

MASTER FILES

ROOM C-130

04

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 86/170

3:00 p.m., October 15, 1986

R. D. Erb, Acting Chairman

Executive Directors

Huang F.
J. E. Ismael
T. P. Lankester

G. Salehkhoul

Alternate Executive Directors

Mawakani Samba
M. K. Bush
G. Seyler, Temporary
T. Alhaimus
M. Sugita
A. Bertuch-Samuels, Temporary

J. Hospedales, Temporary

O. Isleifsson, Temporary
W. N. Engert, Temporary
A. Abdallah
J. J. Dreizzen, Temporary
A. Ouanes, Temporary
J. E. Rodríguez, Temporary
V. Rousset, Temporary
G. Schurr, Temporary
A. V. Romuáldez
O. Kabbaj
A. Vasudevan, Temporary
N. Kyriazidis

L. Van Houtven, Secretary
A. Akanda, Assistant

Also Present

IBRD: K. S. Lateef, Western Africa Regional Office. African Department: A. D. Ouattara, Director; G. E. Gondwe, Deputy Director; E. L. Bornemann, I. Kapur, J. W. Kratz, H. R. Lorie, P. M. Young. Exchange and Trade Relations Department: E. H. Brau, K. M. Huh, P. M. Thomsen. Fiscal Affairs Department: R. Hemming. Legal Department: J. M. Ogoola. Assistants to Executive Directors: F. Di Mauro, R. Fox, J. A. K. Munthali, B. Tamami.

1. GHANA - STAND-BY ARRANGEMENT AND EXCHANGE SYSTEM

The Executive Directors considered a request from Ghana for a 12-month stand-by arrangement in an amount equivalent to SDR 81.8 million (EBS/86/224, 9/26/86; and Sup. 1, 10/14/86).

The staff representative from the African Department stated that after the issuance of the supplement to the staff paper, the staff had received further data on performance under the stand-by arrangement, which could best be described by referring to Table 11 on page 39 of the staff paper. Net foreign assets at end-September were minus \$851 million, which was slightly better than the performance criterion of minus \$855 million; the actual outcome of net claims on government at end-September was C 35.88 billion, compared with the performance criterion of C 36.18 billion. No information was yet available on net domestic assets because its computation involved the consolidation of deposit money banks and balance sheets, which required more time. Cocoa financing had been repaid fully; thus, the September position was zero. The September stock position for arrears other than letters of credit was \$134.4 million, which represented a cumulative net cash reduction of \$14.4 million from August 1986, compared with the \$10 million required as a performance criterion. The September stock position on arrears on letters of credit was \$83.19 million, a reduction of \$30.6 million from August 1986, which was also slightly better than required. It should be understood that the operational significance of those performance criteria related to the second purchase, which, in accordance with the stand-by arrangement, Ghana would be eligible to make after November 14, provided all the performance criteria had been met.

Mr. Salehkhrou made the following statement:

Since mid-1983, the Ghanaian Government has embarked on a set of comprehensive adjustment measures under an Economic Recovery Program (ERP) to arrest domestic and external imbalances that had persisted for a long period of time, largely as a result of unfavorable external factors. The program has been supported by the Fund under two stand-by arrangements covering the period from August 1983 to December 1985. The program aimed on the one hand at promoting incentives and redirecting allocation of resources to sectors in which Ghana has comparative advantages, such as cocoa, gold, timber, diamond, and a number of agroindustries, and on the other at creating a favorable environment conducive to sustained growth and restoration of fiscal and monetary discipline with a view to attaining a viable balance of payments position. To this end, the ERP consists of three key elements:

- depreciation of the cedi to mobilize economic resources in the right direction and to enhance competitiveness of agricultural and industrial sectors;

- liberalization of the pricing system to promote domestic production and to remove misallocation of resources;

- pursuance of cautious fiscal and monetary policies to contain inflationary pressures and to resume confidence in the domestic currency and the banking system.

During 1985, the depreciation of the cedi by 20 percent to C 60 for the U.S. dollar was a significant step toward reaching an equilibrium in the exchange rate and narrowing further the gap between official and parallel exchange rates. Furthermore, considerable efforts were made to enhance price incentives. For example, the producer price for cocoa--which accounts for 60 percent of the country's foreign exchange earnings--was increased significantly. The authorities continued to pursue their prudent fiscal and monetary policies. While those policies aimed at providing adequate level of financial resources, they were cautiously implemented to contain inflationary pressures both on the demand and supply side and, therefore, to limit the rate of inflation to a maximum of 20 percent.

The progress achieved in the rehabilitation of the productive base of the economy under the first stand-by arrangement was less successful than expected. This was due to the larger than expected magnitude of the deterioration and structural bottlenecks as well as to the lack of adequate financial support from the international financial community, which took a wait and see attitude. Despite those discouraging developments, Ghana pursued courageously its determined efforts which eventually led to an unmatched economic and financial performance under the second stand-by arrangement. Indeed, the provisional data for 1985 indicates that real output rose more than the programmed level to 5.8 percent mainly due to a 20 percent increase of industrial output and to more than expected agricultural output growth stemming from favorable weather conditions and adequate price incentives.

On the fiscal side, the overall budget for 1985 recorded a lower than programmed deficit resulting from slightly higher revenues and lower expenditures. Central government revenue increased by 3.6 percentage points to 11.6 percent of GDP, largely reflecting the impact of exchange rate adjustment and larger volume of international trade transactions. Further strengthening of tax collection and a number of discretionary revenue measures were also contributing factors. Again, lower than targeted external assistance, which was seriously needed for the rehabilitation of the economy, forced the authorities to curtail the growth of capital outlays in order to keep the financial program on track. The increase in current expenditures was mainly due to an increase in wages and salaries which still represent only 46 percent of their 1972 levels in real terms. The overall balance recorded a lower than projected deficit of 2.3 percent of GDP.

On the external side, notwithstanding the authorities' full adherence to the targets set in the program, actual disbursement under the long-term loans fell substantially short of the target to less than half the amount programmed. This, along with lower than projected net inflow of medium-term loans and private capital led to a reduction in growth of imports for essentials, spare parts and equipment, and reflected delays in implementation of project and program aid. However, export growth, although recording an encouraging 12 percent increase in 1985, was 4 percentage points lower than expected mainly due to the lower prices of cocoa and timber--the volume of cocoa and timber exports increased by 16 percent and 72 percent to 192,000 tons and 250,000 cubic meters, respectively. Those developments resulted in a much lower than projected trade deficit of \$36.3 million--less than one fifth of the programmed level. Given a substantial reduction in external grants and private unrequited transfers, the current account deficit improved more than targeted to 3.0 percent of GDP. The overall deficit, however, is estimated to have widened from the programmed \$60 million to \$98.1 million, as net disbursements on medium- and long-term loans fell considerably short of the programmed level. That deficit was financed mainly through purchases from the Fund; at the same time, the country's external arrears continued to be reduced by \$56.7 million.

