment facility and from donor assistance. The country's external debt was unsustainable, and its debt service ratio had been more than 50 percent at end-1985. The current account deficit had since deteriorated despite increases in oil revenues and cotton exports. The balance of payments deficit would remain high in the medium term. Benin's circumstances called for the urgent implementation of adjustment policies, and the Fund should stand ready to assist the authorities in designing assertive policies aimed at restoring internal and external balance and at promoting economic growth. The Fund should also assist Benin in mobilizing the needed external assistance to carry out those objectives.

Mr. Parmena stated that he was in broad agreement with the staff appraisal. The Beninese economy had clearly benefited greatly from the oil boom in neighboring Nigeria. In addition, economic activity had been boosted in 1978-80 when a number of major development projects had been executed, including the exploitation of an offshore oil field and the construction of a sugar mill and cement plant. Consequently, real GDP growth had been rapid, averaging about 7 percent a year in 1980-82. However, in the following two years, the rate of economic growth had slowed markedly, reflecting the decline in the economic activity in Nigeria which had significantly affected transit trade. GDP growth had become sluggish and resulted in some decline in per capita income.

The authorities had geared their policy approach to the boom of the 1970s and earlier 1980s, Mr. Parmena noted. However, the expansion of the public sector had been unsustainable. Thus, the deterioration in the external environment had brought into focus some of the problems that had not been apparent when fiscal expansion had been taking place. For example, the steep decline in government revenue, owing to shortfalls in tax receipts from exports, had occurred at a time when expenditure had been rising, although it had slowed somewhat in 1983-84. Expenditure on wages and salaries remained large mainly because the Government represented the principal employer and because it had been the Government's policy to hire all university graduates. Hence, although salaries were low, the wage bill was high as a proportion of government expenditure. Undoubtedly, that problem had presented the authorities with a serious dilemma in formulating a sustainable fiscal program.

Given the medium-term outlook, a dramatic reduction in the fiscal deficit was called for if meaningful adjustment were to take place in the economy, Mr. Parmena considered. However, he did not see how the deficit could be reduced through retrenchment of government expenditure without a reduction in government employment. Could the staff indicate what the benefit would be if the authorities implemented a number of measures recommended by the staff, including a freeze on employment and an accelerated program of attrition of civil service personnel? To introduce any measures on that front, a politically sensitive area, the authorities would be required to take difficult decisions. The authorities were hoping to implement a program that could be supported by the Fund. A fiscal program that was sustainable in the medium term would be central to successful adjustment.

The progress being made toward the rehabilitation of the public enterprises was generally satisfactory, Mr. Parmena considered. The reform program of those enterprises, being undertaken with World Bank assistance, had already proved effective, as some enterprises that had been a large drain on the Government's meager resources were being liquidated. He encouraged the authorities to expand and accelerate the implementation of that program. The problems associated with the parastatal organizations had also originated in the boom period of the 1970s, during which time it had been the authorities' deliberate policy to increase the level of government participation at all levels of economic activity. The program embarked on by the authorities should prove helpful in making those enterprises profitable and reducing their need for budgetary support.

An immediate and complete overhaul of the banking system was called for if the monetary sector were to facilitate a broad-based recovery of the economy, Mr. Parmena pointed out. The authorities would require technical assistance to undertake such an exercise. He wondered if any assistance had been provided through the BCEAO. Indeed, the Fund could also provide technical assistance. He agreed with the staff that the reform of the banking system would be a necessary part of a comprehensive and sustainable adjustment program. It would also make the task of monitoring progress under the program relatively easy. Hence, the Government should be encouraged to speed up its study of the BCEAO inspection report so that the necessary measures could be implemented promptly.

The staff representative from the African Department remarked that the increase in the wage bill was due, in part, to the automatic recruitment policy of the Government and, in part, to the automatic increases in salaries. While there was no general salary increase, promotions and longevity increments were awarded regularly. About one third of the 14 percent increase in the wage bill between 1985 and 1986 was due to new recruitment and about two thirds was due to wage creep. The staff was not suggesting that the number of civil servants could be reduced sharply in any one year. It was proposing that, initially, employment should be maintained at a constant level, by encouraging attrition through early retirement and cutting back on the number of new recruits. More fundamentally, in the medium term, the authorities should change the educational policy, which for the past ten years had been directed toward providing employment solely in the civil service. One of the most difficult problems facing the authorities in formulating an adjustment program was how to reduce the fiscal deficit when a large proportion of the deficit was due to the wage bill. In fact, the wage bill was expected to increase in 1986 owing to administrative changes in the structure of the Government.