As to the 1986/87 program, the authorities are determined to pursue their efforts toward achieving an equilibrium in the exchange rate along with a minimum wage increase and an adjustment of civil service pay relativities. The cedi was further devalued by 50 percent on January 10, 1986 and the daily minimum wage increased from ¢ 70 to ¢ 90 as documented by the staff. Civil service pay relativities were also adjusted with a view to restoring the ratio between top and bottom pay scale. Since the rate of wage and salary increase could have resulted in a higher total wage and salary bill, given the existing uncertainties in import duty revenues and foreign financing, the authorities revised downward the wage and salary scale in June. Furthermore, in early September 1986, they decided to limit the payment of allowances to civil servants in order to mitigate any adverse effect of the wage policy on inflation and to ensure the attainment of budgetary targets. The authorities, however, were cognizant of the possible inflationary pressures resulting from the sizable reduction in the effective rate of personal income taxation and of the consequence of civil service pay increase in the state enterprises and the private sector. In this regard, corrective measures have been taken to mitigate the problem and to hold inflation in the range of 20-25 percent. One should also take into account the particular circumstances facing Ghana--which has been a victim of brain drain--in formulating a wage and salary policy to maintain the well-trained cadre and manpower to enable the country to successfully implement its recovery program.

Despite successful implementation of the two stand-by arrangements and largely encouraging economic and financial performance, the authorities are determined to remove the rigidities still existing in the economy and to take the necessary corrective measures should the slippages occur. The continuation of the ERP, however, necessitated the full and active support of the international financial community including, in the main, the Fund and the World Bank. Implementation of the requested stand-by arrangement will not only help the authorities to further consolidate and move forward with the significant progress achieved since 1984, but also create a more favorable climate for a better and comprehensive medium-term adjustment program which they intend to implement with the Fund's support under an extended Fund facility.

The program envisages a significant reform in the exchange rate system by the institution of an auction market. This would pave the way toward unification of the exchange rate by moving the remaining transactions, excluding special import licenses, to the market system no later than January 1987. Free issuance of type "A" licenses to importers of nonconsumer goods and automatic access to the auction market by October 1987 are the key elements to the new exchange rate and trade system.

The announcement of a 51 percent increase in the cocoa producer price in May 1986, together with a 28.6 percent increase in the minimum wage and a 92 percent increase in civil servants' salaries are to be considered as part of the major policies aimed at the attainment of the program's objectives. The imposition of a temporary 10 percent import surcharge, together with the windfall gains on petroleum products will largely offset the rise in expenditures as a result of a higher wage bill. The government deficit is projected to decline from 2.3 percent of GDP in 1985 to 0.2 percent in 1986. The program also envisages an adequate level of development expenditures as well as a number of structural reforms including rehabilitation of tax administration and restructuring of the state enterprises.

Following the measures taken so far this year, the latest data indicates that real GDP growth is estimated to reach 5.5 percent while the inflation rate, as measured by the consumer price index, is estimated to remain at 25 percent. Total exports are projected to increase by 14 percent in U.S. dollar terms, while a 17.6 percent increase is estimated for total imports despite the sharp reduction in the oil import bill. The current account deficit is projected to increase to 5.1 percent of GDP and is expected to be financed by long-term loans on concessional terms. The overall deficit will be largely financed by purchases from the Fund and increases in other liabilities. However, it should be emphasized that for this scenario to materialize, adequate external financial assistance on concessional terms would be of utmost importance.

Mr. Lankester made the following statement:

The turnaround in Ghana's economic fortunes that has been achieved since 1983 has been impressive by any standards, all the more so when one considers the long decline of the economy over the previous 20 years. The rapid recovery of output and the very sharp reduction in inflation are the most obvious but by no means the only achievements.

Improved climatic conditions have been partly responsible for the recovery, but the critical factor has been the wide-ranging, courageous, and on the whole well-judged adjustment program on which the authorities have embarked. Domestic resource mobilization through the tax system, cautious monetary policies, liberalization of domestic prices--including a massive and necessary increase in cocoa prices--more flexible interest rates, and substantial movement toward an equilibrium exchange rate have all played their part. The impact of these measures--both in terms of stabilization and acceleration of production and investment--has been most encouraging and, in my view, should be a lesson to other countries intent on stabilization and recovery. We offer our sincere congratulations to the authorities for their efforts. It is in recognition of those efforts that the international community, including my own Government, has provided substantial support to Ghana.

There have been some slippages over the past year in the monetary and fiscal areas. There was a substantial overshooting in credit to the Cocoa Board earlier this year, although this was partly due to the authorities' success in their efforts to stimulate cocoa production. There was also a large increase in civil service pay that, although probably justified on merit, in retrospect does not seem to have been adequately costed or targeted closely enough on the more highly qualified staff it has become increasingly difficult in recent years for the Government to retain.

It is to the authorities' credit that they have decided in agreement with the Fund to rein back the overall expansion of credit in the second half of this year. They have also taken resolute action to roll back part of the civil service pay increase. In this way they have commendably avoided having to cut back capital spending.

Provided the authorities' fiscal and monetary targets for the year are met--and it was encouraging to hear from the staff that all the performance criteria for September have been met--it seems to us that the overall policy stance is likely to be satisfactory and consistent with the authorities' final objectives. I understand that the ceiling for credit to the private sector for December was significantly reduced at a very late stage in the

negotiations and that the authorities, although agreeable to the lower figure, believe that the ceiling might be too tight. It would be helpful if the staff commented on this issue. In view of the slippages earlier in the year, I would urge the authorities to monitor the fiscal and monetary position very closely and to respond speedily if it goes off track again. This is especially important if the recent increase in inflation resulting from large pay increases in the private sector and from the cedi devaluation is to be contained. In our view, there is also a need for real interest rates to become positive to promote private savings. Despite the 2 percent increase in nominal interest rates in August, real rates currently appear to be negative.

Few details of Ghana's 1987 fiscal program are as yet available. I note that further pay increases for the civil service are envisaged, but that they are to be offset by a number of desirable measures--improvements in the tax system and in tax administration, more effective expenditure controls, and better administration to expedite the disbursement of external assistance. Clearly, all this must be looked at closely when the Fund's review mission visits Ghana--particularly to ensure that the envisaged pay increases are matched by additional revenue.

Exchange rate policy has provided strong support to the adjustment effort. This has continued in 1986 with the devaluation of the official rate by one third at the beginning of the year, and then the introduction in September of an auction for a fairly wide range of foreign exchange transactions. The auction is a major and welcome step toward a market-determined exchange rate. The four auctions which have been held to date seem to have gone well and appear to have allayed the staff's fears that the auction rate would not go high enough. The official rate, according to the Government's plans, will be unified with the auction rate in January. In view of this relatively short time span, I can approve of the multiple exchange rate which this and other features of the auction involve. However, for the fully unified rate to have an optimal effect on the allocation of resources, access to the auction must be as free as possible. I note that there is still a substantial differential between the auction rate and the parallel market rate, and I would encourage the authorities to formulate a speedy timetable for access of all importers to the auction.

Clearly, the macroeconomic policies outlined in the staff report have to be complemented by structural measures. We attach special importance to measures for rationalizing the Cocoa Board and other public enterprises. The World Bank has been working very closely with the authorities and the Fund in assisting the design of such measures. We welcome the fact that a structural adjustment credit has now been appraised and we hope that negotiations on it can be successfully completed in the next month or so.

The proposed stand-by arrangement marks a further stage in the Fund's assistance to Ghana and it has my full support. Provided the arrangement is successfully implemented, I regard it as a step toward the extended arrangement that I know the authorities are intent on establishing. I believe that the relatively low level of access in the stand-by arrangement is appropriate, and it appears from the staff report's comments on the authorities' expected timetable for an extended arrangement that they may not use all the resources available under the stand-by arrangement. I think it is too early for us to be definitive about the nature and timing of the next steps. But whatever they are, it should be noted that outstanding use of Fund credit is high and will decline only slightly under this program. Heavy repurchases from the Fund are due over the next few years and the staff is right to emphasize the difficulties that this will pose. Therefore, it will be important that the access level in any further program is carefully chosen so as to bring about a significant reduction in Fund exposure.

If Ghana is to be able to make net repurchases to the Fund while at the same time maintaining an adequate growth rate, continued donor support will be needed. I am sure the authorities will recognize the fact that donors will be looking for continued strong commitment on their part to further adjustment and recovery.

I would ask Mr. Salehkhoulou, whom I also thank for his very interesting and informative opening statement, to pass on the very good wishes of my authorities to the Ghanaian authorities.

Mr. Ouane made the following statement:

Since 1983, Ghana has made significant progress in restructuring its economy and has achieved high rates of economic growth. The authorities' strong commitment to the adjustment process, together with technical and financial support from the Fund and the World Bank have been successful in catalyzing financial resources in support of the authorities' efforts.

The achievements under the two consecutive Fund programs are indeed impressive. Appropriate incentives helped redirect resources toward sectors in which Ghana has strong comparative advantages. These incentives were supported by a significant improvement in international competitiveness, by appropriate fiscal and monetary policies, and most importantly, by the dismantling of the extensive system of price controls. Recently, however, there were some unfortunate policy slippages particularly in the areas of credit and wage policies. These slippages need to be corrected if the stabilization gains achieved thus far are to be consolidated, and if Ghana is to continue to enjoy the confidence and the financial support of the international community. Therefore, I am pleased that the proposed financial program for 1986/87 aims at

rapidly offsetting the impact of these slippages and at consolidating the significant progress made in the Ghanaian economy during the past three years. This, together with the authorities' intention to initiate a number of impressive structural measures should help pave the way for an early agreement on an extended arrangement and a structural adjustment arrangement.

It is heartening to note that the 1986/87 program continues to attach importance to growth, while continuing the needed demand management restraint. The targeted 5.5 percent growth rate for 1986 should provide for a significant further improvement in per capita income.

In the fiscal area, the expected acceleration in the annual inflation rate to over 25 percent clearly underscores the need for a particularly cautious demand management policy for the remainder of the year. Although I agree with the authorities that additional incentives for the civil servants were indeed necessary to increase the efficiency of public administration, I am concerned that the size of the increase granted by the authorities will have adverse effects on the budget, inflation, and the cost competitiveness of the economy, since this increase feeds through the rest of the public sector and the private sector. The authorities are clearly aware of these adverse effects and are trying to reduce them through cuts in other expenditures and a significant improvement in the revenue performance. In particular, it is gratifying to note that the capital expenditure programs for 1986 agreed with the World Bank have remained intact and that all the adjustments have been borne by current expenditures. However, as the staff points out, the situation is tight, and improved monitoring and full and timely reaction to unexpected developments will be essential.

In the external sector, it is clear from the staff report that the institutional and structural reforms needed to create the proper environment for sustainable growth and balance of payments viability are now generally well defined, notably in the areas of exchange and trade policies. I welcome the authorities' determination and willingness to reform the exchange rate system to permit the unification of the rates under flexible exchange rate regimes at a realistic level. However, as clearly brought out in the staff report, the authorities are, in a sense, feeling their way through the auction system. It would be helpful if the staff could elaborate on the merits of the Dutch auction system compared with other types of auction systems. I am particularly interested in the stability of the rate under the Dutch auction system. In this context, it will be useful if the staff commented on the inflationary implications of the exchange rate of $\text{C}\text{¢}$ 145 reached during the most recent auction. Given the still wide divergence between the official and parallel rates, I wonder how feasible it is to expect a unification of the exchange rate by January 1987.

I welcome the recent emphasis on the rehabilitation of the cocoa sector. Given the importance of the sector for generating foreign exchange earnings, it is important that sufficient incentives be provided to ensure large-scale replanting and to eliminate smuggling. The recent depreciation in the exchange rate is clearly a move in the right direction. However, prices received by producers remain substantially below those in neighboring countries. I urge the authorities to implement the recommendations of the World Bank in this regard.

As I have stressed on previous occasions, my authorities consider the occurrence of external payments arrears an inappropriate means of financing. Therefore, I welcome the efforts of the authorities to reduce external arrears and their commitment to eliminate them eventually. The information provided by the staff clearly indicates that a faster than expected reduction in external arrears is anticipated. Nonetheless, I was surprised to note that the formal performance criterion for arrears, while stressing the reduction in arrears on a net basis, omits the usual clause that explicitly precludes the accumulation of new external arrears as of the effective date of the program. Such a clause is not only in line with the recent treatment of other member countries, but also conforms to the authorities' commitment as expressed in paragraph 16 of the letter of intent. Staff comment on this issue will be appreciated.

I welcome the progress made by the authorities in restructuring the economy. The task ahead will involve difficult policy choices, with little room for maneuver. Given the very high rate of debt service payments and the need for additional external financial assistance, I urge the authorities to adhere to the program in order to maintain the confidence of the international community. I endorse the proposed decision and wish the authorities well.

Mr. Bertuch-Samuels made the following statement:

I would like to commend the authorities for their successful adjustment efforts under the previous two stand-by arrangements. By pursuing prudent financial policies and at the same time enhancing the supply responsiveness of the economy, the authorities have set the stage for a remarkable recovery. After many years of economic decline, growth has been buoyant in 1984 and 1985 and is expected to remain at satisfactory rates during the coming years. Progress has been made in reducing the fiscal and external imbalances, and inflation has been brought down sharply. In our view, the success of Ghana's adjustment program is an encouraging example demonstrating that a bold, determined approach with a wide range of corrective measures applied at an early stage can indeed yield very positive results within a rather short period of time.

Nevertheless, the problems are far from being solved, and the balance of payments outlook remains a cause for concern. This makes it imperative for the authorities to persevere in their adjustment efforts if the gains made in 1984 and 1985 are to be consolidated.

Against this background, it is unfortunate that the policy slippages that occurred at the end of 1985 and at the beginning of 1986 threaten to jeopardize the success of the stabilization program. It is also unfortunate that these slippages delayed the negotiation of a medium-term adjustment program that would address both macroeconomic and structural imbalances within a more comprehensive framework.

Nonetheless, it should be acknowledged that the authorities have taken a number of steps in recent months to offset the negative effects of the excessive wage increases granted to civil servants in early 1986. And although some of these measures are only of a one-time nature, it is encouraging that the overall deficit for fiscal 1986 is now expected to be reduced to only 0.2 percent of GDP, and that the Government intends to sustain this fiscal effort in FY 1987 through permanent reductions of other current expenditure. However, as the staff points out, Ghana's current budgetary system suffers from a number of deficiencies, and budgeting and expenditure control mechanisms need to be improved to facilitate the implementation and monitoring of the program; they also need to be improved in view of the forthcoming structural adjustment arrangement and to place the fiscal accounts on a sound footing. In this context, I welcome the authorities' initiative in seeking the Fund's technical assistance, and I would encourage them to work together with the staff in finding appropriate solutions once the recommendations of the recent technical assistance mission are finalized. It would be useful if the staff could provide the Board with some of the preliminary findings of the mission.

The overall financial situation of the public sector cannot be seen without considering that of the public enterprises. I am glad to note, therefore, that the authorities are planning to undertake a major reform of the state enterprise sector with a view to establishing a commercially oriented and financially self-sufficient state enterprise sector. Since it appears that the planning stage of this reform program is virtually complete, I would urge the authorities to move quickly toward implementing the reforms.