Some of the problems associated with the banking system in Benin were also faced by some other countries in the West African Monetary Union, the staff representative indicated. The BCEAO had been discussing the issue in great detail with the authorities of the various countries in the Union. The Beninese authorities were currently considering, with the assistance of the BCEAO, what measures could be taken in the banking sector, particularly to alleviate the enormous budgetary costs that would have to be borne in any rehabilitation of the banking system in Benin. Some of the decisions relating to the banks in Benin could not be taken until the Central Bank was in a position to take broader action within the Monetary Union. However, other aspects of reform could be dealt with by the Beninese authorities. The Fund was providing technical assistance through the Central Banking Department to help the authorities formulate specific measures in that sector.

Mr. Alfidja remarked that his Beninese authorities were determined to implement an adjustment program to rectify the unsustainable situation. However, it should be borne in mind that their problems stemmed, in part, from the unfavorable external developments in the region. The nature and pace of adjustment in Benin should be tailored to specific circumstances of the centrally planned economy. On several occasions, the staff had appropriately taken into account the political and ideological difficulties in centrally planned economies.

He agreed with the staff that the problem associated with the wage bill in Benin should be addressed, Mr. Alfidja stated. However, it was not a simple problem to deal with. Many countries implementing measures in that area had faced serious social and political difficulties. The public sector recruiting system was complex and had been inherited from the French colonial period. A rapid reduction in the wage bill through drastic cuts in civil service employment could have disruptive effects. In a country with a large private sector it would perhaps be possible to absorb those individuals that were laid off by the Government, but Benin was a centrally planned economy. It was important to look, first, at reforming the educational system. Second, some cuts could be made in the wage bill, even in the short term. The authorities were currently working with the International Labour Organization and a number of other organizations to work out an approach to solving the employment problem.

Benin had not made use of Fund resources, Mr. Alfidja pointed out. Therefore, the Fund should not restrict the amount of resources that would be made available to Benin, as he believed Mr. Goos had suggested.

The country was facing severe economic imbalances and needed to implement far-reaching, structural adjustment that should be supported by the Fund. He was unclear about the use of resources available under the structural adjustment facility. Would Benin be required to have a stand-by arrangement with the Fund before being eligible for a disbursement under that facility? Even if the Fund's resources were more expensive than concessional resources available elsewhere, as suggested by some Directors, there would be some advantages to addressing the problems with Fund assistance.

Mr. Goos remarked that he had stated that Benin was an obvious candidate for drawing under the structural adjustment facility, as it was a low-income country facing protracted balance of payments problems. He had also indicated that as Benin had not yet made use of Fund resources, there was also scope for drawing under the regular Fund facilities. However, Benin's crisis could not be solved in the short or medium term, and he had advised the authorities to avoid relying excessively on short-term and expensive sources of finance. He had not intended to imply that the Fund should restrict Benin's access to its resources.

Mr. Foot commented that it would be useful if the staff would outline the differences between a stand-by arrangement and a program supported by resources from the structural adjustment facility, as well as their relationship to each other. His understanding was that arrangements under the structural adjustment facility had a longer time horizon of about three years, made up of three, one-year programs. A stand-by arrangement had a shorter time horizon. It would be possible for a country to both adopt a stand-by arrangement and draw under the structural adjustment facility, as a twelve-month stand-by arrangement could represent one of a series of programs to be pursued with the support of resources from the structural adjustment facility. The kind of measures included in an adjustment program supported by a stand-by arrangement would also be appropriate in a program supported with resources from the structural adjustment facility.