The same considerations apply to the cocoa sector. Given its dominance in the economy, priority needs to be given to the continuation of policies aimed at improving incentives to producers in the cocoa sector. The increases in production and exports during 1984/85 clearly show the difference that more appropriate pricing

and exchange rate policies can make. In my opinion, the steps taken thus far need to be carried further, particularly because producer prices still remain substantially below those in competitor countries such as neighboring Côte d'Ivoire. As suggested by the World Bank, more work needs to be undertaken to enhance the efficiency of the operations of the Cocoa Board. We hope that the Bank's preliminary studies will soon be followed up by concrete steps to rationalize the activities of this important marketing board.

As pointed out by the staff, the performance of the cocoa sector will remain critical for Ghana's balance of payments prospects for some time to come. In 1986, for example, cocoa exports are expected to continue to provide approximately 70 percent of all export earnings. Needless to say, such a high dependency on one agricultural commodity makes the economy and the balance of payments highly vulnerable to climatic conditions. Thus, every effort needs to be made to diversify Ghana's export base to make the country less prone to external shocks. The recent progress made in this respect is encouraging. Increased price incentives and investments in the timber and mining sectors are already expected to result in substantial production export gains. Clearly, these sectors could be expanded even further, and considerable scope also exists for promoting nontraditional exports.

Exchange rate policy will play a key role in this endeavor. The authorities have already achieved a significant improvement in external competitiveness through several devaluations. The comprehensive reform of the exchange rate system, aimed at fully unifying the exchange market by the beginning of 1987, would represent only a logical and highly welcome continuation of this more market-oriented approach. In this context, I also welcome the envisaged liberalization of the import licensing system.

In sum, the authorities appear to be moving in the right direction in many areas. As the staff points out, it is important that the implementation and monitoring of these policies and reforms be improved to ensure that slippages do not recur. Further progress in the adjustment efforts can also be expected to contribute to strengthening the confidence of foreign investors in Ghana's economic prospects, thereby encouraging private capital inflows. However, with respect to the normalization of Ghana's financial relations with its external creditors, my authorities note with some concern that it appears that part of the 1986 balance of payments deficit will be financed through an increase of arrears. I would welcome further clarification by the staff on this matter. Like previous speakers, I welcome very much the intention to reduce and eventually eliminate the external arrears at an early date.

The staff's balance of payments projections clearly show that Ghana will continue to need generous assistance from the international donor community if it is to achieve the dual objectives of medium-term balance of payments viability and adequate growth under its economic recovery program. In this context, the recent significant delays in disbursements are regrettable, and it is to be hoped that the recurrence of such delays can be avoided in the future. I support the staff appraisal and the proposed decision.

Mr. Mawakani made the following statement:

Since I am in broad agreement with the staff's analysis and appraisal, I will limit myself to a few general comments.

I welcome the renewed efforts of the Ghanaian authorities to strengthen their economic and financial policies because the significant gains made since 1983 under a bold stabilization program supported by two successive stand-by arrangements seem to have been weakened by slippages. However, these no doubt constitute a temporary setback that has not daunted the resolve of the authorities to continue with their adjustment efforts.

The program for which the stand-by arrangement is being requested should be seen as a bridge to a medium-term program that could be supported with use of Fund resources under the extended Fund facility as well as the structural adjustment facility. Indeed in my view, it represents a decisive step toward a comprehensive and far-reaching medium-term adjustment effort that involves continued emphasis on demand management policies for supporting structural and institutional reforms and supply-side policies needed for ensuring the sustained growth and medium- and long-term viability of Ghana's external position. The adjustment program for 1986/87 contains a number of positive structural actions that are a step in the direction of the needed policy reorientation.

The authorities deserve to be commended for their comprehensive and forceful approach in tackling the economic and financial problems confronting their country. The progress made thus far in policy reforms in such areas as taxation, state enterprises, public sector management, and the important cocoa sector is encouraging. I welcome the major step that has been taken in the exchange rate area of introducing an auction system that aims at broadening access to the foreign exchange market. Regarding the unification of the exchange rates by early 1987, it would be important for the authorities to ensure confidence in the market by firmly resisting the temptation to interfere with the system. I would also encourage them to proceed speedily with their plans to liberalize the import trading system with the assistance of the World Bank.

The authorities face a difficult task that can only be addressed effectively within a medium-term policy framework. To this end, I do urge the authorities to undertake without further delay a detailed preparation of the structural adjustment measures that could be implemented under the extended Fund facility and the structural adjustment facility over the 1987-89 period. Not only is firm policy implementation under an extended arrangement crucial, but monitoring is equally important if slippages are to be avoided. In this connection, I would also urge the authorities to accelerate the completion of their plans for the strengthening of public sector management, and I welcome their close collaboration with the World Bank in this important task.

I would encourage the authorities to follow the new program very closely. I support their request for a stand-by arrangement.

Mr. Sugita made the following statement:

Under the economic recovery program that was supported by the two previous Fund stand-by arrangements, considerable progress was made in rectifying financial and external imbalances during the period 1983-85. The program was well conceived in addressing structural as well as macroeconomic problems, and was generally well implemented. The exchange rate adjustments made since 1983 have indeed been remarkable. Significant efforts were directed toward correcting price distortions and restoring price incentives to producers, in particular to cocoa producers. There was also some progress in domestic resource mobilization, which was achieved through exchange rate adjustments, increased trade volumes, and a strengthening of tax collection. As a result, the level of economic activity picked up significantly in 1984 and 1985. The strong supply response of cocoa production to price incentives was particularly noteworthy in contributing to this favorable outcome. At the same time, there was a sharp decline in the rate of inflation. The progress that had been achieved by the end of 1984 enabled the authorities to embark on a rehabilitation program for transportation and communication, and to establish a partial recovery of real wages and salaries of the public sector in 1985.

Toward the end of 1985, there was a significant credit overrun arising from cocoa financing, which led to a partial reversal of the gains that had been achieved in the balance of payments and inflation. Also, the wage and salary adjustments that were announced in January 1986 were much higher than had been envisaged and had to be revised subsequently.

The higher inflation rate resulting from the two slippages could potentially have a very serious impact on the implementation of the adjustment program. While the adjustment program that

Ghana has embarked on is an ambitious one, the authorities have implemented it with determination, and their efforts have already been rewarded with some good results. In order to consolidate the gains, further constant vigilance will be required to avoid the recurrence of recent slippages. The balance of payments prospects for 1987-89 still remain very difficult, but with appropriate policies Ghana should be able to meet its external obligations while at the same time reducing payments arrears. In this connection, the liberalization of the exchange and trade system is particularly important, and I welcome the introduction of a foreign exchange auction system as a first step toward a far-reaching reform.

The staff has identified various areas in which further structural adjustments are warranted. I can generally endorse the staff's suggestions and note with satisfaction the authorities' intention to proceed with the rehabilitation and development of the economy while committing themselves to structural reforms. I can, therefore, support the proposed decisions and hope that the successful implementation of the program will lead to the adoption of a medium-term program supported by extended and structural adjustment arrangements.

Ms. Bush made the following statement:

Over the past several years, Ghana has made substantial progress in correcting a number of problems in its economy. Following exchange rate and domestic pricing adjustments, the productive sector has been revitalized, real economic growth has been restored, inflation and the balance of payments deficits have been reduced, and fiscal deficits contained. This performance, as other speakers have noted, has been impressive.

Unfortunately, in late 1985 and early 1986, at the time the previous stand-by arrangement neared completion, several deviations in a number of policy and performance areas occurred. The most significant problem occurred in the monetary sphere, with very high expansion of credit contributing to a resurgence of inflation this year--up again to about 25 percent, after falling to 10 percent in 1985--and also leading to a deterioration in the current account position this year. It is these deviations that apparently have led to the 1986 program targets being less ambitious than might have been expected. For instance, the current account deficit will be higher, although that is partly related to a higher level of external financing for imports.

We found it particularly discouraging that external arrears will be higher at the end of 1986 than at the end of 1985 because of large increases that had occurred early this year and which would only partially be reduced in the first four months of 1986.

Also, it appears that a large increase in external debt is occurring this year, with the debt to GDP ratio increasing from about 40 percent in 1985 to about 70 percent in 1986. These trends are certainly the opposite of what would normally have been targeted during the course of an adjustment period, which we find somewhat worrisome. We would welcome any comments that staff might offer on the reasons for the large increase in external debt.

We have been impressed by the continuing rebound of the productive sectors. Agricultural output has expanded at impressive rates and, more important, even the industrial sector is finally showing signs of recovery. These improvements appear to be directly related to adjustments in producer prices of the main export crops and the liberalization of price controls on other products. Furthermore, manufacturers have found it much easier to acquire imports through the utilization of the free foreign exchange market.

These adjustments have been undertaken together with exchange rate adjustments in the official market, and we learn now that the authorities have implemented an auction system to bring about an eventual unification of the markets. The auction system appears to be working well at this stage, and we note that the expectations are that even the official market will be in equilibrium. We hope that that quasi-equilibrium will not lead to delays in achieving unification, since we continue to believe that resource allocation goals, including budgetary resources, would be best served by application of a uniform exchange rate to all transactions. In this regard, we do welcome the authorities' commitment to unification by early 1987.

Fiscal policy appears to have been an area of some difficulty this year, with excessive wage adjustments and some shortfalls in external financing necessitating a series of midyear budgetary adjustments. The additional measures on the revenue and expenditure sides are projected to result in a small deficit this year, although a somewhat higher deficit may emerge in 1987 if additional foreign financing is secured. Clearly, one problem area was that of wage adjustments and, while it was unfortunate that the authorities announced wage increases that could not readily be financed, they have, of course, made efforts to scale back those increases. In addition, the authorities are moving forward on their plan to redeploy civil servants and, although this will be a time-consuming process, we do strongly support their efforts to streamline the civil service.

The fiscal consolidation also includes containing other current spending, including transfers to the public enterprises. These budgetary goals will be supported by the general reform of this sector that has now begun. We welcome the authorities' goal of retaining only basic public services, such as utilities, in

the public sector. The initial study that will determine the actions to be taken with regard to various entities should be completed in the near future and we look forward to seeing the implementation of this program by the end of the year. Furthermore, we welcome the plan to consolidate investment spending and financing into the government budget next year, which should facilitate a comprehensive examination of the impact of fiscal spending on the economy.

The authorities have already begun the process of tax reform, and we support the steps taken so far, which include reducing high marginal tax rates and expanding the coverage of the tax system. One goal is to reduce dependence on export taxes on cocoa, which we believe is important for providing higher returns to the farmers and stronger incentives for both current production and the maintenance of the productivity of the cocoa plants.

As to the problems of credit expansion related to the cocoa crop, rather large extensions of credit have occurred--more than twice as much as normally expected. This high degree of liquidity, which was expected to have been eliminated by end-September as the crop credit was repaid, appears to be having immediate and direct effects on inflation and the balance of payments position. It would appear that much stronger efforts to control credit expansion are required. In that regard, it also appears that a significant part of the problem lies with the Cocoa Board, and we wonder if much stronger efforts at reform that would yield higher returns to farmers and more efficient marketing of cocoa are not warranted. Perhaps the role of the private sector in cocoa marketing could be increased.

We note that interest rates have recently been raised and now may be close to positive in real terms. We wonder if these adjustments are sufficient to bring about the rather large increase in national--particularly private--savings hoped for in 1986. Could the staff provide any preliminary indications of trends in monetary deposits and velocity? We are concerned that confidence in the economy could be eroded by the high rate of inflation.

We note that expectations for 1987 are rather sparsely outlined in this report. At this late stage in 1986, and given the slippages that occurred earlier this year, we would have been more comfortable with a table of indicative targets in the light of the fact that the first review, which will finalize targets and performance criteria, will not be completed until March 1987. In effect, we have here a one-year program with just three months of performance outlined. In that regard, we think it important to have policies and targets for 1987 formulated before the beginning of the year; perhaps the first review could be accelerated to permit formalization of the 1987 program.

I would like to turn to several issues on the medium-term outlook, including the financing gaps projected for the next several years. While the staff paper includes a section entitled "Medium-Term Outlook and Capacity to Service Obligations to the Fund," we find it to be somewhat discouraging in its explanation of how Ghana is to service its debt to the Fund. We find it rather unusual to present the Fund as the prime source of financing for the medium-term balance of payments deficits. Instead, since Ghana is eligible for a structural adjustment arrangement, and in the light of the rather high debt service ratios projected for the medium term, we would prefer to see these resources utilized in the medium term in conjunction with expanded reliance on other concessional resources provided, for instance, by the World Bank in support of the structural reforms that are being initiated in Ghana.

This brings me to the more general point regarding treatment of Fund resources in balance of payments tables. We discussed this matter a few weeks earlier when the Board considered the structural adjustment for Zaïre (EBM/86/162, 9/24/86). Since the use of Fund resources generates a reserve asset and liability, it appears that in many cases the Fund is not generally considered to be closing the financing gap in the same sense that concessional inflows do. Yet, in this case the Fund would be viewed as playing the role of financing medium-term balance of payments gaps. This issue has been raised a few times recently. We would appreciate if the staff could do something about the most appropriate presentation for Fund resources and financing gaps. We wonder if a consistent approach across countries in the Fund might not make some sense. It is somewhat worrisome for us to view the Fund as actually playing a part in closing a medium-term financing gap.

If we understand correctly, the authorities are interested in an extended arrangement, which would begin as early as 1987 and replace this program in midstream. The language used in the paper is that the present program would serve as a bridge to an extended arrangement. In the light of the weak performance during most of 1986, we are not certain that it would be appropriate to move quickly into an extended arrangement without a substantial period of macroeconomic and structural adjustment. We believe that a fully completed one-year stand-by arrangement would allow for this period of adjustment. The concept of a stand-by arrangement that is to be intentionally interrupted in midstream and thought of as a bridge is somewhat worrisome. I think that the completion of the stand-by arrangement would allow the economy time to achieve a somewhat longer period of solid performance before turning to an extended arrangement.

In the light of the Fund's general experience with extended arrangements for various countries, we also think it very important to have evidence of commitment to and implementation of a

broad range of structural measures; therefore, it is very important that, if we are to help ensure the success of an extended arrangement structural measures should be incorporated into such an arrangement, if feasible, in the form of performance criteria or, if more appropriate, in the form of review clauses. Where appropriate, some quantification would be helpful; otherwise, certainly some kind of a qualitative inclusion in review clauses of the progress that is expected on the various structural measures.