Mr. Alfidja recalled that a number of Directors had mentioned at the Board discussion on the structural adjustment facility that the concessional resources available under that facility could be used to supplement the resources available under a stand-by arrangement to help support some of the necessary institutional reforms. It was possible that the authorities might think it more appropriate to adopt an extended arrangement. If they did, would it be possible for them also to draw resources under the structural adjustment facility?

The staff representative from the Exchange and Trade Relations Department remarked that some of the deep-seated problems facing the Beninese economy were beyond the scope of the Fund's expertise, particularly in the areas of education and employment policies, public enterprise reform, and the reform of the banking system. Those problems would need to be tackled in a convincing manner in order to enable the Fund staff to assist the authorities in formulating a realistic program that would lead to economic viability in the medium term.

If the authorities requested the use of Fund resources from the structural adjustment facility, they would present a policy framework to the Board, specifying the general objectives that the authorities hoped to achieve over three years, and they would also present a memorandum outlining the more specific policy steps that would be implemented to reach those objectives in each of the three years, the staff representative from the Exchange and Trade Relations Department commented. The policy framework and the annual programs would be discussed between the authorities and the staffs of the Fund and the World Bank. In requesting to use resources under that facility, there was no requirement that the member also have access to Fund resources under the other Fund facilities; however, use of resources under the structural adjustment facility alongside use of other Fund resources was likely in a good number of instances.

The Acting Chairman made the following summing up:

Executive Directors generally agreed with the thrust of the staff appraisal and expressed concern about the serious economic and financial difficulties facing Benin. They noted that despite some improvement in economic growth over the past year, the outlook for the medium term would be bleak in the absence of appropriate corrective action. The fiscal and external positions were unsustainable, substantial arrears were accumulating on both domestic and external obligations, the banking system was in serious difficulties, and most public enterprises were structurally weak and incurring heavy losses. Although Benin's economic performance had been adversely affected by the lack of access to the markets of neighboring countries, the structural problems of the economy were the direct result of years of inappropriate fiscal and credit policies, and heavy external borrowing for certain investment projects, Directors observed.

Directors stressed the need for urgent action and encouraged the authorities to adopt a comprehensive and vigorous adjustment program that could improve the external position and lead to a sustained economic recovery. In this connection, Directors emphasized that, in view of the major and widespread imbalances facing the economy, strong measures would be essential at an early stage in a program which should involve a major role for the World Bank. The main thrust of an adjustment program would have to consist of a sharp reduction in the fiscal imbalance by simultaneously reducing expenditures and renewing efforts to raise revenues. In order to reduce the fiscal deficit, Directors urged the authorities to bring the current expenditures of the Central Government under control, particularly the high wage bill, and to cut nonpriority investment outlays. Noting that public sector wages were relatively low, Directors stressed that the Government would need to focus on hiring practices, and they welcomed the recent reduction of some automatic hiring. In addition, Directors recognized the role that modifications in education policies and practices over the longer term could play in a reform of government hiring practices. Determined action was needed at the same time to restructure or liquidate loss-making public enterprises, maintain producer prices at realistic levels, liberalize the prices of goods and services provided by state enterprises, and increase incentives for agricultural development. Directors noted that growth in the agricultural sector would be important for Benin's medium-term outlook and urged the authorities to extend the implementation of appropriate incentive policies to the entire sector in order to achieve the desired supply response and export diversification.

Directors emphasized the need for a rapid resolution of the problems faced by the domestic banking system, given the vital intermediation role of the banks in any broad-based economic recovery, and urged the authorities to consider the need to encourage private initiatives and the inflow of investment capital. Directors observed that in the longer run Benin would remain heavily dependent on concessional aid, and they encouraged the authorities to exercise caution in adding to the heavy external debt burden.

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

The Executive Board then took the following decision:

1. The Fund takes this decision in concluding the 1985 Article XIV consultation with Benin, in the light of the 1985 Article IV consultation with Benin, conducted under Decision No. 5392-(77/63), adopted April 29, 1977 (Surveillance over Exchange Rate Policies).

2. The Fund notes with satisfaction that Benin continues to maintain an exchange system that is free of restrictions on payments and transfers for current international transactions.