With regard to the access levels, I agree with Mr. Lankester that the outstanding use of Fund credit is somewhat high. Furthermore, as indicated in the paper, if we were to accept the concept of financing gaps to be closed mainly by the Fund, the Fund's exposure would not diminish significantly, even though this program is 40 percent of quota, with use of Fund credit reducing from 292 percent of quota to only 279 percent of quota. It strikes us as a rather lengthy period of high exposure for the Fund, and we would further suggest, like Mr. Lankester, that access levels should be very carefully chosen if follow-up programs are introduced. On these various issues, we welcome comments from both the Fund and the Bank staff with regard to their prospective roles in Ghana. We support the proposed decisions.

Mr. Rousset made the following statement:

Let me say at the outset that I support this program, which appears well designed for consolidating the gains of the stabilization policies already achieved, recovering from the slippages incurred in late 1985 and early 1986, and supporting a substantial growth of Ghana's GDP in the years to come.

During the past three years, the results achieved by Ghana under its economic recovery program have been impressive both in addressing internal and external imbalances and in laying the groundwork for growth in the agricultural and industrial sectors: GDP grew 10.7 percent in 1984, and 5.8 percent in 1985; the budget deficit was contained under 2 percent; and the rate of inflation dropped from 120 percent in 1983 to 10 percent in 1985.

Ghana's economy has responded particularly well to the measures implemented under the previous stand-by arrangement, as demonstrated by the increase of agricultural production and exports, the recovery of the manufacturing sector, and the greater utilization of the installed industrial capacity in addition to the accomplishments mentioned earlier.

To support this vigorous program of reform, Ghana has been able to mobilize exceptional amounts of financing not only from the Fund, but also from the World Bank and its Special African

Facility, and bilateral donors; this represents an important effort by the international community in support of a strong adjustment program.

Given this very positive and encouraging background, the significant slippages that occurred in late 1985 and early 1986 appear all the more regrettable. The slippages jeopardized a substantial part of the progress that had been made under the stabilization program and made unclear the level of external assistance required.

For these reasons, I welcome the proposed program, which proposes convincing adjustment and structural measures aimed at restoring the adjustment process while fostering economic activities through better allocation of foreign exchange and through various institutional reforms.

In addition to supporting the measures taken to instituting an auction market and liberalizing the import system, I share the staff's views on the importance of proceeding with major reforms in the cocoa sector, the streamlining of the public enterprise sector, and the redeployment of redundant labor in the public sector.

As to the medium-term outlook, I am impressed by the forecast of a 5.8 percent yearly growth rate of GDP because it entails a dramatic increase of gold, timber, and nontraditional exports in addition to the continuing improvement of production in the cocoa sector.

Although these figures may seem too optimistic, the targets seem well within reach provided that the proposed adequate pricing and liberalization policies are implemented; the economy has already demonstrated its ability to respond quickly and efficiently to measures aimed at stimulating production. Therefore, I strongly encourage the authorities to strictly adhere to this program. As mentioned by the staff, the first months of its implementation will constitute a test for the future consideration of a three-year extended arrangement.

Regarding the problem of arrears, I welcome the authorities' intention to eliminate these arrears, although I note with some concern that complete elimination is not provided for under the stand-by arrangement. I would encourage the authorities to carefully review this matter, giving special attention to the question of arrears related to regional projects involving neighboring countries.

Mr. Abdallah made the following statement:

I fully support Ghana's request for use of Fund resources under the proposed stand-by arrangement. In my view, the adjustment program is a commendable effort that should help to consolidate the gains made under previous programs. Those gains could well have been eroded if the slippages that occurred at the end of 1985 and early in 1986 had continued unchecked. Corrective measures had, therefore, become urgent and action is currently being taken. Indeed, as Mr. Salehkhoo affirms in his opening statement, the current program should also create more favorable conditions for undertaking comprehensive and far-reaching adjustment measures.

It is clear that Ghana made significant progress toward economic and financial viability during the recent past. In the past two years, the economy has witnessed impressive rates of growth of real GDP, which were assisted by the return of favorable weather conditions that boosted agricultural production. The implementation of appropriate price incentives meant that productive agents were well placed to take full advantage of the favorable climatic conditions. Furthermore, the rehabilitation program for industry also helped to stimulate production such that manufacturing output picked up strongly in 1985. With improved supply conditions, supported by restrained fiscal and monetary policies, inflationary pressures began to subside.

However, some of this success, particularly the more than anticipated increase in production of cocoa in 1985, resulted in a monetary expansion that partly led to the overshooting of the end-December indicative ceilings. Another factor that led to this monetary expansion was the substantial increase in wages and salaries granted to civil servants. Although the staff had supported considerable salary increases, the amount actually awarded by the authorities was much higher than had been contemplated by the staff. The combination of these two adverse developments caused certain distortions in the economy, partly contributing to the resurgence of inflationary pressures.

It is encouraging to note that additional adjustment measures are being taken to deal with the new imbalances that have emerged. I support the proposal that after the successful completion of the current program, Ghana should promptly undertake a medium-term adjustment program in order to address the more fundamental problems confronting the economy. I believe that Ghana, like many other countries in its position, is better off in taking a longer-term view of its adjustment efforts. In that regard, I find the proposal for a possible extended arrangement, together with a structural adjustment arrangement, to be most relevant and appropriate.

In that connection, the structural reforms--some of which are already being implemented under the current program--should

prove useful in promoting a more efficient allocation of resources. The new exchange rate system, as described in the supplement to the staff paper, should play a central role in the adjustment process. Furthermore, the flexible pricing and interest rate policies already adopted should also prove useful in supporting the new exchange rate system. I also believe that the fundamental reforms of the parastatal sector, particularly the restructuring of the Cocoa Board, to be essential for the success of the program. In the case of the latter, I agree with the staff that such reforms should incorporate the provision of higher prices to cocoa producers, awarding a higher proportion of the export-parity price. In that regard, I wonder if the staff could explain why there is still a large disparity between producer prices in Ghana and those prevailing in Côte d'Ivoire even after substantial increases have been granted in the past two years.

I should like to endorse the baseline scenario implied by the medium-term projections, which involve an annual growth rate of 5-6 percent. This rate of growth provides adequate scope for the expansion of per capita income. It is necessary for the authorities to underpin the amount of investment required in these sectors, which should produce the initial impetus for growth. The staff has indicated that the agricultural sector, particularly cocoa production, will continue to be the leading sector. However, other areas such as timber, gold, and manufacturing sectors could also play an important role in the overall recovery of the economy.

It is worth noting that the baseline scenario also shows that financing gaps will exist throughout the medium-term period. It is suggested that these gaps could be filled by possible drawings under the extended and structural adjustment arrangements. The figures have also assumed substantial amounts of foreign assistance on concessionary terms. As donors had earlier adopted a wait and see attitude that had resulted in shortfalls in capital inflows, it is to be hoped that commitments will be fully met under the current and possible successor arrangements. On their part, the authorities will need to convince the donor community of their commitment to the program by avoiding further slippages. I am sure they are prepared to take additional measures whenever necessary.

I support the proposed decision and would ask Mr. Salehkhoul to convey to his authorities the best wishes of this chair in the challenging tasks that lie ahead.

Mr. Alhaimus made the following statement:

I wish to add my support to Ghana's request for a stand-by arrangement. The policy record of the authorities in the past few years has been commendable, leading to a successful recovery and brighter prospects for the economy.

The new program for 1986/87 will not only have the effect of containing the effects of recent credit and wage slippages, but also appropriately target a fairly high growth rate while pursuing strong demand management.