Decision No. 8260-(86/68), adopted
April 23, 1986

3. SOMALIA - OVERDUE FINANCIAL OBLIGATIONS - SETTLEMENT; AND STAND-BY ARRANGEMENT - EXTENSION

The Executive Directors considered a staff paper indicating that Somalia had fully settled its overdue financial obligations to the Fund and containing a decision withdrawing the Managing Director's complaint under Rule K-1 (EBS/86/91, 4/22/86). They also considered a staff paper on a request by Somalia for a further extension of the period of its stand-by arrangement (EBS/86/92, 4/22/86).

Mr. Finaish remarked that Somalia had become current in all its financial obligations to the Fund on April 22, 1986. He hoped that the Executive Board would agree to the proposed decision, which would allow the extension of the period of the stand-by arrangement until September 30, 1986. Somalia's full settlement of its arrears had been a difficult task requiring close and continuous collaboration between Somalia, its donors, and the Fund. He thanked the management and staff of the Fund for their constructive efforts and Somalia's donors for their contribution. The donors' role would continue to be crucial in the period ahead for the success of the strong adjustment and reform program that Somalia had embarked upon. The progress toward full settlement of its arrears had been frustrating at times. But the willingness of the Somali authorities to take all the action necessary to become current with the Fund was a factor that had made the package work eventually. Somalia not only gave absolute priority to its obligations to the Fund over its other financial obligations, but also had had to use every last penny of foreign exchange available in order to become fully current with the Fund. That effort and Somalia's adherence to strong adjustment even in the period when Fund financial assistance had been unavailable suggested that the Fund should show appropriate flexibility and understanding. If so, Somalia would be able to continue its strong adjustment effort.

Regarding Board consideration of the review paper, he requested a waiver of the circulation rule in order to allow the Board discussion to take place before May 15, Mr. Finaish stated. If the Board approved his request, he suggested that a meeting be held on May 12, resulting in a shortening of the circulation period by slightly more than one week.

Mr. Zecchini commented that it was encouraging that Somalia had become current with the Fund. The clearance of its arrears to the Fund was a good indication of the cooperative attitude that Somalia had always followed in addressing its economic problems and in its financial relationship with the Fund. Furthermore, the authorities' actions demonstrated a strong commitment to pursue appropriate economic and financial policies. There were already indications pointing in that direction. The authorities had discussed the broad elements of a financial stabilization program with the staff and had been implementing some of the measures. He therefore supported the proposed decision, as well as the waiver requested by Mr. Finaish.

Mr. Suraisry remarked that the Somali authorities and donors had made commendable efforts to settle the country's overdue financial obligations to the Fund. He fully supported the staff recommendation to extend the current stand-by arrangement to September 30, 1986. The fact that Somalia had been able to become current with the Fund demonstrated clearly that the flexibility shown by the Fund in dealing with Somalia, including the previous extensions of the stand-by arrangement, had paid off. Somalia needed the Fund's assistance, probably more than at any time in the past. An extension of the current stand-by arrangement was essential to allow the authorities to continue their efforts to bring the economy back on track. Finally, he could support the waiver requested by Mr. Finaish.

Mr. Kabbaj remarked that it was encouraging to note that Somalia had become current in its obligations to the Fund. Somalia's case illustrated the need for the Fund to be flexible when countries were willing to settle their obligations and to formulate and implement strong adjustment programs to remedy their external and internal imbalances. He supported the proposed decision and agreed to the waiver requested by Mr. Finaish. He wondered what amount of resources the authorities would be able to draw under the remaining period of the arrangement.

Mr. Goos commented that he could support the proposed decisions. Somalia would benefit immediately from having eliminated its arrears to the Fund. The stand-by arrangement would become operative again, paving the way for further assistance from both the Fund and other sources. Furthermore, the resulting improvement in the income position of the Fund would increase the likelihood that the interest burden on member countries with outstanding drawings could be reduced. The Somali authorities deserved commendation for their successful efforts to clear their arrears. He also welcomed those countries whose generous financial assistance had been instrumental in helping the authorities to repay the Fund. Finally, he supported Mr. Finaish's request for a waiver of the circulation period.

Mr. Alfidja, Mr. Huang, Mr. Ismael, Mrs. Ploix; Ms. Bush, Mr. Jayawardena, Mr. Leonard, Mr. Schneider; Mr. Parmena and Mr. Weitz welcomed Somalia's settlement of its overdue financial obligations to the Fund and indicated their support for the proposed decisions, as well as for Mr. Finaish's request for a waiver of the circulation period.

The staff representative from the African Department remarked that the staff would shortly be issuing a paper, which would include a proposal on the amount of resources to be made available under the remainder of the stand-by arrangement, together with a revised phasing of the drawings.

The Executive Board then took the following decisions:

Overdue Financial Obligations - Settlement

1. The Fund welcomes the settlement of Somalia's overdue financial obligations to the Fund in the General Resources Account and to the Fund as Trustee of the Trust Fund.

2. The Fund notes that, as Somalia became current in its financial obligations to the Fund on April 22, 1986, the limitation of Somalia's use of the general resources of the Fund was terminated as of that date.

3. The Fund has reviewed Decision No. 8164-(85/188) G/TR, adopted December 27, 1985.

Decision No. 8261-(86/68), adopted April 23, 1986

Stand-By Arrangement - Extension

1. The Government of Somalia has requested that the period of the stand-by arrangement for Somalia (EBS/85/1, Sup. 1, 1/28/85) scheduled to expire on April 23, 1986, be extended. The Fund grants approval of this extension through September 30, 1986.

2. Paragraph 1 of the stand-by arrangement is amended by replacing the date "April 23, 1986" with the date "September 30, 1986."

Decision No. 8262-(86/68), adopted
April 23, 1986

4. SCHEDULE OF MEETINGS

Mr. Dallara remarked that it had been his impression, based on the Board discussion on the work program at the end of EBM/86/65 (4/18/86), that the staff paper on provisioning against loan losses in the context of the Fund (EBS/86/82, 4/15/86) would be considered at the same time that the Executive Board reviewed the Fund's income position for fiscal year 1986, on April 30, 1986. He recognized that a number of Directors would not be in a position to provide a definitive view on provisioning at that time given the relatively brief period to review the staff paper.

Mr. Foot remarked that he was in favor of giving preliminary consideration to the staff paper on provisioning at the meeting on April 30, 1986, even though a number of Directors might not be able to offer definitive comments on the subject.

Mrs. Ploix, Mr. Goos, and Mr. Sugita stated that they supported Mr. Foot.

Mr. Sengupta remarked that his chair would be unable to offer its view on provisioning if it were taken up on April 30, as his authorities would have had insufficient time to consider the staff paper. He suggested that a full discussion on provisioning be held on May 19, as originally scheduled.

Mr. Ortiz recalled that the staff paper on the Fund's income position for fiscal year 1986 (EBS/86/81, 4/14/86) would have a very short circulation period before the Board discussion on the subject. Directors were now being asked to take up a second paper at the same time, which had an even shorter circulation period. The subject of provisioning was extremely important and merited a full discussion. It would be counterproductive to give preliminary consideration to the staff paper on provisioning on April 30.

Mr. Zecchini noted that as there was a logical link between the staff paper on provisioning and the paper on the Fund's income position, the two papers should be considered at the same time, although he recognized that not all Directors would be able to offer any firm views on provisioning.

Mr. Fugmann commented that he agreed with Mr. Zecchini.

Mr. Dallara remarked that he was unclear why it was so difficult for some Directors to offer preliminary thoughts on the paper on provisioning, which had been circulated on April 15, while they could offer their views on other more complicated issues, including mechanisms for dealing with arrears, discussed in a paper that had been circulated only one day earlier on April 14. On a related issue, from a legal viewpoint, would it be possible for the Board to take a temporary decision on the retroactive rate of charge for fiscal year 1986 that would have no implications for the rate of charge in fiscal year 1987. If it were possible, he could support holding only a preliminary discussion on provisioning.

The Deputy Treasurer recalled that when the Board had discussed the special review of the Fund's income position and the remuneration coefficient (EBM/86/37 and EBM/86/38, 2/27/86), it had decided to hold a review of the Fund's income position before the end of the financial year in order to avoid the problem of cash refunds in the event of the need for a retroactive reduction in the rate of charge.