The figures stated by the staff on adherence to performance criteria are encouraging and indicate that policies are on the right track.

I look forward to continued success in program implementation that will be followed by a more comprehensive extended arrangement and structural adjustment arrangement, as now envisaged.

The staff representative from the African Department noted that the overall net domestic asset ceiling had been reduced at a rather late stage in the negotiations. Although that reduction had not affected either credit to the Government or cocoa financing, it had affected the line, "credit to the rest of the economy" in Table 8 on page 27 of the staff report. The amount of credit expansion for the rest of the economy originally agreed on by the authorities, 75 percent, was large by any standard, but it had to be seen against the increase for the same line of credit to the rest of the private sector in 1985, which had been 89 percent at a time when the inflation rate had been only 10 percent. Thus, it was clear that the need for credit to the private sector remained substantial. A large amount had gone to the manufacturing sector, which had been growing at a much faster rate than other sectors of the economy--about 20 percent in 1986--and which was likely to grow faster than those sectors in the future.

At the time of the mission, the staff had concluded that there would be a substantial demand for credit in the last quarter of 1986, partly due to the introduction of the auction market, the staff representative continued. However, in operating an auction market it would not be appropriate to be too generous in providing credit. On balance, it was believed that during the review process that an annual increase of 75 percent could be excessive and thus the credit in the last quarter was reduced by C 2.6 billion. The resulting increase of 65.5 percent was still very large. The Fund mission that would visit Ghana in November would have an opportunity to review that issue once again. If it turned out that the strong fears of the authorities that credit was too tight were borne out, the staff would not hesitate to report to management and, if necessary, ask for a modification of the ceilings, if that would be compatible with the objectives of the program.

Turning to the issue of interest rates, the staff representative remarked that in 1985 interest rates had turned positive in real terms, which was actually earlier than the target date. Unfortunately, the slippages that had occurred, which had resulted in a higher rate of inflation, had eroded the progress made in 1985. Interest rates had recently been raised, but not enough to make them positive again in real

terms. However, with an improvement in the inflation target and further interest rate increases, it should be possible to return to positive interest rates in real terms in 1987.

Replying to a question about whether the unification of the existing two official exchange rates would be possible, given that the parallel market rate was still substantially higher than the auction rate, the staff representative said that the authorities were very serious about their commitment to unify the existing official rates in early 1987. However, a true, unified market could only be established when consumer items were also brought into the auction. The authorities' objective was to ensure that such a move would take place in 1987. The timing of the merging of consumer goods into the auction market would be discussed during the next review. As to the impact of the auction market on inflation, the inflation target for 1986 had already taken into account the introduction of the auction market. As a result of the exchange rate action alone, an increase in the rate of inflation of about 7 percent was estimated to take place in 1987, but it was expected that that would be offset by the better performance of the economy in other areas.

The staff regretted the increase in arrears that had taken place earlier in 1986, the staff representative commented. That increase had occurred during a period when a stand-by arrangement had not been in place, and it had been the result of the slower disbursements of official assistance as well as of the expansionary credit policy. The authorities were expected to make substantial efforts during the last six months of the year to address the problem; between June and September, the performance criteria had been met. However, it would not be possible to reverse entirely what had happened during the first six months of the year; hence, over the year as a whole, there would, unfortunately, be an increase in arrears.

Responding to the questions on the occurrence of new arrears and the reduction of arrears through net cash payments, the staff representative pointed out that the letter of intent contained a statement that the authorities had committed themselves to not incurring any new arrears, and it was hoped that it would be possible to enforce that commitment. The guarded language used in discussing the performance criteria reflected the fact that earlier in the year, when the increase in arrears had been particularly heavy, there had been a situation in which new arrears on letters of credit had been incurred while the previous arrears had been settled. By moving to an auction system, arrears on letters of credit should no longer occur, and the staff would be particularly vigilant about ensuring that other types of arrears would not occur--for example, arrears on debt payments. He agreed with the Executive Directors that the increase in short-term debt was a worrisome aspect that would have to be watched very closely in the future; given the events of 1986, such an increase had been unavoidable.

The staff was confident that the discussions between the authorities and the World Bank on the reform of the Cocoa Marketing Board would yield

positive results soon, the staff representative remarked. The authorities' objective was to sharply reduce the cost of the Cocoa Marketing Board and thereby make it possible to increase the producer price for cocoa substantially. The reason why the producer price for cocoa in Ghana was lower than in Côte d'Ivoire was that the percentage of the world market price that had been passed on to the producers in Ghana was still substantially low; it was the authorities' firm intention to turn that situation around within the next two or three years.

In considering the advisability of an extended arrangement, the staff representative said, it might be useful to review recent relations with Ghana. At the time of the Annual Meetings in Seoul, the authorities had indicated strongly that they were interested in an extended arrangement. They had also indicated that they were preparing a medium-term economic recovery program with a fairly detailed public expenditure program for 1986-88. Two months after the 1985 Annual Meetings, they had submitted to the Consultative Group meeting in Paris a blueprint of their medium-term recovery program. The Fund mission that had visited Ghana in December 1985 had been authorized to begin negotiations on an extended arrangement. Unfortunately, the whole program had been thrown off track owing to the slippages that occurred in the last part of 1985 and the difficulties that the authorities encountered in early 1986, especially with regard to wage increases. It had then been necessary to emphasize again the stabilization aspects so that much less time could be spent on dealing with structural issues. The authorities strongly believed that their program, which was a combination of adjustment and growth, could best be supported by an extended arrangement. The staff felt that the attempts to negotiate an extended arrangement could be supported if the authorities could come up with the necessary structural measures; however, the same strict standards applied to other countries should also be applied to Ghana. It would be desirable not to have a lag between the current program and a follow-up program so that there would not again be an interim period without a program with the same unfortunate consequences that had been observed earlier in 1986.

It was possible that the financing gap had been overstated in the staff report by using the world economic outlook methodology to estimate gross capital inflows over the next few years, the staff representative continued. It was conceivable that with a strong program in Ghana, concessional financing would be larger than indicated in the staff report. A policy framework paper was being prepared in collaboration with the World Bank and the forecast made in that context on the basis of commitments made at consultative group meetings showed capital inflows to be somewhat larger than those indicated in the staff report.

The staff representative from the Exchange and Trade Relations Department explained that the Dutch auction system required the successful bidder to pay the purchase price actually bid, as distinct from an auction where, according to the marginal pricing principle, all successful bidders would pay the marginal price. The marginal pricing principle was one that attempted to duplicate the functioning of an atomistic competitive

market. However, in adopting an auction system, some authorities believed that they should use their power as monopoly sellers of foreign exchange to extract what theory called "consumer surplus" from purchasers willing to pay a higher price than the marginal clearing price established through the bidding process. Some authorities preferred the Dutch auction system because they believed that it tended to prevent the auction exchange rate from depreciating too fast; also, some found it difficult to accept the idea that, under the other system, purchasers of foreign exchange would not be required to pay the price they were bidding if that price was higher than the clearing price. However, the staff was largely indifferent to the choice, since experience showed that neither the Dutch auction system nor the marginal pricing approach would, if applied over a sustained period, produce a significantly different outcome. For example, during the sale of Fund gold in the 1970s for the purposes of funding the Trust Fund arrangements, the Dutch auction and marginal pricing approaches had been applied at different times and it had been found that the outcome of the auctions had not differed very much, mainly because the bidders in the market had been well informed about market prices for gold established outside the auction. In the case of Ghana, bidders would be aware of the price of foreign exchange in the parallel market, and, therefore, it would be difficult for the central bank to extract over time the so-called "consumer surplus" under the Dutch auction system. Nonetheless, the merit of the Dutch auction system as applied to sales of foreign exchange was still a subject of debate among the staff. In his own view, the relative merits of the two approaches should be appraised on the basis of their contribution to facilitating in the long run the development of a true foreign exchange market in an economy. Under a true foreign exchange market, marginal pricing would apply.