The staff paper on provisioning had emerged from a much earlier discussion on the six-monthly review of overdue obligations to the Fund, considered at EBM/85/170 (11/25/85), when the staff had mentioned that the External Audit Committee had questioned whether the Fund should consider loan-loss provisioning, the Deputy Treasurer commented. The Treasurer had stated at that time that the staff hoped to finish a paper on the subject before the end of the financial year 1986, so that it could be taken into account for financial year 1987. There had been no suggestion that the provisioning paper should be linked to consideration of the rate of charge for 1986.

With respect to the discussion on April 30, the staff needed guidance on two issues; the rate of charge for the last half of financial year 1986, and the mechanism to determine the rate of charge on a retroactive basis, the Deputy Treasurer indicated. On the latter aspect, the staff hoped to issue a paper in late May in the light of guidance received by the Board. It would also need to issue a paper providing the final data on the Fund's income for financial year 1986. On the basis of that paper, the Executive Board would be asked to take a decision on the disposition of excess income from FY 1986 and also on the rate of charge for FY 1987. At that time, staff would also present a paper on the Fund's income for financial year 1987, the preparation of which would take into account the Board's discussion on provisioning. Hence, the Board's discussions on the rate of charge for the last half of financial year 1986, the disposition of excess income for FY 1986, the rate of charge and the Fund's income for financial year 1987, and provisioning were related. The Executive Board had, however, agreed to take these matters in two steps, the first stage being the discussion on April 30 to determine the rate of charge for the second half of FY 1986.

Mr. Dallara remarked that he understood that the purpose of the Board discussion on April 30 was not to reach a decision on the rate of charge for financial year 1987, but to decide on the rate of charge for the end of financial year 1986. In that context, it was particularly appropriate for the Board to look at the question of provisioning, with the understanding that the outcome would not have any implications for charges in financial year 1987. The Executive Board would have the opportunity for further consideration of the provisioning issue in May when it considered the appropriate rate of charge for financial year 1987, based on the information of the Fund's actual income position for financial year 1986.

Mr. Sengupta reiterated that the formal agenda for the Board meeting on April 30 should not be changed. However, Directors wishing to discuss the paper on provisioning could do so, even though some Directors would be unable to comment on the subject as their authorities had not been given sufficient time to review the paper on provisioning. Directors would know that the 1987 rate of charge would remain uncertain and that if any decision had to be taken on the rate of charge at the April 30 meeting, it would be purely indicative.

Mr. Alfidja and Mr. Polak indicated their support for Mr. Sengupta.

Mr. Dallara commented that he had no problems with Mr. Sengupta's approach, as long as the purely indicative number was the current rate of charge.

The Deputy General Counsel, responding to a question from Mr. Zecchini, commented that a majority of 70 percent of the total voting power was required for any decision on the rate of charge. Once a rate of charge had been set, a Board decision under Rule I-6(4)(a) was required to change the rate of charge. Otherwise, the rate of charge would remain the same until Rule I-6(4)(b) triggered an automatic change in the rate of charge.

Mr. Goos noted that he was opposed to changing the rate of charge in two stages. He supported Mr. Dallara's suggestion that the old rate of charge should be maintained with the understanding that it was an indicative rate of charge.

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

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/86/67 (4/21/86) and EBM/86/68 (4/23/86).

5. SOCIALIST PEOPLE'S LIBYAN ARAB JAMAHIRIYA - REPRESENTATIVE RATE FOR LIBYAN DINAR

The Fund finds, after consultation with the Libyan authorities, that the representative exchange rate for the Libyan dinar, under Rule O-2(b)(iii), is its fixed relationship to the SDR. The Central Bank of Libya will promptly advise the Fund of any change in the representative rate. (EBD/86/112, 4/16/86)

Decision No. 8263-(86/68) G/S, adopted
April 22, 1986

6. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors and by an Advisor to Executive Director as set forth in EBAP/86/95 (4/18/86) and Supplement 1 (4/23/86) is approved.

APPROVED: January 9, 1987

LEO VAN HOUTVEN
Secretary