In line with standard practice, the medium-term balance of payments projections shown in Table 9 of the staff paper did not incorporate any assumptions about the use of Fund resources after the expiration of the present program, the staff representative continued. However, in the discussion on the medium-term outlook presented in the paper, the staff had pointed out the likelihood of the Fund responding positively to a request from the authorities for use of Fund resources under appropriate conditions. Should that happen, further gross purchases would be possible over the period to which the medium-term scenario applied, but it should be stressed that under likely access levels that would nevertheless entail considerable net repurchases to the Fund. As to presentational aspects of the medium-term scenarios, the staff had acted on the Executive Board's advice by discussing the closing of financing gaps only in tentative terms. The staff paper indicated that the financing gaps in future years should be closed through a mix of incremental borrowing and more adjustment if further use of Fund resources was to be justified.

Ms. Bush noted that the Fund certainly had a role to play in alleviating the balance of payments difficulties of a country. However, presenting the Fund as the sole source of resources to close the financing gap without giving due recognition to the possibility of concessional flows from other sources was inappropriate.

The Acting Chairman pointed out that the financing gap under the medium-term scenario would arise primarily because of repurchases to the Fund. The balance of payments table in the paper showing the overall balance and below-the-line items did not prejudice any use of Fund resources but showed that there would indeed be large-scale repurchases and that most of the future financing gaps of the country would be related to the magnitude of repurchases to the Fund.

Ms. Bush said that the issue went beyond the presentation in the balance of payments table. The staff paper indicated that the Fund would be one of the major sources of resources to close the financing gap over the medium term. On a related issue, she wondered whether the fact that the gap could be closed by offsetting the net repurchases that would be due to the Fund should lead to the conclusion that the Fund should finance those net repurchases.

The Acting Chairman considered that no such conclusion should be drawn.

Mr. Salehkhoul said that it was important to remember that over the three years that Ghana had been provided with Fund resources, the authorities had faithfully carried out the agreement reached with the Fund. They took pride in having met all performance criteria--with the exception of one minor technical modification--under the two stand-by arrangements since 1983, and in the fact that economic performance had been better than expected in several areas, including the balance of payments, government finance, external arrears, and economic performance. In the opinion of his authorities, Ghana's record had not been fully taken into account in designing the current arrangement, which stipulated a reserve bid of C 145 for the auction by the time of the presentation of the arrangement to the Board despite the demonstrated proof that such a reserve bid was unnecessary. Attention should instead have been devoted to liberalizing and removing bottlenecks and expanding eligibility to the auction rather than tampering with market forces. In that connection, the Board might take note of the fact that the third auction had already produced a price of C 145 even before the "A" licenses had been issued.

His authorities felt that it was important that no judgment by the Board be formed on the exchange rate in 1987 and beyond, and that no mechanism or exchange rate targets be fixed in the 1987 program, Mr. Salehkhoul continued. Such targets would be tantamount to pre-set devaluations, whereas the agreement between the Fund and the Government was for market determination of the exchange rate. It had been with the same concerns in mind that the authorities had preferred the auction system over the phased devaluation process that had been taking place since the start of the first stand-by arrangement in 1983.

His authorities sought confirmation that a Fund mission, preferably the next, would be mandated to negotiate an extended arrangement at the earliest possible opportunity, Mr. Salehkhoul remarked; and they believed that annual access under the arrangement of at least 50 percent of quota

would be warranted. It was very important that negotiations for the extended arrangement, as well as for the structural adjustment facility loan, should proceed as planned. In that regard, his authorities were puzzled about the way in which the conditionality and performance criteria had been applied to the proposed stand-by arrangement. They were aware of the opinion that external conditions had caused a fall in export prices; in that context, a delay in cocoa shipments should not be regarded as nonperformance but rather as a signal for a review or a trigger for contingency clauses of the type recently adopted for another Fund-supported program. They were firmly of the view that such conditionality be applied with much more flexibility. Moreover, his authorities strongly believed that credit policies should be set during discussions. Accordingly, staff missions should not arrive in capitals with fixed positions before the beginning of negotiations; such an approach defeated the purpose of the mission.

His authorities were disappointed in the lack of cohesion in the Fund negotiation process, Mr. Salehkhrou noted. It was crucial that interdepartmental consultations within the Fund be completed before negotiations with the member began. His authorities had been troubled to find that individual members of the staff team had been negotiating under direct supervision from their departments rather than the mission chief. After the chief negotiator for the country had briefed his Government on the outcome of the negotiations with the Fund, he could find himself in an embarrassing position if he were required to reverse himself simply because individual Fund officials had not been able to agree among themselves. In any event, the negotiator should not be expected to accept drastic changes in such key policies as credit policy on the grounds that the letters of intent were to be treated as only ad referendum. The concerns expressed by the Ghanaian authorities underlined his long-standing position on the need for close collaboration between the Fund and its members, and on the need to enter into Fund arrangements with sensitivity and faith in the ability of countries to take the right measures.

The Acting Chairman said that Mr. Salehkhrou's comments marked the first time that he had heard of such concerns by the authorities of a member country about the negotiating process. It was his understanding that the different views that might be expressed during the negotiations reflected the effort to reach an outcome that was agreeable to the authorities and consistent with the availability of external financing. As for the agreements themselves, it had always been the practice that any staff negotiation with a member would be ad referendum, until there had been a review with management and within the staff of the results of that negotiation. The points Mr. Salehkhrou had raised on the effects on the negotiating process of a lack of prior interdepartmental consultations were important and would be pursued with the staff.

The Executive Board then took the following decisions:

Stand-By Arrangement

1. Ghana has requested a stand-by arrangement in an amount equivalent to SDR 81.80 million for the period from October 15, 1986 to October 14, 1987.

2. The Fund approves the stand-by arrangement set forth in EBS/86/224, Supplement 2.

3. The Fund waives the limitation in Article V, Section 3(b)(iii).

Decision No. 8422-(86/170), adopted
October 15, 1986

Exchange System

Ghana maintains the exchange restrictions described in EBS/85/211, SM/85/252, and EBS/86/224 in accordance with Article XIV, Section 2, except that the exchange restrictions involved in the exchange auction system as well as the restrictions evidenced by external payments arrears and the restrictions on transfers of balances under the bilateral payments arrangements with Fund members are subject to approval under Article VIII, Sections 2(a) and 3. The Fund welcomes the intention of the authorities to eliminate these restrictions as soon as possible and to unify the dual exchange rates by early 1987. In the meantime, the Fund grants approval of the multiple currency practices until January 15, 1987, and for the retention by Ghana of the exchange restrictions that are subject to Article VIII until March 15, 1987 or the completion of the next Article IV consultation with Ghana, whichever is earlier. The Fund urges Ghana to terminate the remaining bilateral payments arrangements with Fund members as soon as possible.

Decision No. 8423-(86/170), adopted
October 15, 1986

APPROVED: June 15, 1987

LEO VAN HOUTVEN
Secretary